AUSTRALIAN ENERGY REGULATOR

Contact Officer: Laura Considine
Contact Phone: [redacted]
[redacted]

21 May 2025

Trudy Fraser
A/Executive General Manager Regulation
Energy Queensland

Sent by email to: [redacted]

Dear Trudy,

Re: Ergon Energy's ring-fencing waiver application for using the Ergon Energy brand when providing a connection service to Hayman Island

Thank you for the application received on 11 November 2024 for a waiver from the obligation in clause 4.2.3 of the Ring-fencing Guideline (Electricity Distribution) ('the guideline'), to allow Ergon Energy to continue providing a connection from its mainland network to Hayman Island via an undersea cable connection under the Ergon Energy brand name.

Ergon Energy's proposal

Ergon Energy is seeking to renew an existing waiver that allows it to continue to operate and maintain its undersea cable connection under the Ergon Energy brand. The undersea cable is classified as an unregulated distribution service, connecting Hayman Island to the mainland grid. The AER's service classification decision for this undersea cable was made on the basis that any market power on the part of Ergon Energy is mitigated by the contract between Ergon Energy and the operator of Hayman Island Resort (Mulpha).[1] Under the guideline, where DNSPs provide distribution services on an unregulated basis, they must functionally separate the provision of direct control services from the provision of other services. This applies for the Hayman Island undersea cable, and Ergon Energy holds an existing waiver from clause 4.2.3. of the guideline which the AER granted in 2017.

Ergon Energy has had a continuous contract with Mulpha for this service since 1999, with the current agreement extending until 2029. Ergon Energy's application mentions that there are options available for the extension of this contract, including automatic renewal (for a 15-year duration), until the end of the expected economic life of the asset.

The existing waiver will expire 30 June 2025[2] and Ergon Energy has requested that this waiver be granted for the period until 30 June 2040. Ergon Energy has proposed this waiver duration to give flexibility to the customer who has the option of extending the contract term beyond 2029.

AER assessment and decision

Under clause 5.3.2 of the guideline, before granting a waiver the AER must have regard to the National Electricity Objective (NEO), the potential for a distribution network to engage in

---

[1] Final Decision Ergon Energy to 2019-20 – [Attachment 13 – Classification of services](), October 2015
[2] [Ergon Energy – Ring-fencing waiver – August 2017]()

cross-subsidisation of services and discriminatory behaviour, and whether the costs of compliance with the guideline outweigh the benefit to consumers of that compliance, including in relation to impacts on competition.

Our decision is to grant a new waiver to Ergon Energy from clauses 4.2.3 of the guideline to enable Ergon Energy to provide a connection from its mainland network to Hayman Island via an undersea cable connection under the Ergon Energy brand name. This waiver will expire on 30 June 2040, unless varied or revoked sooner.

Ergon Energy's application and cable arrangements align with support of the NEO, as it contributes to ensuring a reliable, safe, secure and cost-efficient supply of electricity for the customer on Hayman Island. It is economically efficient to grant this waiver as it allows Ergon to most cost-efficiently provide services from its existing asset (undersea cable) for its expected remaining economic life (of approximately 25 years). If the waiver is not granted, there will be costs to change the Ergon Energy branding so that it can continue to provide the unregulated distribution service via an undersea cable. This is an unnecessary expense that will raise the cost of service to the single customer, with minimal benefits given the limited alternative options that are currently available.

We consider that granting this waiver to Ergon Energy will have minimal (if any) impact on market competition. Ergon Energy has explained that there are currently limited alternatives available to the customer, and that the undersea cable is a dedicated connection for this sole customer with no other providers in the region. Ergon Energy has not provided an assessment of whether alternatives such as standalone power systems are feasible currently or in the future (such as after the current contract expires in 2029). It is conceivable that a third-party provider may emerge to provide an alternative solution. However, granting Ergon this waiver for a longer duration out to 2040 does not preclude the customer from exploring other options should they emerge over that time. It simply allows Ergon to operate its undersea cable more cost-effectively with Ergon's own branding, rather than having to change its branding to be able to continue providing the service to the customer, if the customer chooses to continue using the cable.

Furthermore, we consider the risk of cross-subsidisation is adequately addressed by Ergon Energy's Cost Allocation Method (CAM) that is approved by the AER. It is noted the undersea cable is not part of Ergon Energy's regulated asset base (RAB). Ongoing maintenance expenditure for the provision of this service is allocated to unregulated distribution services through an appropriate allocator defined in the approved CAM, with costs recovered from the unregulated services streams. There is little opportunity for Ergon Energy to use information it gains through this waiver to advantage an affiliate.

There is minimal (if any) benefit to consumers in requiring Ergon Energy to comply with clause 4.2.3 of the guideline in this instance, and that these would be outweighed by the costs of compliance for Ergon Energy. In the absence of a waiver, Ergon Energy would be unable to provide the undersea cable connection to the sole customer under the Ergon branding. Ergon would incur costs to alter branding so that it can continue to provide the unregulated distribution service via an undersea cable. This would likely result in unnecessary higher costs to the customer given limited other alternatives available to the customer.

For these reasons, the AER has decided to grant a new waiver to Ergon Energy from clause 4.2.3 of the guideline to enable Ergon Energy to continue providing a connection from its mainland network to Hayman Island via an undersea cable connection under the Ergon Energy brand name.

Waiver duration

The AER now has discretion to set waiver durations on a case-by-case basis without a maximum term length under the guideline, including terms beyond the next regulatory control period, where it is appropriate. This flexibility allows the AER to ensure the term for each waiver is appropriate and to cater for circumstances in which there may be little benefit to limiting the length of a waiver to two regulatory periods. In this instance, a longer-term waiver gives greater certainty for Mulpha that Ergon Energy can continue to provide a connection via the undersea cable in a cost-effective and safe manner over a longer period. We are granting this waiver with an expiry on 30 June 2040. We consider it is appropriate given the stability of the contractual arrangements over many years and the likelihood the contract will be renewed to 2040 in-line with the asset lifespan due to limited alternatives being available to the sole customer.

Ergon Energy has indicated that the customer has used their right to extend the contract by 15 years during 2014 and has not expressed a preference to change arrangements in the future. The AER does note however, this waiver does not bind the customer to this arrangement past the expiry of the current contract in 2029, and it is for the customer to decide whether it explores alternative options that might emerge – such as standalone power systems.

We consider the waiver application satisfies the required evidence for granting a waiver of a longer duration. Namely:

- the level of viable competition (that is, alternative service providers) is limited in the remote islands where the customer is located. It is the AER's understanding that there are limited alternatives currently available to the customer.

Granting this waiver for the requested duration up to 30 June 2040 is in the long-term interest of the customer being serviced in the remote Island location. This aligns with the NEO in that, granting a longer duration for this waiver serves in the long-term interest of consumers of electricity with respect to the quality, safety, reliability and security of supply of electricity.

Compliance and review matters

The AER has broad discretion to review and revoke ring-fencing waivers that it grants, at any time on its own initiative if there are grounds to do so. Pursuant to section 5.5 of the Guideline, in deciding whether to vary or revoke the waiver, the AER will have regard to the same matters for granting the waiver under clause 5.3.2 of the Guideline. A minimum of 40 days' notice will be given to Ergon Energy that the AER is considering a variation or revocation of this waiver.

Ergon Energy is reminded that under clause 6.3. of the Guideline, Ergon Energy is required to notify the AER in writing within 15 days of becoming aware of a breach of its obligations under the Guideline.

If you would like to discuss this matter further, or have any questions, please contact Laura Considine, Director, New Markets and Innovation, on AERringfencing@aer.gov.au in the first instance.

Yours sincerely

[redacted]

Jarrod Ball
AER Board Member

Sent by email on: 21.05.2025