



Addressing opex objectives, criteria, and factors in the NER 2025-30 Regulatory Proposal

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Part of Energy Queensland

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1 PURPOSE AND SCOPE

The National Electricity Rules (NER) provide a framework for the Australian Energy Regulator's (AER) assessment of Energex and Ergon Energy Network forecast operating expenditure (opex) and capital expenditure (capex).

Clause 6.5.6 sets out the objectives, criteria, and factors for our forecast opex for Standard Control Services (SCS) and clause 6.5.7 details equivalent matters for our forecast capex.

The purpose of this document (Document 6.01) is to show how the opex forecasts in our Regulatory Proposals promote the objectives and criteria, having regard for the factors. We identify relevant attachments to our Regulatory Proposals that provide further support for how we address these requirements. Document 5.01 provides the equivalent details for the capex forecasts.

Unless otherwise stated, this paper applies equally to the Energex and Ergon Energy Network opex forecasts.

2 OPERATING EXPENDITURE OBJECTIVES

The opex objectives in clause 6.5.6(a) of the NER are:

- (1) *to meet or manage the expected demand for standard control services over that period;*
- (2) *comply with all applicable regulatory obligations or requirements associated with the provision of standard control services;*
- (3) *to the extent that there is no applicable regulatory obligation or requirement in relation to:*
 - (i) *the quality, reliability or security of supply of standard control services; or*
 - (ii) *the reliability or security of the distribution system through the supply of standard control services,*
to the relevant extent:
 - (iii) *maintain the quality, reliability and security of supply of standard control services; and*
 - (iv) *maintain the reliability and security of the distribution system through the supply of standard control services; and*
- (4) *maintain the safety of the distribution system through the supply of standard control services.*

Section 6.1 of our Regulatory Proposal describes our six opex activities and their drivers – vegetation management, maintenance, emergency response, non-network, network overheads and corporate overheads. The following table details the role each opex activity has in promoting the opex objectives.

Table 1: Alignment of opex categories to opex objectives

Opex Category	Alignment to opex objectives
<p>Vegetation management</p>	<p>This includes maintaining safe clearances of our network infrastructure from vegetation through control and prevention measures. These activities contribute to the safety, quality, reliability, and security of our network services through the avoidance of outages and safety incidents and ensuring the full capacity of our network is available to meet the expected demand for SCS.</p> <p>These costs support all four operating expenditure objectives.</p>
<p>Maintenance</p>	<p>This includes the operational repair and maintenance of our network infrastructure to ensure it operates safely and contributes to the reliability, security, and quality of electricity supply.</p> <p>These costs support all four operating expenditure objectives.</p>
<p>Emergency response</p>	<p>This includes our initial response to outages and other high-risk events that require the immediate dispatch of crews to restore power supply. Our restoration activities are vital to maintaining the safety, security, reliability, and quality of the network.</p> <p>These costs support all four operating expenditure objectives.</p>
<p>Non-network</p>	<p>This includes expenditure associated with our non-network assets (eg motor vehicle assets, building and property assets and ICT and communications assets) in support of our network activity.</p> <p>These costs support all four operating expenditure objectives.</p>
<p>Network overheads</p>	<p>This includes the activities associated with the planning and management of our network infrastructure, such as the support of our service deliver, network engineering and major project development. These costs provide the necessary support to our network activities.</p> <p>These costs support all four operating expenditure objectives.</p>
<p>Corporate Overheads</p>	<p>This includes the allocated costs associated with corporate functions such as human resource management, corporate communications and our learning and development function. These costs provide the necessary support to our network activities.</p> <p>These costs support all four operating expenditure objectives.</p>

We developed an opex forecasting method to forecast the level of opex that we need to achieve the opex objectives in the 2025-30 regulatory control period. This method is described in chapter 6 of our Regulatory Proposal and in our Expenditure Forecasting Methodology, which was provided to the AER in June 2023.

We have used a base-step-trend (BST) approach to forecast our opex, except for debt raising costs. The BST is consistent with the approach that we proposed in our Expenditure Forecasting Methodology and is the AER's preferred approach for forecasting opex, as detailed in its Expenditure Forecast Assessment Guideline and its recent Distribution Determinations.

We have used a forecast of the 2023-24 financial year as our base year for our opex forecast. We explain and justify in our Regulatory Proposals why, subject to our proposed adjustments, 2023-24 is representative of our recurrent prudent and efficient future opex requirements.

Our starting point was to consider whether our base year opex reflected the efficient costs required to achieve the opex objectives.

We considered:

- Whether our base year opex achieved the required level of reliability, safety, and security of supply. We received customer feedback that supported maintaining current performance levels.
- Whether our base year opex allowed us to comply with our regulatory obligations, including having regard for the level of payments that we made under the Guaranteed Service Level scheme. We are largely achieving our obligations and are making only modest payments under this scheme.
- Demand for our electricity distribution services in the 2020-25 regulatory control period, which is discussed in chapter 4 of our Regulatory Proposal. Our base year opex is allowing us to currently meet our demand for these services.
- Whether we could incorporate any cost reductions to our opex base year to achieve the opex objectives more efficiently. Based on our analysis, we have proposed a range of adjustments to our 2023-24 opex to determine our efficient adjusted base year, which are discussed in detail in chapter 6 of our Regulatory Proposals.

We consider that our resultant opex forecast for the 2020-25 regulatory control period meets the opex objectives given that:

- The BST method that we used is consistent with the AER's preferred forecasting approach.
- Our opex in our 2023-24 base year is considered sufficient to enable us to: meet our demand for our distribution services; comply with our regulatory obligations or requirements; and maintain the safety of our distribution system, and
- We are forecasting our demand to be relatively stable in the 2025-30 regulatory control period and are not expecting any major changes in our regulatory obligations or requirements.

3 OPERATING EXPENDITURE CRITERIA

In making its opex decision, the AER must be satisfied that our forecast opex reasonably reflects:

- (1) *the efficient costs of achieving the operating expenditure objectives; and*
- (2) *the costs that a prudent operator would require to achieve the operating expenditure objectives; and*
- (3) *a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives.*

We consider our opex forecasting method and supporting inputs demonstrate that we have met the opex criteria. As discussed above and explained in chapter 6 of our Regulatory Proposal:

- We have adopted 2023-24 as our base year as it continues the well-accepted regulatory practice of using the most recent year for which audited data is available by the time of the final Distribution Determination, and it represents a realistic expectation of the efficient and sustainable on-going opex that is required to provide SCS services over the 2025-30 regulatory control period.

- We have adjusted our 2023-24 opex to remove costs which are not representative of opex in the 2025-30 period, including costs relating to the ESO levy and property leases.
- We have applied an efficiency adjustment based on an assessment of the outcomes in the AER’s 2023 annual benchmarking report.
- The rate of change factors applied are consistent with previous AER decisions and our current forecasts of price and output growth.
- We have applied a one per cent productivity growth factor to reflect our ongoing commitment to delivering productivity improvements over the period.

4 OPEX FACTORS

In deciding whether the AER is satisfied with a DNSP reflecting the operating expenditure criteria, the AER must have regard to the following operating expenditure factors.

Table 2 demonstrates how we have addressed each opex factor. We note that factors 1 to 3 are no longer part of the NER.

Table 2: Addressing the opex factors

Opex Factor	How we address the opex factor
<p>Opex Factor 4 - The most recent annual benchmarking report that has been published under rule 6.27 and the benchmark operating expenditure that would be incurred by an efficient Distribution Network Service Provider over the relevant regulatory control period.</p>	<p>As discussed in chapter 6 of our Regulatory Proposals, we have considered the outcomes of the most recent AER 2023 annual benchmarking report.</p> <p>Our opex forecast for the 2025-30 regulatory control period includes an efficiency adjustment for both Energex and Ergon Energy Network.</p>
<p>Opex Factor 5 - the actual and expected operating expenditure of the Distribution Network Service Provider during any preceding regulatory control periods</p>	<p>As discussed in chapter 1.3 of our Regulatory Proposals, both Energex and Ergon Energy Network have forecast an overspend against the AER forecast for the 2020-25 period, due to several drivers.</p>
<p>Opex Factor 5A - The extent to which the operating expenditure forecast includes expenditure to address the concerns of electricity consumers as identified by the Distribution Network Service Provider in the course of its engagement with electricity consumers.</p>	<p>We engaged extensively with customers during the preparation of our Regulatory Proposals. This is detailed in chapter 2 of our Regulatory Proposal where we detail how customer concerns have shaped our opex forecasts.</p> <p>Customers have told us that, although affordability of electricity supply is their primary concern, they expect us to keep our network safe, reliable and secure and to keep the lights on for their homes and businesses.</p> <p>They rely on us to be vigilant with respect to the safety of our network and particularly value how we respond to severe weather events and natural disasters to ensure power supply is restored to communities as quickly as possible. Our opex is therefore focused on ensuring that we continue to operate and maintain our network to meet the everyday performance and service expectations of our customers and communities, in the most affordable way.</p>

Opex Factor	How we address the opex factor
<p>Opex Factor 6 - The relative prices of operating and capital inputs.</p>	<p>The opex and capex forecasts for both Energex and Ergon Energy Network rely on historical data as a basis for forecasting expenditure, providing for a consistent approach to pricing opex and capex inputs. We have applied consistent values for real changes in input labour costs, taking the midpoint between the independent Oxford Economics and the forecast of the AER's economic expert (as sourced from recent AER determinations). This is explained in chapter 6 of our Regulatory Proposal.</p>
<p>Opex Factor 7 - The substitution possibilities between operating and capital expenditure.</p>	<p>We have not identified any material capex/opex substitutions which would require a step change in our opex forecast.</p> <p>Non-network alternatives, such as demand management through load reductions, are always considered in our sub-transmission planning and, where applicable, non-network alternative options for replacement are investigated through the Regulatory Investment Test for Distribution (RIT-D) process.</p> <p>Further information on the application of non-network alternatives is discussed in the Distribution Annual Planning Report (DAPR) (Document Reference 5.2.03).</p>
<p>Opex Factor 8 - Whether the operating expenditure forecast is consistent with any incentive scheme or schemes that apply to the Distribution Network Service Provider under clauses 6.5.8 or 6.6.2 to 6.6.4.</p>	<p>Our forecast opex has been prepared in a manner consistent with the AER's Framework & Approach paper for the 2025-30 regulatory control period, in which the AER proposed the application of the following schemes:</p> <ul style="list-style-type: none"> • a service target performance incentive scheme (STPIS) • an efficiency benefit sharing scheme (EBSS) • a demand management incentive scheme (DMIS) • a demand management innovation allowance mechanism (DMIAM), and • a capital expenditure sharing scheme (CESS). <p>We have not proposed the application of the Customer Service Incentive Scheme (CSIS) or the Export Service Incentive Scheme (ESIS) for the 2025-30 period.</p> <p>More information on the incentive schemes is available in chapter 7 of our Regulatory Proposal.</p>
<p>Opex Factor 9 - The extent the operating expenditure forecast is preferable to arrangements with a person other than the Distribution Network Service Provider that, in the opinion of the AER, do not reflect arm's length terms.</p>	<p>We have not identified opex that does not reflect arm's length terms.</p>
<p>Opex Factor 9A - Whether the operating expenditure forecast includes an amount relating to a project that should more appropriately be included as a</p>	<p>Our proposed opex does not include an amount relating to a project that should be more appropriately included as a contingent project.</p>

Opex Factor	How we address the opex factor
contingent project under clause 6.6A.1(b).	
Opex Factor 10 - The extent the Distribution Network Service Provider has considered, and made provision for, efficient and prudent non-network options or SAPS options.	We include consideration of non-network solutions as a part of our routine planning processes in both Energex and Ergon Energy Network.
Opex Factor 11 - Any relevant final project assessment report (as defined in clause 5.10.2) published under clause 5.17.4(o), (p) or (s).	Any relevant final project assessment reports are published on the Energex or Ergon Energy Network websites.
Opex Factor 12 - Any other factor the AER considers relevant and which the AER has notified the Distribution Network Service Provider in writing, prior to the submission of its revised regulatory proposal under clause 6.10.3, is an operating expenditure factor.	The AER has not notified either Energex or Ergon Energy Network of any other factor.