Ergon Energy Ring Fencing Waiver Application

Unregulated connection service to Hayman Island

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Part of Energy Queensland

CONTENTS

Ergon Energy's Ring-fencing waiver application

1. INTRODUCTION

Ergon Energy Corporation Limited (Ergon Energy) is a subsidiary of Energy Queensland and is a Queensland Government Owned Corporation. Ergon Energy builds, owns, operates and maintains an electricity distribution network and supplies electricity to more than 750,000 customers over a vast operating area covering one million square kilometres – around 97 per cent of the state of Queensland. Ergon Energy's supply area covers the expanding coastal and rural population centres to the remote communities of outback Queensland and the Torres Strait. There are over 150,000 kilometres of power lines and approximately one million power poles in the Ergon Energy distribution network, along with associated infrastructure such as major substations and power transformers. Ergon Energy also owns and operates 33 isolated power stations that support 39 communities across far western Queensland, throughout the cape and across 16 islands of the Torres Strait.

The National Electricity Rules (NER) require Ergon Energy to comply with the Australian Energy Regulator's (AER) Ring-fencing Guideline - Electricity Distribution (the Guideline).[1] Ergon Energy supports the granting of ring-fencing waivers by the AER where appropriate. This is especially so if the harms that ring-fencing is designed to prevent can be avoided or adequately managed, and therefore certain restrictions imposed by the Guideline can be relaxed.

On 18 December 2017, the AER granted Ergon Energy a waiver from the branding and cross-promotion obligations under clause 4.2.3 of the Guideline, to allow Ergon Energy to continue to provide a connection service as an unregulated distribution service until 30 June 2025, or the termination of the agreement if sooner.

The provision of this connection service to Hayman Island is currently classified as an unregulated distribution service[2] and the same classification is proposed for 2025-30 regulatory control period[3]. Noting the impending expiry of this waiver, Ergon Energy seeks a new waiver from complying with the branding and cross-promotion obligations of the Guideline, such that it can continue to provide services to Hayman Island via an undersea cable.

[1] Version 3, which was published in November 2021.

[2] See Final decision - Ergon Energy distribution determination 2020-25 - Attachment 12 - Classification of services - June 2020.pdf (aer.gov.au), page 25.

[3] See https://www.aer.gov.au/system/files/2024-02/Ergon%20-%2012.01%20-%20Service%20Classification%20-%20January%202024%20-%20public.pdf, page 21.

2. DESCRIPTION OF WAIVERS BEING SOUGHT

The obligations for which the DNSP is applying for a waiver

Ergon Energy is seeking a waiver from the branding and cross-promotions obligations under clause 4.2.3, to continue to provide the unregulated distribution service to Hayman Island.

The reasons why the DNSP is applying for the waiver

Under clause 4.2.3 of the Guideline, Ergon Energy must:

- use branding for its direct control services that is independent and separate from the branding used by a related electricity service provider for contestable electricity services, such that a reasonable person would not infer from the respective branding that the DNSP and the related electricity service provider are related; and
- not advertise or promote its direct control services and its contestable electricity services that are not direct control services together (including by way of cross-advertisement or cross-promotion).

Therefore, a ring-fencing waiver from the branding and cross-promotion obligations is required for Ergon Energy to continue to provide this unregulated distribution service using the same branding that Ergon Energy uses for the provision of its regulated distribution services.

Details of services for which the waiver is being sought

This service involves Ergon Energy providing a connection between Ergon Energy's regulated distribution network and the customer's electrical installation and premises, via an undersea cable which Ergon Energy owns.

Figure 1 below illustrates the location of Hayman Island compared to the Ergon Energy regulated distribution network. This connection agreement with the owner operator of the Hayman Island Resort, Mulpha,[4] has been in place for over 25 years since the undersea cable's construction.

[4] https://www.mulpha.com.au/portfolio/hotels-and-hospitality/.

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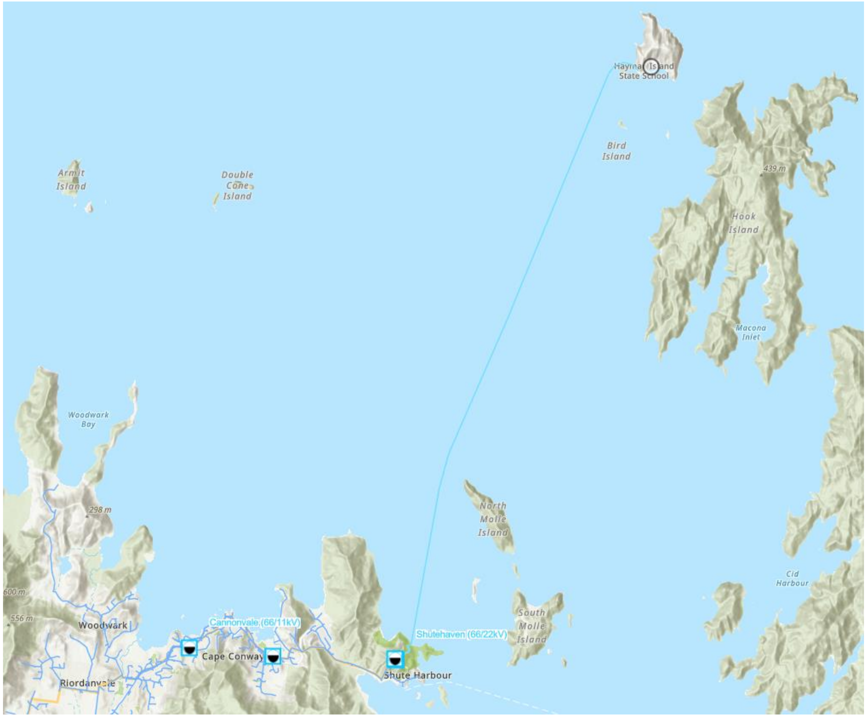

Figure 1 – Hayman Island's location in relation to the Ergon Energy distribution network

Proposed waiver commencement and expiry dates

Ergon Energy proposes that the waiver commences on 1 July 2025 and expires on 30 June 2035,[5] or earlier if the long-term connection agreement is terminated. This aligns with the Guideline's provision[6] that the AER may grant a waiver for a term that coincides with part or all of the DNSP's current regulatory control period, next regulatory control period, or both periods.

The reason for requesting that the waiver covers two regulatory control periods is that the regulatory and connection services arrangements are unlikely to change. In fact, these connection arrangements have been in place for over two decades and there is a long-term history between the parties, and a preference for the services to remain unregulated. The connection agreement commenced in 1999 and ran for an initial 15-year period. An automatic renewal for a further 15 years commenced in late 2014 and the agreement continues on the same terms until 2029.[7] There are options to extend thereafter, with the undersea cable having an expected useful life of 50 years.

[5] Covering Ergon Energy's 2025-30 and 2030-35 regulatory control periods.

[6] Clause 5.3.4(b)

[7] See AER - Final decision Ergon Energy distribution determination - Attachment 13 - Classification of services - October 2015.DOCX (live.com), page 14.

Potential costs if the waiver application is not granted

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 seems an unreasonable outcome given the long-term history between Ergon Energy and the customer and the low prospects of another energy solution, given the asset is only mid-way through its expected life cycle.

Reasons why the waiver should be granted

Clause 5.3.2(a) of the Guideline provides that the AER, in assessing a waiver application and deciding whether to grant a waiver or refuse to grant a waiver, must have regard to:

i. the National Electricity Objective (NEO);

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

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 that obligation.

National Electricity Objective

In examining whether an application for a waiver is appropriate and aligned with the NEO, the impacts on consumers must be at the core of the decision-making process. Ergon Energy submits there would be no adverse impact on consumers if a waiver is granted and Ergon Energy is allowed to continue to use the same branding to provide an unregulated distribution service via an undersea cable to Hayman Island. The ongoing use of the same branding would be a continuation of the status quo and would not involve change for the customer.

Cross subsidisation

To avoid cross subsidisation, Ergon Energy will continue to apply its AER-approved Cost Allocation Method (CAM) in relation the provision of any unregulated distribution services, including the undersea cable connection to Hayman Island. The CAM sets out how Ergon Energy allocates costs towards the provision of services.[8] Expenditure related to this particular service provision would continue to be attributed and allocated to unregulated distribution services, with costs recovered from the customer. Separate accounts are being maintained to demonstrate this clearly and transparently.

[8] See https://www.ergon.com.au/__data/assets/pdf_file/0006/1091661/Cost-Allocation-Method.pdf for the current CAM, in particular Section 3.2 Purpose, page 4.

Discrimination

Ergon Energy is bound by the long-term connection agreement with the owner of the Hayman Island resort to provide an unregulated distribution service. It is therefore not in a position to discriminate in favour of a related electricity service provider to the detriment of other contestable electricity service providers. This is particularly the case given it is essentially a dedicated connection to the customer and there is no competition for this provision of this service. There is also very little prospect of another service provider attempting to compete by building the same type of infrastructure while the existing undersea cable remains in-situ and is operational and midway through its effective life. While it is open for the customer to build their own cable, the customer has a long-term agreement with Ergon Energy and has not expressed a preference to change the arrangements and is content for the service to continue being provided via an unregulated asset.

Benefits

Ergon Energy considers that the costs to comply with the branding obligations seem unreasonable in this circumstance. Mulpha as the owner operator of Hayman Island will benefit in having Ergon Energy continue to provide services under the Ergon Energy brand under an existing long-term connection agreement. Other customers and the market will not be impacted if Ergon Energy is able to continue to provide this service under the Ergon Energy brand. Retaining the status quo will not result in additional compliance costs.

3. CONCLUSION

The proposed continuation of the current ring-fencing arrangement for the Hayman Island connection is necessary because there is no competition for the provision of the unregulated distribution service that Ergon Energy currently provides under a long-term connection agreement and therefore no opportunity for Ergon Energy to discriminate against third parties. Risks of cross subsidisation will be managed by Ergon Energy continuing to use its CAM to ensure regulated operating and capital expenditures are not being used to provide unregulated services. If the AER grants a waiver from the branding and cross-promotion obligation of the Guideline as proposed, Ergon Energy also considers that there will be no harm to electricity consumers.