



Electricity distribution ring-fencing

Existing jurisdictional waivers

October 2016

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Shortened forms

Shortened Form	Extended Form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ACCC	Australian Competition and Consumer Commission
COAG	Council of Australian Governments
CAM	cost allocation method
DNSP	distribution network service provider
IPART	Independent Pricing and Regulatory Tribunal
NEL	National Electricity Law
NEO	National Electricity Objective
NEM	National Electricity Market
NER or the rules	National Electricity Rules
NSP	network service provider
QCA	Queensland Competition Authority
TNSP	transmission network service provider

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1 Summary

On 15 August 2016 we published our *Draft Ring-fencing Guideline—Electricity distribution* (Draft Guideline) for stakeholder comment.¹ When finalised, the Draft Guideline will supersede existing State and Territory (jurisdictional) ring-fencing arrangements.² Consequently, all waivers from existing jurisdictional ring-fencing obligations in those jurisdictions will also cease. Our purpose in this paper is to provide general guidance as to how we consider the circumstances underpinning existing ring-fencing waivers will be treated under the Draft Guideline when finalised.³ This paper should be read in conjunction with the Draft Guideline.

Existing waivers, granted under jurisdictional ring-fencing arrangements, will not be rolled over, or "grandfathered", to the new national ring-fencing framework. The new national AER Ring-fencing Guideline (AER Guideline) will be based on different principles to many, or all, of the existing jurisdictional arrangements. Also, the circumstances underpinning existing waivers may have changed. DNSPs may decide to change their own approach to service provision or ring-fencing arrangements in response to our new guideline. For these reasons, if a DNSP considers a waiver is still needed, it would have to apply for a new waiver under the AER Guideline.

While existing waivers cannot be grandfathered to the new ring-fencing arrangements, we consider there is value in describing how the Draft Guideline would apply to the circumstances in which existing waivers have been granted. We also think it is useful to describe the existing waivers to give stakeholders a sense of the existing ring-fencing approaches.

A ring-fencing waiver excuses a DNSP from meeting a particular obligation contained in the AER Guideline, which is still under development. Waivers may be requested by a DNSP in regard to certain obligations—but not all. We might approve a waiver to avoid imposing a ring-fencing obligation on a DNSP for which the costs to the DNSP are greater than the benefits to electricity consumers. Only waivers that are in the long term interest of consumers are likely to be accepted.

In this paper we do not set out conclusions as to whether particular circumstances will require a waiver. In some cases we have insufficient information to draw such conclusions. Also, while we hope this paper will be informative, it does not bind us in respect of future ring-fencing waiver decisions we may be required to make.

¹ AER, *Draft ring-fencing guideline—electricity distribution*, August 2016.

² NER, cl. 11.14.5. This clause does not apply in Victoria – see NER clause 11.14.1. Nonetheless, we expect DNSPs in Victoria will become subject to our new guideline. We also expect that DNSPs in Western Australia and the Northern Territory will become subject to our new guideline as those jurisdictions adopt the overarching regulatory framework that we work under.

³ A waiver is a permission granted to a DNSP allowing it to not satisfy one or more ring-fencing obligations.

In general, we expect relatively few waivers will be sought under the AER Guideline. The Draft Guideline specified that waivers will not be available for most ring-fencing obligations such as, for example, in regard to prevention of cross subsidies. The Draft Guideline provided for waivers only for functional separation obligations aimed at preventing discrimination in favour of a DNSP's related bodies corporate.⁴

The need for ring-fencing waivers under the AER Guideline will be different compared with waivers granted under the jurisdictional guidelines. This is because, while the broad purpose of ring-fencing is largely the same, the specific obligations on DNSPs vary considerably between the various jurisdictional guidelines and the new AER guideline. For this reason Distribution Network Service Providers (DNSPs) will need to review any existing waivers they may have and, if necessary, apply for new waivers.

We accept the need for a transitional period to the new ring-fencing framework. Our Draft Guideline provides 12 months for DNSPs to comply with legal separation obligations and six months to comply with obligations concerning physical separation and staff sharing. If DNSPs decide they require a waiver from particular obligations in the AER Guideline, they must obtain approval for such waivers prior to the end of the applicable transitional period.

We are aware of 13 existing electricity distribution waivers (with a 14th waiver from transmission ring-fencing obligations) granted under the current jurisdictional ring-fencing arrangements.⁵ Most have been granted to Queensland DNSPs. Two waivers have been granted to NSW DNSPs. A single waiver relates to Tasmania.⁶

The weighting of existing waivers towards Queensland and NSW results from the more prescriptive approach to ring-fencing in those jurisdictions compared to other jurisdictions. For example, Queensland DNSPs are currently prevented from operating solar PV and battery assets within their legal entities as these assets are associated with the generation of electricity by a DNSP, which is prohibited.⁷ NSW DNSPs are subject to the Alternative Service Provider (ASP) scheme in that State which promotes competition in the provision of some types of services such as connections.

Generation assets such as solar PV units and battery assets account for 9 existing waivers, all in Queensland. In 8 of the 9 cases, these assets are being used to provide internal network support or to undertake internal research, or both. In one case, they are being used to generate electricity for supply in remote areas. Information protection and information reporting account for 2 existing waivers, again in Queensland. Two waivers relate to staff of monopoly network DNSPs in NSW undertaking contestable works. One waiver granted to TasNetworks under the Transmission Ring-Fencing Guidelines allows it to provide distribution services in addition to being a Transmission Network Service Provider (TNSP).

Our Guideline places ring-fencing obligations on DNSPs based on the services they provide. Accordingly, the need for a waiver will depend on the purpose for which the DNSP is using

⁴ The scope of the permitted waivers could change between the AER's Draft and Final Ring-fencing Guidelines.

⁵ A 14th waiver has been issued to TasNetworks to allow it to operate both DNSP and TNSP networks.

⁶ The TasNetworks' waiver is not directly affected by the new distribution ring-fencing guidelines because it was granted under transmission ring-fencing arrangements.

⁷ They may own such assets as part of their broader corporate group, but not as part of their DNSP legal entity.

the relevant asset. As such, existing waivers granted for solar PV and battery assets in Queensland are unlikely to be required under the Draft Guideline. We say this based on the assumption the assets continue to be used to provide internal network support services and are not used to provide services in contestable markets. The Draft Guideline prevents DNSPs from selling electricity as this is not a distribution service. While this obligation permits some non-distribution services to be provided by a DNSP, it is subject to the materiality threshold that would quickly be exceeded.⁸

The circumstances underpinning the existing waiver granted in Queensland for generation supply in remote areas may lend themselves to requiring a waiver under the Draft Guideline. This is because the services provided by Ergon Energy may include non-network services. Specifically, Ergon Energy may be providing generation and retail services which are not classified as distribution services so may not be network services. However, we will require more detailed information to draw any conclusions. As such, the DNSP(s) concerned should re-assess its circumstances in light of the Draft Guideline.

Existing waivers in Queensland relating to information reporting and protection of customer information are not compatible with the Draft Guideline. On information reporting, the Draft Guideline does not impose the same information reporting obligations on DNSPs as the Queensland ring-fencing arrangements have done. On the protection of customer information, the Draft Guideline does not allow waivers from these obligations. .

Existing waivers for staff separation in NSW are premised on grounds very similar to those that would be established by the Draft Guideline. It is possible that the NSPs concerned will assess their circumstances in light of the Draft Guideline and seek new waivers to replace their existing waivers.

As this paper is draft on the Draft Guideline and not the finalised AER Guideline, readers should take this paper as providing general guidance only and it is not a definitive description of ring-fencing waiver requirements or outcomes. This paper in no way binds us to particular ring-fencing decisions under the finalised AER Guideline. This paper does not consider or respond to issues raised in stakeholder submissions in response to the Draft Guideline. These issues will be addressed in our explanatory statement to accompany the finalised Guideline.

⁸ The threshold of \$500,000 was included in the Draft Guideline to avoid NSPs incurring

2 The Draft Guideline

This section summarises key aspects of the Draft Guideline with respect to granting ring-fencing waivers and the treatment of existing waivers.

Ring-fencing protects the long term interests of consumers by avoiding cross-subsidies that could undermine the efficient costs of regulated services provided by DNSPs. This aligns with the National Electricity Objective (NEO). Ring-fencing also limits the ability of a DNSP to discriminate in favour of its own associated entities (related bodies corporate and other service providers). Ring-fencing therefore protects the long term interests of consumers more broadly by promoting competition in competitive markets.

Under the Draft Guideline, waivers will be available for obligations relating to functional separation of accommodation and/or employees. Waivers will not be available for obligations relating to legal separation, accounting separation and restrictions on sharing customer information.

This section first sets out a summary of the obligations imposed on DNSPs by the Draft Guideline. Next, we describe the circumstances in which waivers from those obligations would be available under the Draft Guideline. We then discuss how we propose to transition the electricity distribution sector to the new ring-fencing arrangements.

2.1 Draft Guideline obligations

The obligations set out in the Draft Guideline are designed to remedy the harms noted above. The risk of cross subsidies is addressed through obligations requiring legal and accounting separation of a DNSP from its associated entities providing non-network services. The risk of a DNSP discriminating in favour of its own associated entities is addressed by a general obligation to not discriminate and specific obligations preventing cross-promotion, requiring functional separation between a DNSP and its associated entities and by restricting the sharing of DNSP customer information.

Table 1 below summarises the obligations that will be imposed on a DNSP by the Draft Guideline. The Draft Guideline provides a more detailed and complete list of draft obligations.

Table 1 Draft Ring-fencing Guideline—summary of obligations⁹

Harm affecting customers and markets	Ring-fencing obligation
Cross-subsidies	Legal separation of DNSP from other entities A DNSP cannot provide any non-Network Services ¹⁰ (Subject to a \$500,000 materiality threshold)

⁹ Refer to the Draft Guideline for the complete list of obligations.

¹⁰ Network services are distribution services and transmission services.

Harm affecting customers and markets	Ring-fencing obligation	
Non-discrimination	Account separation / Cost allocation	<p>Accounts – DNSP must establish and maintain accounts (in relation to Direct Control Services plus regulated Transmission Services).</p> <p>Costs – DNSP must not allocate / attribute to Distribution Services costs that properly relate to non-Distribution Services.</p>
	Not discriminate	A general obligation on the DNSP that it will not discriminate (either directly or indirectly) in favour of a related body corporate or its customers.
	No cross-promotion	A DNSP will not advertise or promote the services provided by its associated entity.
	Functional separation	<p>Physical separation – DNSP must operate independent and separate offices to a related body corporate or an associated entity service provider that provides non-network energy-related services</p> <p>Staff sharing – DNSP must ensure that staff directly involved in the provision or marketing of a Direct Control Service or a regulated Transmission Service are not also involved in the provision or marketing of non-network energy-related services</p>
	Information access and disclosure	<p>Protection – DNSP must protect information provided by a customer, prospective customer for Direct Control Services and / or regulated Transmission Services, and ensure its use is only for the purpose for which that information was provided. Similarly, a DNSP must protect information it acquires in the normal course of business.</p> <p>Sharing – Where a DNSP acquires information in providing Direct Control Services and/or regulated Transmission Services, and shares this information with a related entity, it must provide access to others on the same price, quality and terms and conditions.</p> <p>Disclosure – DNSP must not disclose information (acquired in providing Direct Control Services and/or regulated Transmission Services) to any party without the informed approval of the relevant customer or prospective customer to whom the information relates.</p>

2.2 The Draft Guideline and service classification

The Draft Guideline provides for accounting and functional separation of direct control services from other services. The ring-fencing treatment of a particular service therefore stems from its service classification. The decision on service classification commences at the Framework and Approach stage of our regulatory review process and is settled at the time we make our Regulatory Determination for a DNSP. Classification will settle the ring-fencing obligations for a particular service for a regulatory control period.

From time to time a DNSP may commence providing a new service that was not considered at the time the classification of services was finalised. Our approach to service classification is to classify services in groupings rather than individually. This obviates the need to classify services one-by-one and instead defines a service cluster, that where a service is similar in nature it would require the same regulatory treatment. A new service might simply be added to the existing grouping and hence be treated in the same way for ring-fencing purposes. Alternatively, a service that does not belong to any existing service classification is 'not classified' and would be treated as an unregulated service.

2.3 Waivers under the Draft Guideline

The Draft Guideline provides for waivers in relation to functional separation of accommodation and/or employees. Core ring-fencing obligations for legal separation, cost allocation and information protection cannot be waived.

A ring-fencing waiver excuses a DNSP from meeting a particular obligation contained in the AER Ring-fencing Guideline, which is still under development. Waivers may be requested by a DNSP in regard to certain obligations—but not all.

We will assess waiver applications with respect to the potential for cross-subsidisation, discrimination and with a view to the net benefits in terms of the long term interests of consumers. In considering whether to accept or reject a waiver application, we will also consider whether a waiver would better achieve the National Electricity Objective (NEO). Depending on the circumstances of the waiver sought, we may also consider such other matters we think are relevant. The DNSP submitting a waiver application will need to demonstrate why the waiver should be granted with reference to these matters.

For example, for a DNSP offering network and non-network services in a rural area, we are likely to consider whether any competitive services are available. We will also consider whether the benefit, or any likely benefit, to electricity consumers of the DNSP's ring-fencing compliance with the guideline will be outweighed by the cost to the DNSP of complying.

For minor matters we are likely to adopt a simple approval process with no or limited public consultation. For matters we consider likely to attract stakeholder interest, or with potentially significant impacts on the provision of contestable energy services, we will conduct formal consultation and publish the reasons for our decision. In all cases, we will publish the terms and conditions of any waiver granted.

The duration of a waiver will be limited to the (then) current regulatory control period and upcoming regulatory control period.

2.4 Transition to the new ring-fencing arrangements

Existing waivers cannot be rolled over, or "grandfathered", into the new ring-fencing arrangements. Rather, we will consider applications for waivers in respect of our new AER Guideline.

Existing waivers have been granted under jurisdictional ring-fencing arrangements which in many cases do not reflect the principles underpinning the Draft Guideline. When the existing jurisdictional ring-fencing arrangements are superseded by the finalised new national AER

Guideline, existing waivers will no longer have a legal basis. It is appropriate for DNSPs subject to existing waivers to consider their circumstances and, in light of the Draft Guideline, reconsider their need for waivers going forward. If necessary, and if a waiver is available under the new national AER Guideline, DNSPs may submit an application to us for a new waiver.

With respect to existing ring-fencing waivers, in the Explanatory Statement to the Draft Guideline, we said:¹¹

We intend to review each of the existing ring-fencing waivers before the Draft Guideline comes into effect. We propose undertaking a separate consultation process to jointly consider all existing jurisdictional waivers, which will provide an effective means of dealing with them.

We further said we will:

- seek advice from DNSPs in regard to any existing waivers they consider are still required under our Draft Guideline
- publish a discussion paper setting out our views with respect to existing waivers
- indicate at the time the final guideline is published how existing waivers will be treated.

While existing waivers will not be grandfathered, to assist the industry and all stakeholders we consider there is value in describing how the Draft Guideline would apply to the circumstances in which existing waivers have been granted.

We have already begun to engage with DNSPs informally on their existing waivers. This discussion paper is the second step described above. We propose to set out our final position on existing waivers in the explanatory statement to our final ring-fencing guideline, to be published by 1 December 2016.

Transition periods for ring-fencing obligations

As we noted in the Explanatory Statement to the Draft Guideline, we accept the need for a transition period to the new ring-fencing arrangements.¹² Given the practical limits to achieve compliant implementation of the ring-fencing obligations, the Draft Guideline provides a transitional period for compliance with particular obligations.

Our Draft Guideline provides 12 months for DNSPs to comply with obligations that require DNSPs to be separate legal entities that only provide network services. Further, our Draft Guideline provides DNSPs with six months to comply with obligations concerning staff sharing. The Draft Guideline does not provide transitional provisions for other ring-fencing obligations.

If a DNSP decides to apply for a waiver from particular obligations in the finalised AER Guideline, it must obtain approval prior to the end of the transition to compliance period of the relevant ring fencing obligation. Failure to do so would result in a breach of the Guideline.

¹¹ AER, *Draft ring-fencing guideline—Explanatory statement*, August 2016, p. 7.

¹² AER, *Draft ring-fencing guideline—Explanatory statement*, August 2016, p. 7.

3 Existing ring-fencing waivers

In this section we describe the current waivers granted under existing jurisdictional ring-fencing arrangements.

We are aware of 13 existing distribution ring-fencing waivers granted under jurisdictional ring-fencing arrangements (with a 14th waiver from transmission ring-fencing obligations). Of these distribution ring-fencing waivers, 11 relate to Queensland DNSPs Energex and Ergon Energy. The large number of Queensland waivers stems from the existing Queensland ring-fencing arrangements which are prescriptive and impose prohibitions on ownership of certain types of assets that can only be avoided by way of a waiver. A further 2 waivers relate to NSW DNSPs EnergyAustralia (now Ausgrid) and Country Energy (now Essential Energy). A single waiver relates to TasNetworks, the joint DNSP and TNSP in Tasmania—granted under transmission ring-fencing arrangements.

Of the 11 distribution waivers granted in Queensland, 9 relate to use of generation assets such as solar PV or battery technology or both. The remaining 2 Queensland waivers relate to information protection and submission of regulatory accounts to the regulator. Waivers granted in NSW relate to separation of staff performing contestable services in addition to monopoly network services and co-location of staff performing both types of service. TasNetworks' waiver allows it to operate both TNSP and DNSP networks.¹³

We begin this section with an overview of existing waivers, including a description of which types of waivers have been granted to DNSPs. We list existing waivers in Table 2. We then set out a more detailed description of each existing waiver, including the reasons for a waiver being sought and the rationale behind a waiver being granted.

3.1 Overview of existing ring-fencing waivers

In this section we provide an overview of the existing ring-fencing waivers we are aware of. In doing so we describe the current ring-fencing arrangements applicable in Queensland and NSW, under which almost all of the existing waivers have been granted.

Queensland ring-fencing arrangements

Of the 14 existing waivers across all jurisdictions, 11 relate to Queensland DNSPs Energex and Ergon Energy. This weighting towards Queensland does not result from actions taken by Energex and Ergon Energy that differentiate them from DNSPs in other jurisdictions. Rather, the existing Queensland ring-fencing arrangements are relatively prescriptive compared to those in other jurisdictions.

Most of the 11 waivers granted to Energex and Ergon Energy relate to use of generation assets such as solar PV or to battery assets. One of these relates to Ergon Energy's isolated remote networks. Queensland's *Electricity Distribution Ring-fencing Guideline* prohibits Energex and Ergon Energy from undertaking a related business which is defined as the

¹³ The waiver granted to TasNetworks will not be superseded by our new national ring-fencing guidelines.

generation, purchase or sale of electricity. The intent of this provision was to prevent the Queensland DNSPs from vertically integrating into generation or electricity retailing.

As solar PV and battery technology have increasingly become cost effective options for network support, in place of more expensive generation investment or network augmentation for example, the Queensland DNSPs have invested in these technologies. They have also sought to undertake research into the likely future impacts of solar PV and batteries on their network. The Queensland ring-fencing provisions have required the Queensland DNSPs to either establish separate legal entities to undertake these activities or seek waivers. The Queensland DNSPs have generally sought waivers in preference to establishing separate legal entities.

One waiver granted to the Queensland DNSPs relates to customer information collected by Ergon Energy. While the DNSP would normally be required to ensure this information is kept separate from its associated entity electricity retailer, Ergon Energy was granted a waiver because of reduced market significance of that information in this case. Ergon Energy's associated entity retailer is not permitted to compete for customers, so competition issues do not arise.

The final waiver granted to both Energex and Ergon Energy relates to an information reporting provision in Queensland that has been superseded by our annual reporting framework.

NSW ring-fencing arrangements

Two existing waivers granted to EnergyAustralia (now Ausgrid) and Country Energy (now Essential Energy) relate to staff of the monopoly DNSPs undertaking work that in NSW is generally provided by accredited Alternative Service Providers.¹⁴ Both waivers are, at least in part, premised on the understanding that remote areas are less likely to see effective competition in the provision of services. This is because Alternative Service Providers are less likely to travel to remote areas, particularly at reasonable cost to the consumer. From a ring-fencing perspective, the cost of enforcing prohibitions on DNSPs undertaking contestable work is likely to be higher in remote areas relative to the likely competitive neutrality benefits.

Transmission ring-fencing arrangements

One existing waiver granted to TasNetworks relates to its role as both a TNSP and DNSP. The ACCC's Transmission Ring-Fencing Guidelines prohibit a TNSP from providing DNSP services. As the result of a merger between the previously separate Tasmanian electricity DNSP and TNSP, TasNetworks would breach this prohibition. We granted TasNetworks a waiver because the likely public benefits of enforcing this prohibition were small compared to costs imposed on TasNetworks in complying. TasNetworks would have been forced to establish separate workforces to undertake its separate TNSP and DNSP services.

¹⁴ Under the NSW Accredited Service Provider (ASP) Scheme some services traditionally performed by DNSPs are instead contestable. The scheme includes meter installation, connections and some network design activities.

The waiver granted to TasNetworks will not be affected by establishment of our new national distribution ring-fencing guideline because it relates to transmission ring-fencing guidelines. We have included it here for completeness. Table 2 below lists the existing electricity network waivers.

Table 2 Current electricity distribution ring-fencing waivers

	DNSP	State	Date	Regulator	Waiver
1	Ergon Energy	Qld	2001	QCA	Waiver from requirement to establish a separate legal entity
2	Ergon Energy	Qld	2004	QCA	Waiver from requirement to establish a separate legal entity
3	EnergyAustralia (Ausgrid)	NSW	2005	IPART	Waiver from staff separation requirement
4	Country Energy (Essential Energy)	NSW	2005	IPART	Waiver from staff separation requirement
5	Ergon Energy	Qld	2007	QCA	Waiver from customer information protection requirement
6	Ergon Energy	Qld	2010	QCA	Waiver from requirement to establish a separate legal entity
7	Ergon Energy	Qld	2011	AER	Waiver from requirement to establish a separate legal entity
8	Energex & Ergon Energy	Qld	2011	AER	Waiver from requirement to submit regulatory accounts
9	Ergon Energy	Qld	2014	AER	Waiver from requirement to establish a separate legal entity
10	TasNetworks	Tasmania	2014	AER	Waiver from prohibition on a TSNP providing DNSP services
11	Ergon Energy	Qld	2016	AER	Waiver from requirement to establish a separate legal entity
12	Energex	Qld	2016	AER	Waiver from requirement to establish a separate legal entity
13	Energex	Qld	2016	AER	Waiver from requirement to establish a separate legal entity (commercial BESS)
14	Energex	Qld	2016	AER	Waiver from requirement to establish a separate legal entity

4 Detailed description of existing ring-fencing waivers

In this section we separately describe each of the existing ring-fencing waivers. While these descriptions are more detailed than the summary description in section 3 above, for brevity we have summarised the details of each waiver and the circumstances in which they were granted. For full details please refer to the regulatory decision papers referenced (see footnotes) for each waiver.

1. Ergon Energy - 2001 - waiver from requirement to establish a separate legal entity

In September 2001 the Queensland Competition Authority (QCA) granted Ergon Energy a waiver from the requirement to establish a separate legal entity to carry on a related business¹⁵ in respect of its operation of isolated generation services.

Background

Ergon Energy operated (and still operates) generation services for remote Queensland communities unconnected to Ergon Energy's distribution network.¹⁶ Ergon Energy submitted that it provided these isolated generation services not for commercial reasons but because it was obligated to do so. Under the Queensland Electricity Distribution Ring-fencing Guideline, Ergon Energy's isolated generation services are a "related business"—defined as the business of producing, purchasing or selling electricity. Section 1(b) of the Queensland Electricity Distribution Ring-fencing Guideline prohibits a DNSP from carrying on a related business within its legal entity. Without a waiver, Ergon Energy would have been required to establish a separate legal entity to provide its isolated generation services.

The QCA noted, in agreeing to waive the section 1(b) requirement, that Ergon Energy's isolated generation activities would remain subject to other aspects of Queensland's ring-fencing arrangements. Ergon Energy was granted an ongoing waiver from the section 1(b) requirement.

2. Ergon Energy - 2004 - waiver from requirement to establish a separate legal entity

In February 2004 the QCA granted Ergon Energy a waiver from the requirement to establish a separate legal entity to carry on a related business¹⁷ in respect of four grid-connected generation assets used for network support.

Background

¹⁵ Section 1(b) of Queensland's *Electricity Distribution Ring-fencing Guideline*.
¹⁶ For example:
¹⁷ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

Ergon Energy operated four grid-connected generation assets at Queensland regional centres Winton, Cooktown, Dajarra and Kajabbi. Ergon Energy submitted that these generation assets were cost effective alternatives to network augmentation. Ergon Energy sought a waiver for those generation assets in addition to any similar assets it may establish in future.

The QCA granted Ergon Energy a waiver for its four then-existing grid-connected generation assets but not for any further generation assets. By limiting the waiver to only the four then-existing generation assets, the QCA intended to signal that its decision in this case was not necessarily a precedent for treatment of further generation assets in future. Ergon Energy was granted an ongoing waiver from the section 1(b) requirement.

3. EnergyAustralia (now Ausgrid) - 2005 - waiver from staff separation requirement¹⁸

In September 2005 the NSW Independent Pricing and Regulatory Tribunal (IPART) granted EnergyAustralia a waiver from the NSW ring-fencing obligation preventing DNSP staff from providing contestable services.¹⁹

Background

Section 5.4.1 of the NSW Distribution Ring Fencing Guidelines requires a DNSP to ensure that staff providing monopoly services do not also provide contestable services. EnergyAustralia applied for a waiver from s. 5.4.1 for staff undertaking high and low voltage network switching in areas of the Upper Hunter region of NSW. Also, for staff performing low voltage switching on all parts of the network.

IPART accepted EnergyAustralia's argument that areas of the Upper Hunter are sufficiently remote that enforcing the staff separation ring-fencing obligation would create more costs than benefits. IPART granted a waiver for staff performing high voltage switching in remote areas of the Upper Hunter region but not for Maitland and Cessnock as also proposed by EnergyAustralia. IPART determined that only areas remote from major regional centres were appropriate for a waiver because the competitive neutrality impacts of a waiver would be concentrated in and near population centres. Maitland and Cessnock, as population centres, were not considered by IPART to be sufficiently remote to warrant a waiver.

IPART also accepted EnergyAustralia's proposition that its staff should be allowed to undertake switching across the network to prevent related staff skills from declining. IPART granted a waiver for this purpose. However, IPART made the waiver conditional so that EnergyAustralia staff performing contestable construction works could not also undertake switching for the same project.

4. Country Energy (now Essential Energy) - 2005 - waiver from staff separation requirement²⁰

¹⁸ IPART, *Application by EnergyAustralia for a waiver of clause 5.4.1 of the Distribution Ring Fencing Guidelines—Final decision*, September 2005.

¹⁹ IPART, *Distribution Ring Fencing Guidelines*, February 2003, s. 5.4.1.

In November 2005 IPART granted Country Energy a waiver from the NSW ring-fencing obligation preventing DNSP staff from providing contestable services.²¹

Background

Section 5.2.1 of the NSW Distribution Ring Fencing Guidelines requires a DNSP to ensure that its offices from which staff provide monopoly services are separate from the offices from which staff provide contestable services. As described above, s. 5.4.1 prevents staff providing monopoly services from also providing contestable services. Country Energy applied for a waiver from s. 5.2.1 for its field service depots.²² It sought a waiver from s. 5.4.1 for field service staff involved in network access permit services, substation commissioning services and level 2 inspection work.

In granting a waiver from sections 5.2.1 and 5.4.1, IPART noted that much of Country Energy's network is remote with staff often undertaking long journeys to perform works. In this context, IPART determined that enforcing obligations relating to co-location of staff and staff separation would likely incur large costs relative to small competitive neutrality benefits.

5. Ergon Energy - 2007 - waiver from customer information protection requirement²³

In February 2007 the QCA granted Ergon Energy a waiver from restrictions on sharing customer information with an associated entity and from sharing marketing staff with an associated entity.²⁴

Background

Sections 1(f), 1(g) and 1(i) of the Queensland Ring-fencing Guidelines require a DNSP to ensure that:

- confidential customer information is not disclosed to an associated entity²⁵ of the DNSP
- its marketing staff are not also staff of an associated entity.

Ergon Energy applied for a waiver because, resulting from Queensland Government energy market reforms at the time, its associated entity retailer was no longer permitted to compete for customers in the contestable retail market. As there was no possibility of the associated entity retailer using Ergon Energy customer information to its advantage, the information and staff sharing restrictions were no longer relevant. Ergon Energy submitted that, were the

²⁰ IPART, *Application by Country Energy for a waiver of clauses 5.2.1 and 5.4.1 of the Distribution Ring Fencing Guidelines—Final decision*, September 2005.

²¹ IPART, *Distribution Ring Fencing Guidelines*, February 2003, s. 5.4.1.

²² Country Energy also applied for a temporary waiver from s. 5.2.1 in respect of its regional offices, as a transitional step, to give it time to comply with the requirement. A temporary waiver was granted, which expired on 30 June 2007. Because this waiver has expired we have not further addressed it in this discussion paper.

²³ QCA, *Application for waiver of ring-fencing arrangements by Ergon Energy—Final decision*, February 2007.

²⁴ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(f), 1(g) and 1(i).

²⁵ The Queensland Ring fencing guidelines use "associate" rather than "associated entity". We consider these terms are interchangeable.

ring-fencing restrictions to continue to apply, it would incur costs in ensuring compliance but no benefits would accrue to electricity customers.

The QCA agreed with the premise behind Ergon Energy's waiver application, that enforcing the ring-fencing restriction on information sharing could not benefit customers. Ergon Energy was granted a waiver.

6. Ergon Energy - 2010 - waiver from requirement to establish a separate legal entity²⁶

In June 2010 the QCA granted Ergon Energy a waiver from the requirement to establish a separate legal entity to carry on a related business²⁷ in respect of a grid-connected generation asset used for network support in the Barcaldine region of Queensland.

Background

Ergon Energy submitted that its 1 MW generator was a cost effective alternative to network augmentation. Also, that the QCA had previously granted waivers for similar network support generation assets.

The QCA noted that the Barcaldine generator would not involve Ergon Energy in the wholesale electricity market as it would not sell generated electricity. Rather, electricity from the Barcaldine generator would be injected into the local network free of charge. Also, because Ergon Energy's retail arm was not competing in the market for retail customers, that there was reduced scope for benefits to accrue to Ergon Energy or its associated entities.

The QCA granted Ergon Energy an ongoing waiver for its Barcaldine generator.

7. Ergon Energy - 2011 - waiver from requirement to establish a separate legal entity²⁸

In May 2011 we granted Ergon Energy a waiver from the requirement to establish a separate legal entity to carry on a related business²⁹ in respect of 16 PV installations on office buildings and depots.

Background

In granting a waiver to Ergon Energy we noted that creating a separate legal entity to operate the PV installations would be costly, the PV systems involved were relatively small and that Ergon Energy would not sell the generated electricity. Also, that the PV installations supported the Queensland Government's climate change strategy and improved the energy efficiency of Ergon Energy's buildings.

²⁶ QCA, *Ergon Energy application for waiver of certain ring-fencing arrangements—Final decision*, June 2010.

²⁷ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

²⁸ AER, *Final decision—Ergon Energy—Application for waiver from ring-fencing guidelines*, May 2011.

²⁹ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

The waiver granted to Ergon Energy allowed for further PV installations to be covered by the waiver, up to a cumulative maximum capacity of 300 kW. Any further PV installations on office buildings or depots that exceeded 300 kW in aggregate would not be covered by the waiver.

8. Energex & Ergon Energy - 2011 - waiver from requirement to submit regulatory accounts³⁰

In October 2011 we granted Energex and Ergon Energy a waiver from the requirement to establish, maintain and submit to us annual regulatory accounts.³¹

Background

Queensland's ring-fencing arrangements require Energex and Ergon Energy to establish and maintain regulatory accounts, both for their entire DNSP and for only 'prescribed distribution services' (equivalent to 'standard control services' under the NER). The Queensland DNSPs are also required to comply with the QCA's Regulatory Reporting Guidelines which specify that the DNSPs should submit regulatory accounts to the regulator annually.

In jointly applying for a waiver from the above ring-fencing obligations, Energex and Ergon Energy noted that, at the time, we were developing an annual reporting framework. The new reporting arrangements made the ring-fencing reporting obligations obsolete.

In granting a waiver we agreed that the new annual reporting requirements superseded the ring-fencing reporting obligations.

9. Ergon Energy - 2014 - waiver from requirement to establish a separate legal entity³²

In April 2014 we granted Ergon Energy a waiver from the requirement to establish a separate legal entity to carry on a related business³³ in respect of a 1MVA generation asset at Mt Isa.

Background

The waiver sought by Ergon Energy would allow it to own and operate a 1MVA grid-connected generation unit in the Mount Isa region for network support purposes. Ergon Energy submitted that it was required to construct the generation unit to avoid potential load shedding for the 2013-14 summer following the failure of negotiations for contracted third party network support services.

In granting a waiver we noted the benefit to the public of compliance with section 1(b) of the Guidelines would be outweighed by the administrative cost to Ergon Energy of complying

³⁰ AER, Final decision—Queensland DNSPs—Application for Waiver from Ring-Fencing Guidelines, October 2011.

³¹ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(c), 1(d) and s.2.

³² AER, *Ergon Energy—Application for Waiver from Ring-fencing Guidelines*, April 2014.

³³ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

with the ring-fencing obligation. Further, that the waiver would facilitate adoption of an efficient non-network solution in preference to augmenting the distribution network and therefore reduce costs to consumers.

10. TasNetworks - 2014 - waiver from restriction on a TNSP providing DNSP services

In May 2014 we granted TasNetworks a waiver from the Transmission Ring-Fencing Guidelines' prohibition on a TNSP providing distribution services.³⁴

Background

Section 7.1(a)(ii) of the ACCC's Transmission Ring-Fencing Guidelines³⁵ provides that a TNSP must not carry on a related business, which is defined as the activities of generation, distribution and electricity retail supply.

TasNetworks sought a waiver from s. 7.1(a)(ii) of the Transmission Ring-Fencing Guidelines to allow it to own and operate both the transmission business which until then had been operated by Transend and the distribution business operated by Aurora. The integration of the two Tasmanian network businesses was one of a number of reforms to the Tasmanian electricity supply industry announced by the Tasmanian Government in May 2012.

In granting TasNetworks a waiver we noted that the benefit, or likely benefit, to the public of enforcing the ring-fencing obligation was in this case outweighed by the administrative cost to TasNetworks of complying with the ring-fencing obligation. The ring-fencing obligation would impose administrative costs on TasNetworks in the form of duplicate functions, assets and staff. The public benefits lost as a result of waiving the obligation were minimal, as other key ring-fencing obligations and the NER would continue to apply.

11. Ergon Energy - 2016 - waiver from requirement to establish a separate legal entity³⁶

In February 2016 we granted Ergon Energy a waiver from the requirement to establish a separate legal entity to carry on a related business³⁷ in respect of 20 Grid Utility Support System (GUSS) battery units.

Background

Ergon Energy submitted that it intended to install 20 GUSS units (shipping container sized battery units) on some of its remote single wire earth return (SWER) distribution lines as a cost effective substitute for more expensive network augmentation. In granting a waiver we noted that Ergon Energy would not sell electricity injected into the network by the GUSS units, so would not be undertaking the "business" of selling electricity.

³⁴ AER, *Final decision— TasNetworks application for waiver from Transmission Ring-fencing Guidelines*, May 2014.

³⁵ ACCC, *Transmission Ring-Fencing Guidelines*, August 2002.

³⁶ AER, *Final decision—Ergon Energy application for waiver from Queensland ring-fencing guidelines*, February 2016.

³⁷ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

The waiver granted to Ergon Energy was conditional on it not selling electricity. It was also temporary. The waiver noted Ergon Energy would be required to comply with the new national ring-fencing guideline within 12 months of its establishment, or otherwise comply with arrangements for existing ring fencing waivers as set out by the new guideline.

12. Energex - 2016 - waiver from requirement to establish a separate legal entity (domestic BESS)³⁸

In March 2016 we granted Energex a waiver from the requirement to establish a separate legal entity to carry on a related business³⁹ in respect of a Battery Energy Storage System (BESS) pilot project incorporating solar PV and batteries.

Background

Energex submitted that it intended to undertake research to develop a better understanding of how residential (domestic) batteries used in conjunction with PV will impact its future network load profile and power quality. Energex also indicated that, while the pilot project is primarily to understand network operational issues, it may also provide insight for future capital investment and tariff reform decisions. The domestic BESS pilot project was to include three separate installations of batteries from Tesla (total storage 11.65kW), SunVerge (11.65kW) and Redflow (10kW). The SunVerge battery will be paired with a 3kW solar PV unit. The Tesla and Redflow batteries will be paired with 6kW PV units.

In granting a waiver we noted that Energex would not sell electricity injected into the network by the BESS trial, so would not be undertaking the "business" of selling electricity.

The waiver granted to Energex was conditional on it not selling electricity. It was also temporary. The waiver noted Ergon Energy would be required to comply with the new national ring-fencing guideline within 12 months of its establishment, or otherwise comply with arrangements for existing ring fencing waivers as set out by the new guideline.

13. Energex - 2016 - waiver from requirement to establish a separate legal entity (commercial BESS)⁴⁰

In August 2016 we granted Energex a waiver from the requirement to establish a separate legal entity to carry on a related business⁴¹ in respect of a commercial building BESS project incorporating solar PV and batteries.

Background

Energex submitted that it had a positive investment case for installing 150kW of solar PV and a commercial scale (250kW) Tesla battery unit at its Eagle Farm facility. That is, that the proposed investment was cost effective with consequential benefits for electricity customers

³⁸ AER, *Final decision—Energex application for waiver from Queensland ring-fencing guidelines*, March 2016.

³⁹ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

⁴⁰ AER, *Final decision—Energex application for waiver from Queensland ring-fencing guidelines—Solar PV and BESS trial project*, March 2016.

⁴¹ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

through lower network operating costs. Also, that it intended to gain a better understanding of how the installation of batteries and solar PV will impact its network.

In granting a waiver we noted that Energex would not sell electricity injected into the network by the BESS trial, so would not be undertaking the "business" of selling electricity.

The waiver granted to Energex was conditional on it not selling electricity. It was also temporary. The waiver noted Energex would be required to comply with the new national ring-fencing guideline within 12 months of its establishment, or otherwise comply with arrangements for existing ring fencing waivers as set out by the new guideline.

14. Energex - 2016 - waiver from requirement to establish a separate legal entity (mobile educational exhibit)⁴²

In August 2016 we granted Energex a waiver from the requirement to establish a separate legal entity to carry on a related business⁴³ in respect of a mobile educational exhibit incorporating solar PV and batteries.

Background

Energex submitted that it proposed to build a mobile exhibit incorporating solar PV, residential BESS, a Home Energy Management System (HEMS) and a number of typical home appliances (e.g. dishwasher, TV, clothes washer/dryer). Energex proposed to display the exhibit at community events.

In granting a waiver we noted that Energex would not sell electricity injected into the network by the BESS trial, so would not be undertaking the "business" of selling electricity.

The waiver granted to Energex was conditional on it not selling electricity. It was also temporary. The waiver noted Energex would be required to comply with the new national ring-fencing guideline within 12 months of its establishment, or otherwise comply with arrangements for existing ring fencing waivers as set out by the new guideline.

⁴² AER, *Final decision—Energex application for waiver from Queensland ring-fencing guidelines—Solar PV and BESS trial project*, March 2016.

⁴³ QCA, *Electricity distribution: Ring fencing guidelines*, September 2000, s. 1(b).

5 Existing waivers and the Draft Guideline

This section describes, at a high level, how the circumstances underpinning existing waivers would be treated under the Draft Guideline. We have compiled this discussion to provide general guidance only. For this discussion we have grouped existing waivers by type. The largest group of waivers relates to distributed generation and electricity storage assets. We then discuss together those waivers related to staff separation obligations. And finally we discuss waivers related to customer information and reporting.

This section does not set out definitive conclusions on the ring-fencing treatment of particular services. Rather, we describe the provisions of the Draft Guideline that we think would apply to the circumstances of the various types of existing waivers. Exactly how the final guideline will apply to specific circumstances will vary according to a range of factors, including how the relevant DNSP intends to structure its business activities, how its services are classified and the manner in which it provides its regulated services going forward. The discussion set out in this section does not bind us in relation to any future ring-fencing decisions we may be required to make.

How assets such as solar PV and batteries are treated under the Draft Guideline depends on the services the assets are used to provide. A DNSP must not exceed the materiality threshold in providing non-network services. Non-network services that exceed the threshold may only be provided by a DNSP's related body corporate..

Section 4 of the Draft Guideline specifies that a DNSP must not provide both direct control services and contestable energy-related services from the same offices. Staff directly involved in providing direct control services are not permitted to also provide, or engage in marketing for, contestable energy-related services. Where a DNSP wishes to allow its staff to provide both direct control and contestable energy-related services, or to provide both direct control and contestable energy-related services from the same offices, they must secure a waiver from section 4 of the Draft Guideline.

The Draft Guideline does not allow waivers from information protection provisions set out in its section 4.3.

5.1 The Draft Guideline and generation/storage assets

In this section we describe how the Draft Guideline treats assets such as solar PV and battery units that are currently subject to waivers.⁴⁴ This relates to at least 8 of the 11 existing waivers granted to the Queensland DNSPs. Under our Guideline, we will focus consideration on the services provided by the assets in question rather than on the assets themselves. This issue relates predominantly to prevention of cross subsidies (section 3 of the Draft Guideline).

Section 3 of the Draft Guideline specifies:

⁴⁴ Relates to the following existing waivers: Ergon Energy 2001; Ergon Energy 2004; Ergon Energy 2010; Ergon Energy 2011; Ergon Energy 2016.

- a DNSP may provide network services⁴⁵
- a DNSP may provide non-network services up to a cumulative materiality threshold value of \$500,000⁴⁶
- non-network services above the threshold value may not be provided by the DNSP—they must be provided by a separate legal entity (which may be owned by the DNSP or its corporate group).⁴⁷

This means that under the Draft Guideline the ring-fencing treatment of PV and battery assets would depend on how the service(s) provided using the asset is classified. Potentially, a single installation (asset) may provide more than one service. This is true for both distributed generation and distributed energy storage assets. Such assets may provide network support by, for example, substituting for network augmentation. They may also facilitate involvement in electricity wholesale markets through the sale of electricity. How an installation would be treated would depend on the DNSP's intended use of the unit to provide one or more services.

Under our Draft Guideline:

- if the service(s) to be provided using the asset(s) were classified as a network service, the DNSP may provide the service(s)
- if the service(s) to be provided using the asset(s) were considered a non-network service, the DNSP may still provide the service up to low cumulative threshold value (of \$500,000 per year)
- if the service(s) to be provided using the asset(s) were considered a non-network service and the DNSP had reached the threshold value, the service(s) must be provided by a separate legal entity and ring-fencing obligations apply.

The Queensland waivers granted for use of PV and batteries relate to assets currently providing only network services. As network services, the Draft Guideline specifies that these may be provided by the DNSP. Any non-network services (such as selling electricity into the wholesale market) must be provided by a separate legal entity in order for the DNSP to satisfy its ring-fencing obligations.

The waiver granted to Ergon Energy for generation to remote communities is difficult for us to form a judgement on now. We do not have sufficient information to draw conclusions on the ring-fencing requirements of these Ergon Energy services. Also, the existing waiver was granted in 2001. Many things may have changed in the intervening 15 years.

5.2 The Draft Guideline and staff separation obligations

In this section we describe how the Draft Guideline deals with DNSP staff providing monopoly network services and contestable services. This relates to the 2 existing waivers

⁴⁵ AER, *Draft ring-fencing guideline—electricity distribution*, August 2016, s. 3.1(a).

⁴⁶ AER, *Draft ring-fencing guideline—electricity distribution*, August 2016, s. 3.1(b).

⁴⁷ AER, *Draft ring-fencing guideline—electricity distribution*, August 2016, s. 3.1(a) and (b).

granted to NSW DNSPs. This issue relates to both prevention of cross-subsidies (section 3 of the Draft Guideline) and non-discrimination (section 4 of the Draft Guideline).

The relevant provisions of section 3 of the Draft Guideline are described in section 4.1 above.

Section 4 of the Draft Guideline specifies:

- a DNSP must operate independent and separate offices for the provision of direct control services (distribution) and regulated transmission services from the offices from which its related bodies corporate provide energy related services (does not relate to corporate staff such as payroll or human resources staff)⁴⁸
- a DNSP must ensure that staff involved in providing direct control or prescribed transmission services are not also involved in providing contestable energy-related services

The obligations described above are broadly equivalent to the current NSW ring-fencing obligations from which Essential Energy and Ausgrid have existing waivers. Section 5.2.1 of the NSW Distribution Ring Fencing Guidelines requires a DNSP to ensure that its offices from which staff provide monopoly services are separate from the offices from which staff provide contestable services. Section 5.4.1 of the NSW Distribution Ring Fencing Guidelines requires a DNSP to ensure that staff providing monopoly services do not also provide contestable services.

The existing waivers granted by IPART to Essential Energy and Ausgrid were premised on the remoteness of the service areas specified by the waivers. IPART determined that enforcing the existing staff separation ring-fencing provisions was not warranted in remote areas with limited prospect of competition to provide the services in question. That is, the cost of enforcing the ring-fencing provisions by requiring the DNSPs to establish multiple offices and separate workforces to perform contestable services was likely to outweigh any benefits in terms of enhanced competitive neutrality.

Essential Energy and Ausgrid must assess their circumstances in light of the new ring-fencing arrangements and consider whether, in their view, they require waivers under our Guideline. We are not able to pre-empt any decision on a waiver application by making statements now in favour of, or against, granting a waiver. We note that remote areas may be less likely than more populated areas to see a wide variety of competing service providers. However, it is not desirable to put a line on a map to designate which areas are or are not adequately serviced by alternative service providers—this will likely depend on the remoteness of the customer and the services required. Both may vary over time.

5.3 The Draft Guideline and information confidentiality

In this section we describe how the Draft Guideline deals with confidential customer information. This relates to the existing waiver granted to Ergon Energy for customer

⁴⁸ AER, *Draft ring-fencing guideline—electricity distribution*, August 2016, s. 4.2.1(a).

information protection obligations in the context of its associated entity retailer. This issue relates to non-discrimination.

Section 4.3 of the Draft Guideline specifies that a DNSP must keep confidential any information provided by a customer, prospective customer or service provider for direct control services and/or regulated transmission services. The DNSP may only use such information for the purpose for which it was provided. Further, the DNSP may only share that information with a related body corporate if it provides the information also to parties competing with the related body corporate.

The Draft Guideline does not allow for waivers from section 4.3, dealing with information protection.

5.4 The Draft Guideline and information reporting

The waiver from annual regulatory reporting obligations granted to Energex and Ergon is not necessary under the Draft Guideline because the Draft Guideline does not impose the same reporting obligation.