

3 September 2018

Mr Moston Neck  
Director Network Regulation  
Australian Energy Regulator

By email: ringfencing@aer.gov.au

Dear Moston

### Application for extension to waiver from AER Ring-fencing Guideline – Legal Separation: Other Services maintenance and construction contracts

SA Power Networks has a number of existing infrastructure maintenance and construction contracts with large customers which have post 1 January 2018 completion dates. Under the AER's Ring-Fencing Guideline (**guideline**) we interpret these contracts as SA Power Networks providing non-distribution services – which can no longer be provided by distribution network service providers (**distributors**) after 1 January 2018. To comply with the guideline we had intended to negotiate, with each of the customers involved, the transfer of these existing contracts to Enerven Energy Infrastructure Pty Ltd (**Enerven**), prior to 1 January 2018.

However, we had advice that such transfers could create tax liabilities which exceed the cost-pass-through threshold. In October 2017, we applied to the Australian Energy Regulator (**AER**) for a waiver for legal separation for 20 Other Services maintenance and construction contracts, to allow SA Power Networks to continue as the named party on these contracts. This short-term waiver period was to provide time for us to seek a Private Binding Ruling from the Australian Taxation Office (**ATO**) for any tax liabilities that could be incurred in transferring these contracts to Enerven Energy Infrastructure Pty Ltd (Enerven), prior to 1 January 2018.

The initial waiver allowed SA Power Networks to continue providing these contracted services until:

- These contracts terminated. A number of these contracts will terminate prior to 30 September 2018; or
- The ATO has provided us with a favourable ruling allowing us to effect transfers to Enerven without incurring tax liabilities; or
- The ATO has provided us with an unfavourable Ruling at which point we will consider whether further waiver(s) or some other course of action is appropriate.

Unfortunately, after lengthy discussions with the ATO, they have not provided us with a favourable ruling. This means that if we do transfer any contracts to Enerven, we would be at high risk of being liable to pay significant capital gains tax on the transfer of any associated assets.

As we have not secured a favourable ruling by the ATO, we are now seeking a waiver extension.

Some contracts will reach their end date by the time our initial waiver period expires. However, a number of contracts will remain active for a further period of time. These contracts are summarised, with end dates, in Attachment A.

Our application (attached) is set out according to the requirements listed in section 5.2 of the guideline.

Our contact for this application is Samantha Hicks, 08 8404 4194.

Yours sincerely



Richard Sibly  
**Head of Regulation**

## SA Power Networks' application for waiver from AER Ring-fencing guideline – Legal Separation: Other Services (maintenance and construction contracts)

### Details of the services in relation to which the distributor is applying for the waiver

This waiver application relates to 'other services' maintenance and construction contracts. These contracts are listed in confidential Attachment A. These contracts have been executed by SA Power Networks and will involve the provision of 'other services' beyond 1 January 2018, and beyond the existing waiver period of 30 September 2018. The guideline does not permit SA Power Networks to provide 'other services' after 1 January 2018.

### The obligation in respect of which the distributor is applying for a waiver

In respect of these contracts only, SA Power Networks is applying for an extended waiver from the legal separation obligations listed in Section 3.1 of the guideline.

### The reasons why the distributor is applying for the waiver

The reasons SA Power Networks is applying for this waiver are:

- **Cost and efficiency**

As described in the cover letter to this application, transfer of these contracts without the favourable ruling from the Australian Taxation Office could result in SA Power Networks incurring significant additional ring-fencing costs associated with any ultimate tax liabilities. Any additional taxation costs would exceed the cost pass through threshold. The amount of taxation costs are estimated to be approximately \$10 million.

As noted in our 30 October 2017 application, SA Power Networks has not been funded for any ring-fencing costs and recently absorbed other significant and new compliance costs. We would be unable to absorb further costs associated with significant tax liabilities and would be seeking a pass-through for tax liabilities that arise from ring-fencing.

- **No cross-subsidisation or discrimination**

Not imposing legal separation for these contracts for an extended period will not in any way advantage an SA Power Networks affiliate, as these are contracts already won in competitive markets and for services which are currently being provided. SA Power Networks will still be subject to other guideline obligations.

SA Power Networks' Cost Allocation Method (CAM) addresses the risk of cross-subsidisation. We will continue to allocate and attribute costs as required in accordance with the CAM and cost allocation procedures, in accordance with NER requirements.

Functional separation measures will still be applied to the services provided under these contracts, in line with guideline obligations. SA Power Networks considers that the functional separation that will be thus achieved will be a sufficient measure in the short-term to avoid any adverse impact with respect to its obligations not to discriminate. We will comply with all of the functional separation obligations, avoiding any opportunity to discriminate. The services and their provision will be fully in compliance with the guideline. If the provision of these contracted services is undertaken by any staff who also provide direct control services, or from locations which also deliver direct control services, these will be published on the appropriate registers. Delivery of these services has already been re-branded as Enerven.

Internal audits and the annual independent compliance assessment, as required by the guideline, will ensure SA Power Networks' ongoing compliance with the cost allocation and functional separation obligations throughout the duration of these contracts.

**The proposed commencement date and expiry date of the waiver and reasons for those dates**

The proposed commencement is 1 October 2018. The proposed expiry date is the completion of the final contract, being 30 June 2021, to allow these contracts to conclude without requiring transfer which will incur tax liabilities.

**Details of the costs associated with the distributor complying with the obligation if the waiver of the obligation were refused**

If we assign existing contracts or assets to Enerven, there is a risk that for each contract, tax liabilities could be payable. As noted earlier, these costs would be substantial, and could trigger a cost-pass through event in accordance with the National Electricity Rules (NER) section 6.6.1.

**The regulatory control period to which the waiver would apply**

The waiver would apply for the remainder of the existing current regulatory control period (June 2020) and the first year of the next regulatory control period, ie from 1 October 2018 to 30 June 2021.

**Any additional measures the distributor proposes to undertake if the waiver were granted**

SA Power Networks has undertaken a substantial ring-fencing implementation project to reach guideline compliance by 1 January 2018.

New entities were established to comply with legal separation requirements, and we complied with all other legal separation obligations by 1 January 2018. New contracts are all being established under the new entity. Where a contract included in this waiver application is terminated or otherwise concludes and is re-tendered prior to the forecast end date, any new contract will be entered into by Enerven.

**The reasons why the distributor considers the waiver should be granted with reference to the matters specified in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers**

With reference to the three matters in 5.3.2(a) of the guideline:

**i. the National Electricity Objective;**

Granting of the waiver will enable SA Power Networks to comply with the guideline and avoid potentially unnecessary and significant cost for SA Power Networks' regulated customers. The proposed waiver will promote efficient operation and use of electricity services for the long-term interests of electricity customers, specifically in regard to a lower price. If the waiver is not granted and a cost pass-through to customers is approved for any tax liabilities, this will not be in the long-term interests of consumers as a higher price would arise, with no off-setting benefits to customers of any kind.

**ii. the potential for cross-subsidisation and discrimination if the waiver is granted or refused;**

SA Power Networks maintains separate accounts for its regulated and contestable electricity services to capture and isolate the direct costs incurred in providing these services and allocates costs to these services in accordance with the CAM. These services are not cross-subsidised.

With respect to discrimination, the contracts in question have already been won in competitive markets, so no discrimination is feasible as a result of their operation under the waiver. Also,

functional separation obligations will still be met with respect to delivery of these contracts, ensuring the potential for discrimination is eliminated. This includes the operational delivery of these services already being branded as Enerven.

**iii. whether the benefit, or likely benefit, to electricity consumers of the distributor complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the distributor of complying with that obligation.**

In respect of these contracts, we do not believe there is any benefit to consumers in requiring SA Power Networks to comply with the obligation for the life of these contracts. Granting this waiver extension will neither discriminate against existing competitors nor lessen competition for future work. The taxation liabilities that could flow to SA Power Networks and (subject to a successful cost pass through application) ultimately to our customers from enforcement of the obligation by the AER far outweigh any conceivable perceived benefit of not granting the waiver.