Ring-Fencing Guideline: Waiver Applications

31 July 2017

Contents

Glossary of terms	Definition
Affiliated Entity	In relation to a DNSP, means a legal entity: a) which is a direct or indirect shareholder in the DNSP or otherwise has a direct or indirect legal or equitable interest in the DNSP; b) in which the DNSP is a direct or indirect shareholder or otherwise has a direct or indirect legal or equitable interest; or c) in which a legal entity referred to in paragraph (a) or (b) is a direct or indirect shareholder or otherwise has a direct or indirect legal or equitable interest.
Alternative control service (ACS)	A distribution service that is a direct control service but not a standard control service.
Community Service Obligation (CSO)	The payment by the Queensland Government that represents the difference between the cost to supply customers in regional Queensland and the prices charged to customers under the uniform tariff policy.
Compliance Strategy	Document that sets out the strategic approach that Ergon Energy is taking to compliance with the Guideline.
Contestable electricity services (CES)	Other distribution services and other electricity services.
Direct Control Service (DCS)	An electricity network service which the National Electricity Rules (NER) specify as a service, the price for which the AER specifies in an Ergon Energy determination as a service the price for which, or the revenue to be earned from which, must be regulated under the Ergon Energy determination.
Distribution Network Service Provider (DNSP)	A person who engages in the activity of owning, controlling, or operating a distribution system and is registered as a network service provider (i.e. Ergon Energy).
Distribution service	A service provided by means of, or in connection with, a distribution system.
Electricity services	Services that are necessary or incidental to the supply of electricity to consumers of electricity, including the generation of electricity; electricity network services; the sale of electricity (relevant to definition of electricity information).
Other distribution services (ODS)	A distribution services other than direct control services. Note: As Ergon Energy does not provide negotiated distribution services this applies only to distribution services that are not classified (i.e. unclassified distribution services).
Other Electricity Services (OES)	Services for the supply of electricity or that are necessary or incidental to the supply of electricity, other than transmission services or distribution services.
Other Services	Services other than transmission services or distribution services.
Related Electricity Service Provider (RESP)	In relation to a DNSP, includes an Affiliated Entity of the DNSP; and the part of the DNSP that provides contestable electricity services.
Standard Control Service (SCS)	A direct control service that is subject to a control mechanism based on Ergon Energy's total revenue requirement.
Unclassified Distribution Service (UDS)	This is not a defined term in the National Electricity Law (NEL) or Rules, or through the AER's Framework and Approach. However, an unclassified distribution service is a distribution service that is not classified as a direct control service or a negotiated distribution service by the AER.
Uniform tariff policy (UTP)	The Queensland Government policy which is intended to provide that small standard retail contract customers and large non-market customers of the same class pay no more for their electricity regardless of their geographic location in regional Queensland.

Overview

Ergon Energy supplies electricity to over 740,000 customers across a vast operating area of over one million square kilometres – from the coastal and rural population centres to the remote communities of outback Queensland and the Torres Strait.

In December 2015, the Queensland Government announced that it would merge its two government owned electricity corporations (GOCs), Ergon Energy and Energex. On 1 July 2016, the Queensland Government established Energy Queensland (EQL) as a sole parent company, with Ergon Energy and Energex as subsidiary distribution businesses. These reforms were implemented to create a corporate structure that achieves operational efficiencies, provides customers with greater choice, more control over their energy usage and access to innovative technology and delivers more stable energy bills.

In addition to these recent corporate changes, there are a range of factors that combine to create Ergon Energy's unique operating environment:

- Ergon Energy's network area covers 97% of Queensland and covers a diverse range of areas – costal, rural, remote outback and the Torres Strait.
- Ergon Energy's electricity network consists of approximately 160,000 kilometres of powerlines and one million power poles, along with associated infrastructure such as major substations and power transformers. Ergon Energy also owns and operates 34 isolated networks and 33 isolated generators (referred to together as isolated systems) that supply isolated communities across Queensland which are not connected to the main electricity network.
- Ergon Energy Queensland (EEQ) is a non-competing retailer servicing non-market customers in Ergon Energy's distribution area. EEQ is unable to actively attempt to acquire new customers or provide them with services on a market contract (i.e. EEQ's retail customers may only be supplied on the terms and conditions of the standard retail contract under the National Energy Retail Rules). EEQ is required to charge its customers notified prices, which are set by the Queensland Competition Authority (QCA) in accordance with the requirements of the delegation of the Minister for Energy, Biofuels and Water Supply.
- EEQ receives community service obligation (CSO) payments in support of its delivery of the Queensland Government's uniform tariff policy (UTP). The UTP is intended to provide that, wherever possible, small standard retail contract customers and large non-market customers of the same class should pay no more for their electricity, regardless of their geographic location in regional Queensland. The CSO underpins the UTP and compensates EEQ for the additional costs of supplying electricity customers in regional Queensland. Without the CSO, EEQ would operate at a loss.

Ergon Energy is committed to achieving compliance with the Australian Energy Regulator's (AER) Ring-Fencing Guideline (Guideline) by 1 January 2018, supported by a limited number of proposed waivers which are outlined in this waiver applications document. These waivers are to address temporary administrative and practical delivery issues and the unique characteristics of Ergon Energy's network, and should be considered in conjunction with Ergon Energy's ring-fencing compliance strategy which further demonstrates Ergon Energy's commitment to compliance.

In developing its ring-fencing compliance strategy and related waiver applications, Ergon Energy has considered the impact of different implementation options on its customers and communities. This has resulted in a compliance approach that seeks to minimise costs through a pragmatic approach to implementation while still achieving compliance with the Guideline's requirements and objectives. Striking this balance means Ergon Energy will be able to minimise the impact on customers and the community.

> *We are committed to delivering on our purpose – 'to safely deliver secure, affordable and sustainable energy solutions with our communities and customers'.*

Waivers are allowed under the Guideline for four key obligations:

- Legal separation
- Staffing separation
- Locational separation
- Branding and cross-promotion obligations.

There are three distinct areas of impact that Ergon Energy is seeking to address through its waiver applications. These emanate from:

- Administrative anomalies for which the granting of a waiver would not materially impact the intent of the Guideline:
    1. Service classifications – a temporary waiver for the remainder of the 2015-20 regulatory control period from the legal separation, office, staff, and branding and promotions obligations relevant to a range of services flagged for reclassification in the 2020-25 regulatory control period.
    2. Novation of contracts to an Affiliated Entity (AE) – a short term waiver to facilitate Ergon Energy's transition to a compliance with the Guideline given lead times and preconditions for novating contracts associated with the delivery of Other Services to the AE.
- The specific characteristics of Ergon Energy's supply area and the regulatory frameworks under which it is required to operate, resulting in some areas of material inefficiency and cost as a consequence of Guideline application:
    1. EEQ branding – a waiver from the branding separation obligation for retail services provided by EEQ which is a non-competing retailer.
    2. Regional offices – a waiver to allow the offices within the Mareeba and Charters Towers depot boundaries to be classified as regional offices for the purposes of the Guideline.
    3. Isolated systems – a waiver from legal, physical, staffing and branding obligations in relation to services provided to customers relying on isolated systems (comprising 34 isolated networks and 33 generators).
    4. Services to Barcaldine – a waiver from the physical separation, staff separation and branding and promotion obligations, in respect of the services provided to the Barcaldine Power Station, where these services are provided from the Cairns depot.
- Transitional costs of compliance and the need to consult with employees and unions:
    1. Uniform and fleet branding for Contestable Electricity Services (CES) – a waiver from branding separation obligations relating to its provision of services which are classified under the Guideline as CES.

A reference in this document to 'Ergon Energy' as an entity is a reference to Ergon Energy in its capacity as a distribution network service provider (DNSP) for the purposes of the Guideline.

Ergon Energy would welcome the opportunity to discuss its proposed waivers with AER. If the AER has any questions or requires clarification on any aspect of this document, please do not hesitate to contact:

General Manager Regulation and Pricing
Energy Queensland
E: mailto:ringfencing@energyq.com.au

1. Service classification

Ergon Energy is seeking a temporary waiver for the remainder of the 2015-20 regulatory control period from the legal separation, office, staff, and branding and promotions obligations relevant to a range of services flagged for reclassification in the forthcoming regulatory control period. The waiver would expire once new service classifications take effect, as part of Ergon Energy's 2020-25 regulatory determination.

1.1. Description of service

A DNSP's service classifications underpin the ring-fencing obligations that it must comply with for a particular regulatory control period. Ergon Energy's current service classifications which apply to the 2015-20 regulatory control period were established prior to the Guideline's development.

Ergon Energy provides a number of services that are classified by the AER as unclassified distribution services (UDS) for the 2015-20 regulatory control period. Recent analysis of the services indicates that there are three services which would be potentially more appropriately classified as direct control services (DCS):

- Emergency recoverable works – work to repair damage to the distribution network caused by third parties
- Watchman lights – unmetered lights mounted on a customer's property or a distribution pole for security purposes
- High load escorts – scope of an appropriate route and lift of wires to allow passage of high vehicles, as requested by a customer.

Clauses 4.2.1, 4.2.2 and 4.2.3 of the Guideline require these services to be functionally separated, meaning that separation of staff, office and branding is required. Further, the part of Ergon Energy providing these services would be considered to be a Related Electricity Service Provider (RESP) under the Guideline and subject to discrimination and information access and disclosure obligations.

Ergon Energy also undertakes a number of activities which are not classified as distribution services and therefore are unregulated services for the 2015-20 regulatory control period. Where appropriate, these will be provided by an affiliated entity (AE) of Ergon Energy to achieve compliance. However, Ergon Energy considers that the following services are likely distribution services and their classification should be reconsidered for the next regulatory control period:

- Property services – customer request for the distributor to undertake conveyancing property searches, conduct easement negotiations or purchase negotiations
- Rental and hire services – rental of distributor-owned property (e.g. plant hire and asset leasing)
- Sale of inventory – sale of inventory to developers and suppliers of developers including where these items are subsequently gifted to Ergon Energy as part of a network connection

Training to external party services – training of contractors/third parties to permit them to access and work on Ergon Energy's distribution network/other network service provider's networks or training of contractors/third parties to permit them to access and undertake work on non-network related assets. Under clause 3.1 of the Guideline:

- these services cannot be provided by Ergon Energy, but can be provided by a legally separated entity, referred to under the Guideline as an AE
- the provision of staff and/or offices to the AE are subject to the functional separation obligations, including staff, office, branding and information separation requirements, as described above.

Unclassified distribution services and non-distribution services are both CES under the Guideline, and clause 4.2.3 of the Guideline provides that a DNSP cannot use common branding for, or advertise or promote, its DCS and its CES.

Ergon Energy is performing preparatory work for its forthcoming regulatory control period, and is considering the reclassification of certain services, informed by:

- preliminary analysis of its services, which indicates that a different classification would be more appropriate
- the AER's final Framework and Approach (F&A) for NSW.

1.1.1. Appropriateness of current classification

Sale of inventory and property services are not classified by the AER as distribution services, however re-examination of activities that make up this service indicates that they may be more appropriately classified as distribution services. For sale of inventory this is considered appropriate because these services relate to sales of network assets to third parties, which are then in many instances gifted back to Ergon Energy to form part of the regulated distribution network. For property services, customer requests relate to services that only Ergon Energy as the distribution business is able to action, meaning that these should be considered as distribution services.

Sale of scrap is also treated as a non-distribution service under the service classification decision. However, further analysis suggests that this is not a service, but a supporting activity carried out as part of network services (i.e. as a standard control services (SCS)). This is because, where assets form part of the regulated network, the sale is treated as a disposal under the roll forward of the Regulatory Asset Base (RAB) with revenue recognised separately in the statutory accounts. As this activity is immaterial and incidental to the provision of network services, Ergon Energy considers that until the next regulatory control period, it would be more appropriate that sale of scrap is treated as not a service.

1.1.2. Consideration of NSW Final Framework and Approach

Ergon Energy notes that the AER's final F&A decision for the NSW DNSPs gives effect to the reclassification of a number of existing unclassified services or unregulated services to DCS or unclassified distribution services for the 2019-24 regulatory control period. However, as noted previously, Ergon Energy is yet to consult the business and its customers on whether to seek reclassifications of services as part of the forthcoming regulatory control period.

1.1.3. Proposed interim treatment of services

Under the Guideline, UDS and non-distribution services are both contestable electricity services (CES), which means they must be functionally separated from the part of Ergon Energy that provides DCS. In addition, non-distribution services must be legally separate from Ergon Energy.

Ergon Energy has considered its current service classifications and identified several services that it will potentially seek to have reclassified as part of the 2020-25 regulatory control period. As discussed below, implementing changes to achieve legal and functional separation for the remainder of the current regulatory control period will incur costs that will exceed any benefits to customers. On this basis, Ergon Energy proposes to seek an interim waiver from the obligations (i.e. treat them as if they have been reclassified), as reflected in the table below:

Services	Current classification	Proposed treatment
Emergency recoverable works	UDS	DCS
Watchman lights	UDS	DCS
High load escorts	UDS	DCS
Property services	Non-distribution	DCS
Training to external party services	Non-distribution	DCS
Sale of inventory	Non-distribution	UDS
Rental and hire services	Non-distribution	UDS

Proposed treatment for the remainder of the 2015-20 regulatory control period

Treating these services as if they have been reclassified for the remainder of the current regulatory control period would result in different ring-fencing implementation requirements applying to Ergon Energy:

- Emergency recoverable works, watchman lights, high load escorts and training services would not be subject to functional separation requirements within Ergon Energy
- Property services, sale of inventory and rental and hire services could continue to be provided by Ergon Energy.

1.2. Description of waiver

Ergon Energy is seeking a temporary waiver commencing on 1 January 2018 and expiring on 30 June 2020 (i.e. for the remainder of the 2015-20 regulatory control period) from the legal separation, office, staff, and branding and promotions obligations relevant to a range of services flagged for potential reclassification in the forthcoming regulatory control period. The waiver would expire once new service classifications take effect, as part of Ergon Energy’s 2020-25 regulatory determination.

1.3. Rationale for waiver

1.3.1. Costs

Depending on the AER's service classifications for Ergon Energy in its 2020-25 determination, any changes to business practices made now to comply with the Guideline would only be required for a 30 month transitional period and would either be unnecessary or unsuitable (and therefore required to be unwound) in the 2020-25 regulatory control period. This is inconsistent with achievement of the National Electricity Objective.

Ergon Energy estimates that the cost to implement these changes, including staff duplication and relocation, rebranding of assets, systems access control and any actions to subsequently reverse ring-fencing arrangements, would far outweigh any benefit derived for customers for this period, particularly given the potential lack of competition for some of these services.

DCS customers will benefit from lower costs as a consequence of the proposed waiver as Ergon Energy would not unnecessarily incur costs of complying with ring-fencing obligations for the remainder of the current regulatory control period for these services, and the costs of reversing the arrangements for the next regulatory control period when service classifications are reviewed.

1.3.2. Competition

Ergon Energy notes that the AER indicated in the Guideline Explanatory Statement[1], that some current service classifications may not be the most suitable in the context of the new national ring-fencing approach and are likely to change classification in the DNSPs' next regulatory control periods. Ergon Energy further notes that the AER has proposed reclassification of some services under the final F&A decision for NSW. The competitive environment for each of the services in Queensland, including the potential similarities with the services in the NSW final F&A decision, is discussed for each service in turn below.

There are no competitors for emergency recoverable works, as these services relate to repairs on the distribution network and only Ergon Energy is able to perform this work. Ergon Energy notes that the AER's NSW final F&A decision is to reclassify these services as SCS in recognition that the services are provided in connection with a DNSP's distribution system and it would be extremely difficult for a competitor to provide the service.

Competition is limited for watchman light services given that these services typically rely on the use of network assets, although they are for the customer's individual security reasons. There is some potential for competition, as a customer could install their own pole or potentially use a pole or building owned by a third party. However, it is understood that a robust market for these services does not currently exist. The AER's NSW final F&A decision is to reclassify this service as an ACS. This classification does not preclude provision of this service by a third party.

[1] Ring-fencing Guideline Explanatory Statement, p 74

Although there is potentially competition for some aspects of high load escort services, there are some activities, such as lifting wires, which can only be performed by Ergon Energy because they relate to the safe operation of the network. In relation to the competitive aspects of high load escort services, Ergon Energy's current practice is to offer this service as a 'provider of last resort' where there is no market and customers are not able to procure the service elsewhere. Ergon Energy notes that the AER's proposed approach for the NSW distributors is to reclassify this service as an ACS as part of Network Safety Services.

Property services include instances where customers request that Ergon Energy conducts easement or purchase negotiations. Treating this service as if it is reclassified as DCS would not have an impact on competition, as it relates to information about the distribution system that is only held by Ergon Energy.

Ergon Energy considers there a limited number of registered training organisations (RTO) that provide the specialist training services that Ergon Energy delivers to ensure its workforce and contractors (that access and work on our network/ access and work on network related assets) operate safely, efficiently and effectively. There are reasonably high barriers to entry given the costs associated with establishing and maintaining a RTO. Moreover, Ergon Energy notes that the AER's NSW final F&A decision is to classify training of contractors to work on the network as a DCS.

The AER indicated that the provision of distribution asset services (rental and hire services) will be classified as an UDS for all DNSPs' forthcoming regulatory control periods. This is on the basis that only a distribution business is in a position to make its assets available for lease and it would be excessively costly for another provider to construct these assets.

Sale of inventory relates to the sale of assets to developers which will, in most instances, ultimately form part of the distribution network. By making inventory available for sale to developers, Ergon Energy increases the volume of inventory that it purchases which lowers the average cost per item, benefiting customers overall. The activity is immaterial and incidental to providing network services. The use of inventory provided by Ergon Energy ensures compatibility and contributes to the safe and efficient use of the network. Therefore, Ergon Energy considers this service falls within the National Electricity Rules (NER) definition of a distribution service and should be reclassified for the 2020-25 regulatory control period. As noted above, Ergon Energy does not consider that the sale of scrap is a service and instead is an activity under network services, which occurs when a regulated asset is disposed of and reflected in the roll forward of the RAB. There is no competition for this activity, as it relates to sale of Ergon Energy's scrap.

1.3.3. Discrimination and cross-subsidy

Ergon Energy's Cost Allocation Methodology (CAM) ensures there is no cross-subsidisation within distribution services, and between distribution and other services. The CAM will be applied to ensure that only distribution costs are allocated and attributed to distribution services. Further, accounts will be auditable under the Guideline.

Ergon Energy considers there is no opportunity for staff providing DCS to discriminate in favour of Ergon Energy or an AE's CES business because the services that will be reclassified are not considered contestable services. Indeed some of these services are more appropriately viewed as activities undertaken during the course of providing DCS.

1.3.4. National Electricity Objective

This waiver is consistent with the National Electricity Objective as it will promote efficient investment in electricity services for the long term interests of consumers of electricity in respect of price. This is because it will prevent Ergon Energy from having to incur inefficient expenditure to implement temporary changes to achieve compliance with the Guideline, which would likely be unwound in 30 months.

1.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	1.2
(b)	The reasons why the DNSP is applying for the waiver	1.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	1.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	1.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	1.3.1
(f)	The regulatory control period(s) to which the waiver would apply	1.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	N/a
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	1.3.4
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	1.3.4
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	1.3.3
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	1.3.1

2. Novation of contracts to an Affiliated Entity

Lead times and preconditions for the novation of contracts associated with the delivery of Other Services to Energy Impact is likely to mean that Ergon Energy will not be able to effectively transfer services, and therefore comply with legal separation obligations for some Other Services by 1 January 2018. A short term waiver, for a period of 6 months, is sought to facilitate Ergon Energy's transfer to compliance with the Guideline.

2.1. Description of service

Ergon Energy provides the following non-distribution services, treated under the Guideline as Other Services:

- Test, inspect and calibrate services
- Contracting services to other network service providers
- Equipment services
- Operation and maintenance of customer assets
- Construction and sale of modular substations
- Demand-side management advisory services for customers (as opposed to services undertaken for direct control services)

Given the prohibition on providing Other Services, Ergon Energy will cease its provision of these services and Energy Impact will assume accountability for the delivery of these services. As part of this transfer process, customer and third party contracts associated with the delivery of Other Services by Ergon Energy will need to be novated from Ergon Energy to Energy Impact, a separate legal entity.

The novation of contracts is dependent on:

- the finalisation of the EQL group corporate structure, which is yet to receive Board and shareholding Ministers' approval, and Energy Impact's service offerings.
- changes to the Energy Impact constitution to allow services to be transferred.

2.2. Description of waiver

Although Ergon Energy will commence novating contracts to Energy Impact, once the final structure and services are determined, the lead times required mean that some contracts may not be novated by 1 January 2018. This means there will be some Other Services that Ergon Energy will need to continue to provide after this date.

Ergon Energy is therefore seeking a waiver from legal separation obligations that apply to the Other Services listed above that it is currently providing, commencing on 1 January 2018 and expiring on 30 June 2018. This would allow Ergon Energy to continue to provide these services for six months until the contracts are novated. Although Ergon Energy will use best endeavours to novate all contracts by 30 June 2018, the position of third parties is as yet unknown. If Ergon Energy has to enter into re-negotiations that delay novation of a contract beyond 30 June 2018, the business may be required to seek an extension of this waiver.

Importantly, Ergon Energy is not seeking a waiver from staffing and locational separation in relation to these services, and will comply with obligations relating to discrimination and information access and disclosure.

2.3. Rationale for waiver

2.3.1. Cost

Obtaining a waiver is critical to smoothing the transition to compliance for Other Services. In the absence of a waiver, Ergon Energy may either find itself with a potential breach of the Guideline or breach of the terms and conditions of a contract if it is unable to provide certain services.

Temporarily ceasing the service until it can be transferred to Energy Impact would result in foregone revenue, actions relating to the breach of contractual obligations and adverse electricity customer impacts. The costs in this scenario would outweigh the benefits of a waiver not being approved.

2.3.2. Discrimination and cross subsidisation

By 1 January 2018, Ergon Energy will meet its functional separation requirements in relation to the Other Services that are the subject of this waiver and this will mitigate any risks of discrimination that could occur. This will involve seeking a waiver from the AER to allow the provision of DCS and Other Services under the Ergon Energy brand and the implementation of compliance measures to:

- ensure that it does not share staff or offices for providing DCS and Other Services, unless an exemption applies
- only provide information to the part of the business that provides Other Services in accordance with Guideline restrictions
- ensure that there is no opportunity to discriminate against competitors for the provision of the Other Services.

The application of Ergon Energy's CAM will ensure that costs associated with the Other Services are not subsidised by those associated with DCS provided by Ergon Energy. The CAM ensures that costs are allocated and attributed to distribution services, and between distribution services, in accordance with the Cost Allocation Principles under the National Electricity Rules.

By 1 January 2018, Ergon Energy will have established internal accounting procedures to demonstrate the nature and extent of transactions for Other Services. These will be provided to the AER if requested to provide comfort that no cross-subsidisation is occurring.

2.3.3. Supporting compliance activities

As discussed above, Ergon Energy plans to meet the remaining obligations applying to its Other Services, either through a branding waiver, or through the implementation of compliance measures.

Table 2-1 illustrates the key activities associated with novating contracts and transferring services from Ergon Energy to Energy Impact, and demonstrates that it is anticipated to take a further three months from Day 1 for all applicable contracts to be identified and novated to Energy Impact.

Date	Milestone
Aug 2017	Finalisation of the EQL group company structure and commence identification of impacted contracts
Sep 2017	Review of contract terms and conditions
Oct 2017	Changes to Energy Impact constitution (subject to multiple Board and shareholder approvals)
Nov 2017	Commence negotiation of novations with third parties (subject to there not being any significant re-negotiation of terms)
Dec 2017	Where possible, execute deeds of novation for impacted contracts
Jan - May 2018	Continue negotiation of novations for outstanding contracts
Jun 2018	Transfer of contracts to the Energy Impact and provision of Other Services by Energy Impact

Table 2-1 High level implementation plan

2.3.4. National Electricity Objective

This waiver is consistent with the National Electricity Objective as it will promote efficient investment in electricity services for the long term interests of consumers of electricity with respect to:

- price, given that ceasing to provide the services could have cost impacts for Ergon Energy
- safety, given that the Other Services relate to testing, operating and maintaining assets which contribute to safety objectives for the Ergon Energy network and on other networks
- reliability, given that a temporary hold on Other Services by Ergon Energy could impact customers relying on these services to operate assets or train staff.

2.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	2.2
(b)	The reasons why the DNSP is applying for the waiver	2.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	2.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	2.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	
(f)	The regulatory control period(s) to which the waiver would apply	2.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	2.3.3
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	2.3.4
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	2.3.4
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	2.3.2
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	2.3.2

3. Ergon Energy Queensland branding

Ergon Energy is seeking a waiver from the branding separation obligation for retail services provided by EEQ. EEQ is a non-competing retailer that is required to offer regulated prices set by the QCA in accordance with the requirements of the delegation of the Minister for Energy, Biofuels and Water Supply. Given its status as a non-competing retailer shared branding will not lead to discrimination against other retailers.

Under the proposed waiver, EEQ and Ergon Energy could continue to both use the Ergon Energy brand. It is proposed that the trigger for the waiver ceasing should be changes to the legislative framework in Queensland to remove EEQ's inability to offer market contracts to all market customers in Queensland. In these circumstances, Ergon Energy would work with the AER to develop transitional arrangements that both satisfy the Guideline requirements and allow Ergon Energy sufficient time to transition.

3.1. Description of service

EEQ provides retail services to non-market customers in Ergon Energy's distribution area. As a retailer, the services provided by EEQ are Other Electricity Services (OES) under the Guideline and are required to be offered under a different brand to that used by Ergon Energy as a DNSP (i.e. the Ergon Energy brand) to provide DCS.

While the brands are differentiated to customers in terms of associated colours, Ergon Energy and EEQ currently share the 'Ergon Energy' brand. To be compliant with the Guideline, one of the businesses would not be able to use the 'Ergon Energy' brand.

3.1.1. EEQ as non-competing retailer

EEQ is a non-competing retailer servicing non-market customers in Ergon Energy's distribution area. EEQ is unable to actively attempt to acquire new customers or provide them with services pursuant to a market contract. The inability to offer market contracts means that EEQ's customers may only be supplied on the terms and conditions of the standard retail contract under the National Energy Retail Rules. It is noted that there is legislative provision that allows EEQ to offer market contracts in very limited circumstances as may be prescribed by the Queensland Government. However Ergon Energy does not consider this would be sufficient to change its status as a non-competing retailer.

EEQ receives CSO payments in support of its delivery of the Queensland Government's UTP. The UTP is intended to provide that, wherever possible, small standard retail contract customers and large non-market customers of the same class should pay no more for their electricity, regardless of their geographic location in regional Queensland. The CSO underpins the UTP and compensates EEQ for the additional costs of supplying electricity customers in regional Queensland. Without the CSO, EEQ would operate at a loss.

3.1.2. Implications of Guideline

Under the Guideline, Ergon Energy must use a brand to provide DCS that is independent and separate from that used by EEQ in providing OES and does not enable a reasonable person to infer that Ergon Energy and EEQ are AEs.

To achieve compliance in the absence of a waiver, either Ergon Energy or EEQ would need to cease using the 'Ergon Energy' brand as it makes it clear that the two businesses are AEs.

3.2. Description of waiver

The Guideline requires that separate branding be used between a distribution business and an AE, such as EEQ, providing a contestable electricity service. Ergon Energy is therefore seeking a waiver from the branding separation obligation for EEQ so that both entities can continue to use the Ergon Energy brand.

It is proposed that the trigger for the waiver ceasing should be changes to the legislative framework in Queensland to remove EEQ's inability to offer market contracts to all market customers in Queensland. The appropriate timeframe for transition would be agreed with the AER. In these circumstances, Ergon Energy would work with the AER to develop transitional arrangements that both satisfy the Guideline requirements and allow Ergon Energy sufficient time to transition.

3.3. Rationale for waiver

3.3.1. Cost

EEQ has calculated the cost of rebranding, including developing a new brand from ideas to final approval, identifying assets that are currently Ergon Energy branded and estimating the cost to replace them.

Preliminary estimates indicate that a full rebranding exercise for EEQ is forecast to cost at least $7 million.

The Guideline does not specifically require affiliated entities to change their branding but just sets out that it cannot be identifiable with the brand used by the DNSP. For completeness, Ergon Energy considered the cost of it rebranding and identified that it would be significantly more than rebranding EEQ, due to the larger workforce, fleet and number of other assets. On this basis, the forecast cost would be in excess of $7 million.

3.3.2. Discrimination and cross subsidisation

Ergon Energy is not seeking a waiver from legal or functional separation (staff and office sharing), which will be implemented by 1 January 2018, and so there is limited opportunity for the business to discriminate in favour of EEQ under this waiver. The legal separation also ensures Ergon Energy will not have the opportunity to cross-subsidise EEQ and all costs will be allocated in accordance with the Ergon Energy CAM and supporting Cost Allocation Principles.

3.3.3. Competition

Granting a waiver to allow EEQ to continue to operate under its current brand will not have an impact on competition because EEQ is a non-competing retailer and, cannot actively compete for new customers. In addition, as described below, EEQ operates under a number of provisions that seek to promote the interests of consumers in regional Queensland by subsidising the provision of electricity services to enable the same quality, safety and reliability to be delivered for similar prices as those available to customers in south east Queensland. Competition in regional Queensland remains limited.

Legislative provisions under the *National Energy Retail Law (Queensland) Act 2015* (Qld) (NERL) and *Electricity Act 1994 (*Qld*)* operate to constrain EEQ's ability to compete.

EEQ receives a community service obligation (CSO) payment to cover the difference between the cost to supply electricity to customers in regional Queensland and the prices EEQ can charge customers under the UTP. A CSO is an obligation to perform activities that are not in the commercial interests of the business. The cost of providing this service is subsidised by all Queensland tax-payers through the CSO payment by the Queensland government. EEQ's CSO payment for electricity supply in 2016-17 was $547.7 million, reflecting the high costs of supply to small customers, which can deter other retailers.

Ergon Energy considers that the risks that the Guideline seeks to address (i.e. discrimination, cross-subsidy and reduced competition in the market) are mitigated by the restrictions applied to EEQ as a non-competing retailer. They are further addressed by the legal and functional separation between Ergon Energy and EEQ. Given this, Ergon Energy considers that the costs that EEQ would incur to rebrand would not be offset by benefits to consumers.

3.3.4. National Electricity Objective

This waiver is consistent with the National Electricity Objective, as the waiver will avoid incurring inefficient expenditure, while protecting consumers' long term interests, through the inclusion of a sunset arrangement that will ensure that, should the competitive environment change, customers will be able to benefit from increased competition.

3.3.5. Supporting compliance activities

Ergon Energy proposes that the end date for the waiver will be contingent on the Queensland government amending the legislative framework in Queensland to allow EEQ to compete for, or acquire, market customers. Ergon Energy proposes that it will advise the AER when any material changes are flagged for introduction and provide an implementation timetable, including a proposed end date for the waiver arrangements.

3.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	3.2
(b)	The reasons why the DNSP is applying for the waiver	3.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	3.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	3.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	3.3.1
(f)	The regulatory control period(s) to which the waiver would apply	3.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	3.3.5
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	3.3.4
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	3.3.4
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	3.3.2
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	3.3.1

4. Regional offices

Ergon Energy is seeking a waiver to allow the offices within the Mareeba and Charters Towers depot boundaries to be classified as regional offices for the purposes of the Guideline. This would allow the application of the Guideline's regional office exemptions for office, staff, branding and promotion obligations to these locations[2]. This would avoid incurring imprudent costs associated with compliance, while not negatively impacting the competitive landscape within these regions. This waiver will commence on 1 January 2018 and cease at the end of the next regulatory control period, in 2025.

Ergon Energy's distribution area is divided into 78 depot boundaries, which vary across Queensland both in size and number of connection points. The depot boundaries have developed over time as a result of operational drivers, such as geographical considerations, the ability for an office to provide timely service, and the potential to minimise the impact of meteorological events.

With the exception of emergency situations, the connection points within each depot boundary are serviced by staff located at an office (depot) within the depot boundary. Depot boundaries range from less than, to significantly more than, 100 kilometre (km) in radius.

Clause 1.4 of the Guideline defines a regional office as having fewer than 25,000 connection points within a 100 km radius of that office. Ergon Energy is continuing to review its depot boundaries against this definition having consideration for whether there are any locally available alternative service providers. To date approximately half of its depots qualify as a regional office. Ergon Energy may need to revisit the issue of its regional depots with the AER at a later date, but prior to 1 January 2018.

4.1. Description of service

This waiver applies to the provision of CES from within the Mareeba and Charters Towers depots, and the staffing, locational and branding and promotion obligations that would apply to the provision of these services in the absence of a regional waiver. This relates primarily to services which are unclassified distribution services, and therefore CES under the Guideline.

While the depot boundaries do not align with the regional office definition Ergon Energy's view is that Mareeba and Charters Towers should qualify for a regional exemption. These depots do not meet the definition of regional office because of their proximity to large regional towns yet their large service areas mean it would not be efficient to meet the Guideline obligations. To illustrate:

- Mareeba is located within 100 km of Cairns (where there are more than 25,000 connection points) but services only 9,200 connection points within a 100 km radius of the depot. However due to its proximity to Cairns, there are a further 105,400 connection points within a 100 km radius of the Mareeba depot which are serviced by other depots. The Mareeba depot boundary has a total of 28,700 connection points across its 230,000 square km area.
- Charters Towers is located some 108 km from Townsville (where there are more than 25,000 connection points) but services only 5,600 connection points across a 55,000 square km area. However due to its proximity to Townsville, there are a further 30,600 connection points within a 100 km radius of the Charters Towers depot which are serviced by other depots.

[2] Ring-fencing Guideline, clauses 4.2.1(b)iii, 4.2.2(b)iii, 4.2.3(b)ii

Figure 4-1 demonstrates how the regional office definition results in the offices within the Mareeba depot boundary not being classified as regional offices. Only 7% of connections within a 100 km radius of the Mareeba depot are serviced by the Mareeba depot.

Further, Figure 4-2 shows a similar result for Charters Towers with only 15% of connections within a 100 km radius of the Charters Towers depot serviced by the Charters Towers depot.

As noted above, these depot boundaries and their associated service areas have developed over time as a result of operational drivers, such as geographical considerations, the ability for an office to provide timely service (e.g. there is a significant mountain range separating the Mareeba and Cairns offices with the potential to materially impact access and the timeliness of service delivery across the existing depot boundaries), and the potential to minimise the impact of meteorological events.

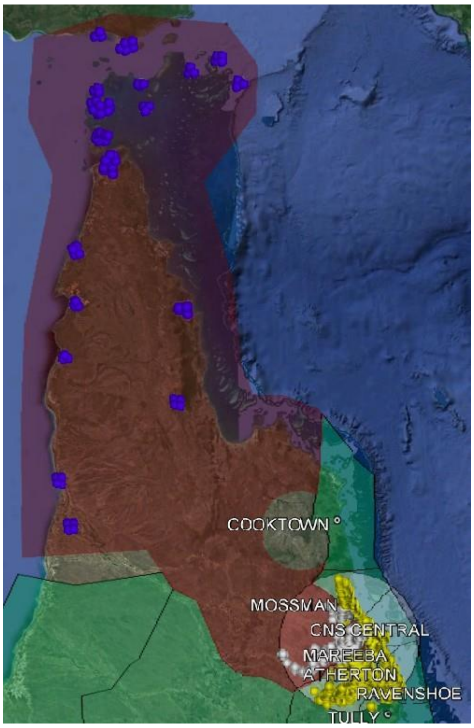

Figure 4-1 Connection points within a 100 km radius of the Mareeba office and connection points within the Mareeba depot boundary

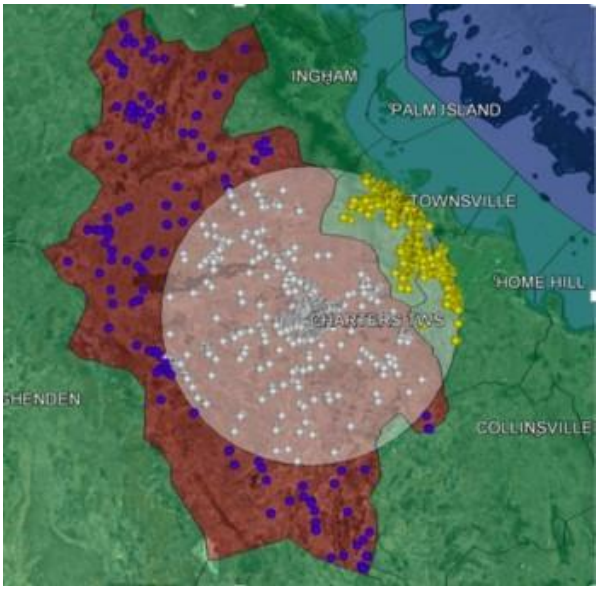

Figure 4-2 Connection points within a 100 km radius of the Charters Towers office and connection points within the Charters Towers depot boundary

In the above figures:

- The depot boundary is shaded in brown and the surrounding depot boundaries are shaded in green
- The names of offices are shown in white text
- The large white circle represents a 100 km radius around the Mareeba and Charters Towers depots
- White dots represent connection points that are both within the Mareeba and Charters Towers' depot boundaries and a 100 km radius of the office
- Blue dots represent connection points that are within the depot boundary (i.e. serviced from the office) but outside a 100 km radius of the office
- Yellow dots represent connection points that are outside the depot boundary but within a 100 km radius of the office
- Connection points that are both outside of the depot boundary and a 100 km radius from the office are not shown.

4.2. Description of waiver

Ergon Energy is seeking a waiver to allow the offices within the Mareeba and Charters Towers depot boundaries to be classified as regional offices for the purposes of the Guideline. This would allow the application of the Guideline's regional office exemptions for office, staff, branding and promotion obligations to these locations[3].

4.3. Rationale for waiver

4.3.1. Cost

In the absence of a waiver, Ergon Energy will need to:

- Send separate DCS and CES crews to a customer's premises over distances of up to 150 km to comply with staff separation obligations, where Guideline exemptions cannot be applied. This results in extremely inefficient use of resources and higher costs, and increases wait times faced by the customer. To illustrate, a DCS crew may be called to investigate an outage, for which restoration is considered a CES service. To restore supply the customer would need to request a service from a CES crew which would need to be dispatched separately.
- Upgrade the Mareeba and Charters Towers offices to physically separate DCS and CES crews and potentially accommodate a larger workforce of separate DCS and CES crews should staff duplication be required.
- Use separate branding for DCS and CES staff.

Ergon Energy estimates that implementing these changes would result in significant cost. Given that the potential for discrimination is limited by a lack of competition (discussed below), this cost would far outweigh the benefits to customers.

4.3.2. Competition

Ergon Energy considers that the rationale for allowing a regional exemption under the Guideline applies to its application for a waiver for the Mareeba and Charters Towers depots. That is, the Guideline Explanatory Statement indicates that the regional office exemption exists because if a DNSP did not provide the contestable services, then there would be little or no other entities able to service customers in the region.[4] Therefore, any compliance activities undertaken by the DNSP would "likely result in wasted resources".[5]

Although some connection points within the Mareeba and Charters Towers depots are within 100 kms of larger centres, the Mareeba and Charters Towers depot boundaries service only 9,200 and 5,600 connection points respectively and are located in such locations that there is no (or very limited) competition with respect to the CES provided within these depot boundaries.

Ergon Energy notes that it is effectively the 'supplier of last resort' for some customers within these depot boundaries and as such cannot simply cease providing CES in order to more cost-effectively achieve compliance. If these CES were not provided by Ergon Energy, it is likely that some customers could not obtain the service elsewhere, or for a reasonable price.

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[3] Ring-fencing Guideline, clauses 4.2.1(b)iii, 4.2.2(b)iii, 4.2.3(b)ii
[4] Ring-fencing Guideline Explanatory Statement, p 37
[5] Ring-fencing Guideline Explanatory Statement, p 40

Therefore, Ergon Energy believes granting the waivers to classify the offices within the depot boundaries as regional offices will support the National Electricity Objective by providing customers with services of a known, and fair, price and quality, without Ergon Energy incurring imprudent costs.

4.3.3. Alternatives considered

Ergon Energy considered seeking a waiver that only applied to the connection points within the Mareeba depot boundary that were outside the 100 km radius. However, seeking to apply the Guideline's obligations on a varied basis within a single depot boundary would materially increase the complexity of implementation and compliance, including with respect to the communication of service provision options and outcomes to impacted customers.

4.3.4. National Electricity Objective

This approval of this waiver would promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to reliability and security of supply of electricity. This is because customers would be likely to face higher wait times for services if separate crews need to be dispatched to perform DCS and CES work.

This waiver is also consistent with the National Electricity Objective, as Ergon Energy will avoid incurring inefficient expenditure, while protecting consumers' long term interests, through the inclusion of an appropriate sunset arrangement to allow the proposed arrangements, costs and benefits, to be reassessed.

4.3.5. Supporting compliance activities

Mareeba and Charters Towers are included in the office and staff registers required under clause 4.2.4(a) of the Guideline.

It proposed that this waiver cease at the end of the next regulatory control period to allow Ergon Energy and the AER to reassess the feasibility of the waiver. Prior to the end of the waiver term, Ergon Energy will have engaged with its stakeholders and conducted a market analysis to assess the feasibility of another waiver application.

4.3.6. Discrimination and cross-subsidisation

Ergon Energy considers that the absence of competition in the Mareeba and Charters Towers depot boundaries means that there are no third parties for the business to discriminate against. Ergon Energy's Cost Allocation Methodology (CAM) ensures there is no cross-subsidisation within distribution services, and between distribution and other services. The CAM will be applied to ensure that only distribution costs are allocated and attributed to distribution services.

4.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	4.2
(b)	The reasons why the DNSP is applying for the waiver	4.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	4.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	4.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	4.3.1
(f)	The regulatory control period(s) to which the waiver would apply	4.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	4.3.5
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	4.3.4
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	4.3.4
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	4.3.6
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	4.3.1

5. Isolated systems

Ergon Energy is seeking a waiver from legal, physical, staffing and branding and promotion obligations in relation to services provided to customers in its isolated systems. This waiver will commence on 1 January 2018, and only cease should there be a change in regulatory arrangements such that the basis upon which services are provided in isolated systems are no longer determined by the Queensland Government.

5.1. Description of service

5.1.1. Isolated systems

Ergon Energy defines 'isolated systems' to be the generation and distribution services it provides on isolated networks. These services are regulated by the Queensland Government and contribute to the requirement for CSO payments. Whilst distribution and generation are distinct services, the unique factors associated with providing the generation and distribution services on isolated networks are similar. Ergon Energy believes it is therefore appropriate to submit a combined waiver application for these services.

Ergon Energy owns and operates 33 isolated, predominately diesel power stations, for isolated communities. These are unregulated services therefore the Guideline prevents Ergon Energy providing the services, and from sharing staff, offices and branding with the provision of DCS.

The isolated generation services are provided in tandem with Ergon Energy's distribution services across 34 unregulated isolated networks. These are UDS and therefore the Guideline requires these services to be functionally separate from the provision of DCS. Figure 5-1 shows the remote locations of the isolated power stations owned and operated by Ergon Energy for the benefit of electricity customers within isolated communities.

Ergon Energy is seeking a waiver from these obligations on the basis that the services are regulated by the Queensland Government and contribute to the requirement for CSO payments. Further there is little competition in remote locations and therefore little opportunity to discriminate against third parties. Regulatory arrangements are discussed below.

Figure 5-1 Map of Queensland showing location of the isolated systems

5.1.2. Isolated systems regulatory arrangements

While the isolated distribution services are classified as UDS under the AER's existing service classification decision, neither the isolated generation services nor the distribution services provided in unregulated isolated networks are subject to regulation under Chapter 6 of the National Electricity Rules. There are also various exemptions from, and amendments to, Chapter 5A under the Queensland derogations to recognise the unique nature of these networks.

While the services provided in relation to isolated systems are not regulated by the AER, they are not provided on a competitive basis. This is because the Queensland Government determines, through the CSO Deed, the amount that Ergon Energy can recover from EEQ for services provided on isolated systems. Specifically the CSO Deed between EQL and the Queensland Government defines the asset base and Weighted Average Cost of Capital (WACC) that is applied in calculating allowable revenue for generation and distribution services. Further, Ergon Energy must report to the Queensland Government on its expenditure in relation to isolated systems.

The isolated systems service charges passed onto EEQ, and then onto customers, are subject to scrutiny by the Queensland Government. This is because the Queensland Government pays the difference, through the CSO subsidy, between the isolated systems charges passed through by Ergon Energy and the amount recovered by EEQ through the notified prices that it must charge its customers.

5.1.3. Staffing arrangements

Services to isolated systems are provided by:

- Staff dedicated to isolated systems who provide ODS and OES from within the remote locations (i.e. these staff do not operate from an office)

- Staff located at depots and offices, which may or may not be regional offices, who provide DCS services in relation to Ergon Energy's regulated network, as well as ODS and OES for the isolated networks.

5.2. Description of waiver

The impact of the Guideline on services provided in relation to isolated systems services would be that:

- Ergon Energy would be prohibited from providing the generation service
- staff also providing DCS could not be used to provide these services, unless exempt from staffing separation obligations
- staff providing these services would need to be separated from staff providing DCS, unless exempt from staffing separation obligations
- these services could not be provided under the Ergon Energy brand.
- There are Ergon Energy staff, such as planning and design staff, who are shared across the provision of DCS and OES, therefore staffing and locational separation would not apply.

Ergon Energy is therefore seeking a waiver from the legal separation,[6] office separation,[7] staff separation,[8] and branding and promotions obligations[9] of the Guideline.

5.3. Rationale for waiver

5.3.1. Cost

The costs associated with ring-fencing would include:

- the costs of setting up secure access sections of offices where staff provide DCS and services to isolated systems
- potential costs of duplicating roles where it is not possible to consolidate staff roles to comply with staffing separation requirements
- the costs associated with rebranding uniforms and fleet.

These costs would increase the costs of operating Ergon Energy's isolated systems and would flow through to EEQ and to the CSO payment ultimately made by the Queensland Government in respect of these services. EEQ's CSO payment for electricity supply in 2016-17 was $547.7 million. There would be no benefit to customers for this increased cost to the Queensland Government because there is little to no competition in remote locations.

[6] Ring-fencing Guideline, clause 3.1(a)
[7] Ring-fencing Guideline, clause 4.2.1(a)
[8] Ring-fencing Guideline, clause 4.2.2(a)
[9] Ring-fencing Guideline, clause 4.2.3(a)

5.3.2. Discrimination and cross subsidisation

There will be no cross-subsidisation issues associated with this waiver as Ergon Energy will allocate costs to isolated systems in accordance with its CAM and the Cost Allocation Principles set out in the National Electricity Rules. No costs associated with isolated systems will be allocated to distribution services and accounts will be maintained to ensure clear and transparent demonstration of this to the AER.

Ergon Energy will comply with its non-discrimination obligations under the Guideline for all services. It is investigating its activities in relation to services to isolated networks to ensure that there are no areas which might give rise to discrimination against competitors for these services and their customers. It will implement measures to mitigate the risk of any breaches under the Guideline.

5.3.3. Competition

The remote locations, high cost, and lack of incremental demand associated with isolated systems means that competition is limited for these services. For instance, infrastructure is already established and demand on these systems is typically not growing, therefore it would be challenging for another party to provide the service.

The remote location also means that the market may be less appealing to competitors. To this end, Ergon Energy is not aware of any competitors that would provide these geographically disparate services in the absence of subsidy funding. If Ergon Energy were to not provide the services, there is a possibility that there would be no other providers for the service, which would significantly jeopardise the security of supply to electricity customers connected to isolated networks.

5.3.4. Regulation by Queensland Government

While isolated systems are not regulated by the AER, the Queensland Government specifies, through the CSO Deed, the asset base and WACC that Ergon Energy must apply in developing charges for isolated systems. Through this process the Queensland Government has control over the prices that apply to services on isolated systems. Ergon Energy is therefore prevented from leveraging monopoly power in relation to the operation and maintenance of these isolated systems.

5.3.5. National Electricity Objective

This waiver is consistent with the National Electricity Objective as it will promote efficient investment in, and efficient operation and use of, electricity services. While the benefits of avoided costs are not provided to electricity customers, ultimately the government will contribute less to the CSO which benefits the State of Queensland and Queensland communities.

5.3.6. Supporting compliance activities

Ergon Energy proposes that this waiver commence on 1 January 2018, and continue until there is a change in regulatory arrangements such that the basis upon which services are provided in isolated systems are no longer determined by the Queensland Government. In these circumstances, Ergon Energy would work with the AER to develop transitional arrangements that both satisfy the Guideline requirements and allow Ergon Energy sufficient time to transition.

5.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	5.2
(b)	The reasons why the DNSP is applying for the waiver	5.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	5.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	5.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	5.3.1
(f)	The regulatory control period(s) to which the waiver would apply	5.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	5.3.6
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	5.3.5
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	5.3.5
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	5.3.2
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	5.3.1

6. Services to Barcaldine

Ergon Energy provides staff to EEQ for the purpose of delivering non-distribution services (operational and maintenance activities) to the Barcaldine Power Station. These staff are primarily sourced from the Barcaldine depot, which is subject to a regional office exemption under the Guideline. In limited circumstances (e.g. relief during periods of annual leave) the workforce may be supplemented by staff from the Cairns office, to which the regional office exemption does not apply.

Ergon Energy is seeking a waiver from the physical separation, staff separation and branding and cross promotion obligations under clause 4.2 of the Guideline, in respect of the services provided to the Barcaldine Power Station, where these services are provided from other depots. Ergon Energy is also seeking a waiver from the legal separation obligation under clause 3.1(b) of the Guideline, to allow Ergon Energy to continue providing the OES to EEQ. This waiver will cease at the end of the next regulatory control period, in 2025.

Granting of the requested waivers would largely be consistent with the waiver arrangements applied under the previous Queensland jurisdictional Electricity Distribution Ring-Fencing Guidelines ('previous Guideline') with respect to the conduct of a 'related business'.

Under the notification arrangements Ergon Energy was required to notify the AER if any of its employees, consultants, independent contractors or agents worked on the Barcaldine Power Station. Under this regime Ergon Energy consequently would notify the AER each time that staff from the Cairns office would service the Barcaldine Power Station. The AER did not raise issue with these notifications.

6.1. Description of service

EEQ owns the Barcaldine Power Station and a gas pipeline connected to the Barcaldine Power Station.[10] As EEQ does not have an internal technical capability to service these assets it uses Ergon Energy staff for operational and maintenance activities. These staff are primarily located at the Barcaldine depot.

The operational and maintenance activities undertaken using Ergon Energy staff are not distribution services and are classified under the Guideline as Other Electricity Services (OES).

Barcaldine, which has a population of about 1,600 (including surrounding localities), is situated approximately 520 kilometres west of Rockhampton. As the Figure 6-1 below illustrates, Barcaldine is in a remote Queensland location.

[10] Office of Government Owned Corporations, achieved 6 December 2008 <https://web.archive.org/web/20081206034234/http://www.ogoc.qld.gov.au/current-issues/sectoralchanges.shtml>

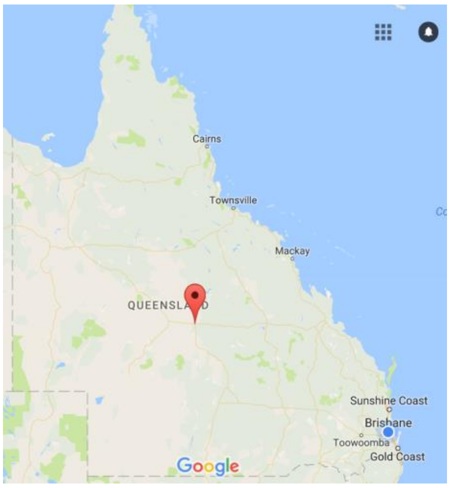

Figure 6-1 Location of Barcaldine

6.1.1. Staffing and accommodation arrangements

The Barcaldine depot services approximately 1,500 connection points within a 100 km radius, and is a 'regional office' for the purposes of the Guideline.[11] Ergon Energy staff located at the Barcaldine depot are permitted by the Guideline to be shared with EEQ as a consequence of:

- the regional office exemption
- the legal separation requirement not preventing Ergon Energy from providing staff to a Related Electricity Service Provider (i.e. EEQ) where this is not prohibited by locational, staffing and branding separation obligations.[12]

Although services to the Barcaldine Power Station are primarily provided by staff located at the Barcaldine depot, these are occasionally supplemented by non-dedicated staff from the Cairns office. This is necessary as there are only five staff located at the Barcaldine depot, including a casual cleaner and a support officer.

Non-dedicated staff from the Cairns depot, which is not a regional office for the purposes of the Guideline, provide the following:

- support during the annual shutdown of the power station
- relief to back fill Barcaldine staff during periods of annual leave
- maintenance planning and scheduling activities
- safety, environmental, and audit support.

[11] Ring-fencing Guideline, clause 1.4

[12] Ring-fencing Guideline, clauses 4.2.1(b)iii, 4.2.2(b)iii, 4.2.3(b)I and 3.1(d)iii

6.2. Description of waiver

Cairns depot staff who periodically provide services to the Barcaldine Power Station also provide DCS from their non-regional office in Cairns. As such they are not covered by the regional exemptions that apply to the staff undertaking activities from the Barcaldine depot. Therefore, a waiver is required from the office, staff, branding and cross-promotion obligations to allow these staff to continue to provide this service.[13] Obtaining these waivers would also mean that the staff could be shared with EEQ under the legal separation exclusions.[14]

In supporting the Barcaldine Power Station, Ergon Energy will be providing both DCS and OES. A waiver is therefore required under the Guideline from the legal separation obligation, to allow Ergon Energy to continue providing the OES to EEQ.[15]

6.3. Rationale for waiver

6.3.1. Cost

Ergon Energy investigated the possibility of rationalising the number of non-regional office based staff that provide services to Barcaldine. This activity considered whether it was feasible and cost effective to develop full time equivalent (FTE) positions that could be functionally separated from the staff providing DCS from the Cairns depot.

This analysis identified that:

- During the annual shutdown and refurbishment of the Barcaldine Power Station two Cairns based Ergon Energy staff are required in Barcaldine for two weeks.
- Every two months approximately one Cairns based Ergon Energy staff is required in Barcaldine for a period of two weeks to backfill annual leave entitlements
- Approximately 0.1 Cairns based Ergon Energy FTE is required for maintenance planning and scheduling activities
- Approximately 0.3 Cairns based Ergon Energy FTE is required for safety, environmental, and audit support.

Ergon Energy consider the skills required by the Cairns based Ergon Energy staff to support Barcaldine are of a specialised nature. The analysis indicates that a functionally separated, devoted Barcaldine team would be significantly underutilised, and it would not be prudent to make such an investment. Limited synergies are capable of being achieved across these roles.

6.3.2. Discrimination and cross subsidisation

Ergon Energy's CAM ensures there is no cross-subsidisation within distribution services, and between distribution and other services. Further, accounts will be auditable under the Guideline.

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[13] Ring-fencing Guideline, clauses 4.2.1(a), 4.2.2(a), 4.2.3(a)
[14] Ring-fencing Guideline, clause 3.1(d)iii
[15] Ring-fencing Guideline, clause 3.1(b)

Costs incurred by Ergon Energy in the provision of services to EEQ are managed under a service level agreement which was negotiated by both parties at arm's length. In accordance with the Guideline,[16] the service level agreement is structured to allow Ergon Energy to demonstrate the extent and nature of the transactions with EEQ.

6.3.3. Competition

One of the aims of the Guideline is to promote competition and prevent a DNSP from holding significant advantages in the provision of electricity services.[17] Ergon Energy believes the remote location of the Barcaldine Power Station, and the specialised skills required to operate and maintain the asset result in little or no effective competition existing for the provision of the required operational or maintenance services. Ergon Energy believes if the AER were to reject this waiver request, competition for these services will not increase sufficiently to realise benefits for electricity consumers.

6.3.4. Supporting compliance activities

It is proposed that this waiver cease at the end of the next regulatory control period to allow Ergon Energy and the AER to reassess the feasibility of the waiver. Prior to the end of the waiver term, Ergon Energy will have engaged with its stakeholders and conducted a market analysis to assess the feasibility of another waiver application.

6.3.5. National Electricity Objective

This waiver is consistent with the National Electricity Objective, as it will avoid incurring inefficient expenditure, while protecting consumers' long term interests, through the inclusion of an appropriate sunset arrangement to allow the proposed arrangements, costs and benefits, to be reassessed.

[16] Ring-fencing Guideline, clause 3.2.1(a)
[17] Ring-fencing Guideline Explanatory Statement, page 1

6.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	6.2
(b)	The reasons why the DNSP is applying for the waiver	6.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	6.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	6.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	6.3.1
(f)	The regulatory control period(s) to which the waiver would apply	6.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	6.3.4
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	6.3.5
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	6.3.5
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	6.3.2
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	6.3.1

7. Branding for CES - 2025

Ergon Energy is seeking a waiver from branding separation obligations relating to instances where staff perform services which are CES, that is, any service which is an UDS or OES under the Guideline. This waiver is made on the basis that there are a range of practical challenges and constraints associated with introducing new branding.

7.1. Description of service

Ergon Energy currently provides a range of UDS and OES which will be impacted by the Guideline, and Ergon Energy will not be able to fully comply with its obligations in respect of branding and cross-promotions.

7.1.1. OES

Ergon Energy currently provides the following OES and these are the subject of this application:

- Test, inspect and calibrate services
- Contracting services to other network service providers
- Operation and maintenance of customer assets
- Equipment services
- Construction and sale of modular substations.

Ergon Energy will transfer its OES to AEs. AEs within the EQL Group include Energy Impact, Metering Dynamics and Nexium. Most OES will be provided by Energy Impact under an independent brand.

Ergon Energy will ensure that staff and locations for these services are only shared where exemptions apply; that Confidential Information is only disclosed to an AE in accordance with the Guideline; and that it does not discriminate against any competitors of its AE. It will therefore be compliant with all obligations with the exception of branding and cross-promotion obligations.

In terms of meeting branding and cross-promotion obligations, the provision of these services will be supported by separate branding which will be used for communications from the AE, marketing material, invoicing, and website design. Due to significant challenges associated with rebranding uniforms and fleet, Ergon Energy will not be able to fully comply in relation to these obligations until, 30 June 2025. Ergon Energy will use best endeavours to achieve compliance in advance of the waiver end date, including transitioning to new branding over time focussing on high demand service delivery areas initially.

7.1.2. UDS

Ergon Energy provides two types of UDS which are the subject of this waiver, Type 1-4 metering services which are contestable metering services, and a connection service to Hayman Island.

Type 1-4 metering services will be treated consistently with the OES services set out above. That is, functional separation such as staffing, office, information separations will be implemented; and Type 1-4 metering services will also be transferred from Ergon Energy to affiliated entity, Metering Dynamics.

In relation to the Guideline's branding and cross-promotion obligations, the provision of these services will be supported by separate 'Metering Dynamics' branding which will be used for communications, marketing material, invoicing, and website design regarding type 1-4 metering. Due to the significant challenges associated with rebranding uniforms and fleet, Ergon Energy will not be able to fully comply with these obligations until 30 June 2025. As above, Ergon Energy will use best endeavours to achieve compliance in advance of the waiver end date, including transitioning to new branding over time.

Connection services to Hayman Island will be treated differently to Type 1-4 metering services. These services relate to an undersea cable owned by Ergon Energy that provides a connection service from Hayman Island to the Ergon Energy network and is an UDS. Since its construction almost 20 years ago, the undersea cable has been unregulated. A customer connection agreement exists between Ergon Energy and Mulpha Australia Limited (Mulpha) (operator of Hayman Island).

Ergon Energy will continue to provide services to Hayman Island, but will comply with its Guideline obligations by ensuring that staff and locations for this service are only shared where exemptions apply; Confidential Information is only disclosed in relation to this service in accordance with the Guideline; and that it will not discriminate against any competitors for the service (it is unlikely that there are any competitors). It will therefore be compliant with all obligations with the exception of branding and cross-promotion obligations.

In terms of meeting branding and cross-promotion obligations, Ergon Energy is seeking a waiver in order to be able to continue to provide services to Hayman Island under the Ergon Energy brand for the duration of the current contract for services.

7.1.3. Services covered by other branding obligation waiver applications

Ergon Energy provides other UDS and OES for which waiver applications for branding obligations are being sought. These services are:

- services to the Barcaldine Power Station which are an OES and are the subject of a waiver application from legal, staffing, office and branding separation obligations;
- services to isolated systems, comprising isolated networks services which are UDS, and isolated generators which are OES, and are the subject of a waiver application from legal, staffing, office and branding separation obligations;
- emergency recoverable works, watchman lights and high load escorts which are classified as UDS, but which Ergon Energy considers may be reclassified in the next regulatory control period, and is seeking a separate transitional waiver that would treat the services for ring-fencing purposes as if they had been reclassified.
- property services, rental and hire services, sale of inventory and training services which are classified as non-distribution services, but which Ergon Energy considers may be reclassified in the next regulatory control period and is seeking a separate transitional waiver that would treat the services for ring-fencing purposes as if they had been reclassified.

To the extent that waiver applications relating to services to Barcaldine, isolated systems and service classification are not successful, Ergon Energy would also seek to include these in this branding waiver application. Specifically, Ergon Energy would seek to provide these services under the Ergon Energy brand.

7.2. Description of waiver

Ergon Energy is seeking a partial waiver from its branding and cross-promotion obligations such that uniforms and fleet used to deliver CES can continue to bear Ergon Energy branding (i.e. the branding used to deliver DCS) from 1 January 2018 until 30 June 2025 Ergon Energy will work to replace uniforms with Ergon Energy branding starting with its workforce in the larger, non-regional depots from 2020 and will continue to progress through its workforce to all depots (other than those defined as regional depots) by no later than 30 June 2025.

Ergon Energy is also seeking a waiver from the full branding and cross-promotion obligations such that staff can continue to provide services to Hayman Island under the Ergon Energy brand for the duration of the current services contract with Mulpha. The commencement date for this waiver would also be 1 January 2018.

7.3. Rationale for waiver

7.3.1. Cost

Ergon Energy has made a significant investment in Ergon Energy branded uniforms, which means it is most cost effective for this supply of uniforms to be exhausted before new uniforms are acquired.

7.3.2. Employee negotiations

Employee uniforms serve to provide protection to employees in harsh and hazardous conditions, with design, colour and fabrics all being a key factor in the suitability of the uniform. Given these factors, it is therefore incumbent upon Ergon Energy to work closely with and consult with employees, internal and external stakeholders when considering changes to existing uniforms and/or branding on vehicles.

Consultation must be undertaken in good faith, which typically takes a considerable period of time and would include significant trials of proposed uniforms across the State and also across a range of climatic seasonal conditions. Such consultation and trials take a significant period of time (it can take 12 months to trial uniform items and items may not pass trial). Ergon Energy has only recently completed a consultation process to introduce new uniforms. It would not be prudent use of funds to commence another consultation process to replace uniforms and fleet branding so soon after the recent process. Ergon Energy therefore plans to work with suppliers and to consult with employees and stakeholders at the time the uniform contract expires toward the end of this regulatory control period. Ergon Energy anticipates that there will be a transition period, once a new uniform contract has been entered into and existing stocks have been depleted, before newly branded uniforms and fleet can be implemented across the business.

In addition to the contractual issues that will influence the speed with which Ergon Energy can implement new branding, there are also operational constraints, which cannot be overcome by assigning additional resources. For example, there will be a minimum manufacturing time, over which Ergon Energy has limited control.

Ergon Energy will commence the transition once it has new procurement arrangements in place, following the expiry of existing contracts. Ergon Energy will work to replace uniforms with Ergon Energy branding starting with its workforce in the larger, non-regional depots and continuing to progress through its workforce to all depots (other than those defined as regional depots) by no later than 30 June 2025.

7.3.3. Discrimination and cross subsidisation

There will be no cross-subsidisation issues associated with this waiver as legal separation will be established for OES. In conjunction with this Ergon Energy will set up accounts to ensure clear and transparent accounting which will demonstrate the nature and extent of transactions between Ergon Energy and its AEs. For both OES and UDS, the application of Ergon Energy's CAM will ensure that costs are appropriately allocated and attributed and that cross-subsidisation does not occur.

Ergon Energy will comply with the non- discrimination obligation under the Guideline for all services. It is investigating its activities in relation to UDS and OES to identify any risk areas which might give rise to discrimination against competitors for these services and their customers. It will implement measures to mitigate the risk of any breaches under the Guideline.

In relation to the service provided to Hayman Island, there is not risk of discrimination or cross-subsidisation, if the services are provided under the Ergon Energy brand, as there is no competition for the provision of this service.

7.3.4. Supporting compliance activities

Should the AER approve Ergon Energy's waiver application, Ergon Energy will provide the AER with updates on its progress to compliance with its branding obligation for CES services. , Ergon Energy will report as part of its annual compliance report key compliance activities undertaken each year. As noted above, in line with Ergon Energy's commitment to compliance, the focus will be on high demand service delivery areas initially with full compliance expected by 2025. The implementation of new branding will be supported by significant training for impacted staff to ensure awareness of the compliance obligations.

7.3.5. National Electricity Objective

This waiver is consistent with the National Electricity Objective as it will promote efficient investment in electricity services for the long term interests of consumers of electricity with respect to price. This is on the basis that it will mitigate the costs of replacing Ergon Energy's uniforms and fleet in order to rebrand.

7.4. Compliance matrix

Clause	Waiver requirement	Waiver application reference
5.2 DNSP's application for a waiver		
(a)	The obligation in respect of which the DNSP is applying for a waiver	7.2
(b)	The reasons why the DNSP is applying for the waiver	7.3
(c)	Details of the service, or services, in relation to which the DNSP is applying for the waiver	7.1
(d)	The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	7.2
(e)	Details of the costs associated with the DNSP complying with the obligation if the waiver of the obligation were refused	7.3.1
(f)	The regulatory control period(s) to which the waiver would apply	7.2
(g)	Any additional measures the DNSP proposes to undertake if the waiver were granted	7.3.4
(h)	The reasons why the DNSP considers the waiver should be granted with reference to the matters specific in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers	7.3.5
5.3.2 The AER's assessment of the waiver application		
(a) Subject to clause 5.3.3(a), must have regard to:		
5.3.2(a)(i)	The National Electricity Objective	7.3.5
5.3.2(a)(ii)	The potential for cross-subsidisation and discrimination if the waiver is granted or refused	7.3.3
5.3.2(a)(iii)	Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with the obligation	7.3.1