Replacement of framework and approach papers

Ergon Energy, Energex, SA Power Networks and Directlink

1 July 2025 – 30 June 2030

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AUSTRALIAN ENERGY REGULATOR

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1 Introduction

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia. The regulatory framework governing electricity transmission and distribution networks is the National Electricity Law and Rules (NEL and NER). Our work is guided by the National Electricity Objective (NEO).

A regulated network business must periodically apply to us for a determination of the revenue it can recover from consumers using its network. Electricity distribution network service providers Ergon Energy (Ergon), Energex and SA Power Networks (SAPN), and electricity transmission network interconnector Directlink, are due to submit their next revenue proposals on 31 January 2024, for the period 1 July 2025 to 30 June 2030 (2025–30 period).

The first step in our process to determine efficient prices for electricity distribution and transmission services for these businesses is to publish Framework and Approach papers (F&A). The F&A sets our approach to key elements of the upcoming determinations and facilitates early consultation on these before businesses prepare and submit their revenue proposals. These elements include:

- Which incentive schemes will apply, for example, to service quality, improvements in network reliability or capital and operating expenditure.[1] The purpose of incentive schemes is to encourage network service providers to manage their business in a safe, reliable manner that serves the long-term interests of consumers. The schemes provide network service providers with incentives to only incur efficient costs and to meet or exceed service quality targets.
- For distribution network service providers, which services will be covered by our revenue determination[2], and the form of regulation that will apply to them[3]. For example, we may determine that costs for a particular service can be bundled into a generic electricity supply service (standard control service). Alternatively, we may decide that charging for a service on a user-pays basis is more appropriate (alternative control service), or to allow consumers and network service providers to negotiate the price of a service (negotiated distribution service).
- Our approach to setting efficient expenditure allowances[4] and the establishment of the opening regulatory asset base for the upcoming regulatory control period[5].

The F&As that have applied to Ergon, Energex, SAPN and Directlink in the current (2020–25) regulatory control period were published in July 2018. Since then, we have seen

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1 NER, cll. 6.8.1(2)(iii), (iv), (v), (vi), (vii); 6A.10.1A(b)(1), (2), (3), (4), (7).

2 NER, cll. 6.8.1(2)(i);

3 NER, cll. 6.8.1(1)(i); 6.8.1(2)(ii).

4 NER, cll. 6.8.1(2)(viii); 6A.10.1A(b)(5).

5 NER, cll. 6.8.1(2)(ix); 6A.10.1A(b)(6).

significant transition in the energy market and the rules, schemes and guidelines under which we regulate electricity networks.

On 31 October 2022, all four businesses wrote to us asking us to consider amending and replacing their current F&As in preparation for the 2025–30 period. We published those letters on our website and sought submissions from stakeholders on whether amendments to the F&As are necessary or desirable.

Having received no submissions, we considered the information provided by the businesses and have decided that we will make amended or replacement F&As for each of Ergon, Energex, SAPN, and Directlink. Our reasons for commencing this review are summarised in this paper.

We will engage further with stakeholders as we consider preliminary positions on the amendments required, before making a final decision on amended or replacement F&As in July 2023.

2 Matters identified for review

This section sets out our reasons for deciding to make amended or replacement F&As for each of Ergon, Energex, SAPN, and Directlink in preparation for the 2025–30 period.

2.1 Distribution service classification

Our F&As for Ergon, Energex and SAPN will set out our proposed approach to the classification of distribution services in our determinations for the 2025–30 period.[6] Service classification determines the type of economic regulation, if any, that we apply to electricity distribution services provided by distribution network service providers. Our initial views about service classification are set out in our F&As. Classification decisions are then finalised as part of our revenue determinations for the relevant regulatory control periods.

As the transition of the energy market continues, expectations for the way consumers interact with the electricity network are also changing. In addition to this, a number of significant regulatory changes have been introduced that are relevant for these jurisdictions. Some of these changes are outlined below.

- The electricity market is rapidly evolving, and electricity networks are becoming platforms for consumer energy resources (CER) with a move away from the operation of ‘traditional poles and wires’ towards new options for leveraging new technologies.
- Regulatory changes have enabled the incorporation of Stand Alone Power Systems (SAPS), as a distribution service. There have been rule changes to access, pricing and incentive arrangements for CER and the AEMC has been undertaking a review of the metering services framework.
- Additionally, in their letters to us, the businesses noted the surge of interest in electric vehicles, raising particular challenges around charging infrastructure in regional and rural Australia, a growth in interest around the leasing of excess capacity from community batteries and exploring opportunities for renters to benefit from rooftop solar.
- In particular, SAPN noted strong consumer interest around the provision of additional energy advisory services as a new service.

Since we made our decisions on service classifications for the current, 2020–25 period, we have updated our approaches to service classification and ring-fencing to recognise some of these changes.

We agree with Ergon, Energex and SAPN that these changes warrant review and amendment of the service classifications for the 2025–30 period.

2.2 Form of control

Once distribution services have been classified, our F&As for Ergon, Energex and SAPN will set out the form of control mechanisms[7] (how we will determine prices for regulated services)

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[6] NER, cl. 6.8.1(2)(i).

[7] NER, cl. 6.8.1(b)(1)(i).

and the control mechanism formulae that give effect to the form of control mechanisms[8] for each group of services.

For distribution services classified as direct control services, we must determine the price or revenue controls (or some other hybrid arrangement) for each service or group of services. The form of control may be, for example, a cap on revenue or a cap on prices charged by the network service providers. The Rules set out assessment criteria we must consider.[9] Our assessment is particularly important as we have limited discretion to amend the form of control in our final determination.[10]

At present, Ergon, Energex and SAPN operate under a revenue cap for standard control services and a price cap for alternative control services.

The Rules also require us to set out the control mechanism formulae we will use to calculate service prices.[11] The distributors have requested amendments to the formula to reflect minor adjustments for the application of the AER's updated service target performance incentive scheme (STPIS). They have also proposed the inclusion of a tax element within the price cap formula for quoted services in order to align with other recent F&A decisions.

We have limited discretion to alter control mechanism listed in the F&A at the time of the determination unless we consider unforeseen circumstances have arisen.[12] As a result, we consider it important to review the form of control applicable to Ergon, Energex and SAPN before finalising the F&A for the 2025–30 period.

2.3 Dual-function assets

Dual-function assets are high voltage transmission assets forming part of a distribution network. Considering transmission assets as part of a distribution determination avoids the need for a separate transmission proposal. Where a network service provider notifies us that it owns, controls or operates dual function assets, we assess how material the value of the dual-function asset is to decide whether the revenue attributed to dual-function assets is to be recovered according to the transmission or distribution pricing principles.[13]

Ergon Energy, Energex and SAPN do not have any dual-function assets.

2.4 Application of incentive schemes

Our F&As for Ergon, Energex, SAPN and Directlink will set out our proposed approach to the application of the following incentive schemes in the 2025–30 period:

- STPIS[14]

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8 NER, cl. 6.8.1(b)(2)(ii).

9 NER, cl. 6.2.5.

10 NER, cll. 6.8.1(b)(1)(i) and 6.12.3(c) and (c1).

11 NER, cl. 6.8.1(b)(2)(ii).

12 NER, cl. 6.12.3(c1).

13 NER, cll. 6.8.1(b)(1)(ii) and 6.25(b)-(d).

14 NER, cll. 6.8.1(b)(iii); 6A.10.1A(b)(1).

- efficiency benefit sharing scheme (EBSS)[15]
- capital expenditure sharing scheme (CESS)[16]
- demand management incentive scheme (DMIS) and demand management innovation allowance mechanism (DMIAM)[17]
- customer service incentive scheme (CSIS)[18] (for Ergon, Energex and SAPN).

These schemes work together within a revenue determination to provide incentives for network service providers to invest efficiently and operate in the long-term interests of consumers.

Since we published the F&As for the current, 2020–25 period, we have initiated a review of the CESS and EBSS that have applied under determinations for that period and expect to make new versions of those schemes before revenue proposals for Ergon, Energex, SAPN and Directlink are submitted on 31 January 2024. We also released a new CSIS for electricity distributors that will be available to Ergon, Energex and SAPN for the first time in the 2025–30 period.

While the DMIS and DMIAM that have applied to Ergon, Energex and SAPN are still in effect, we released a new DMIAM for transmission network service providers in May 2021 that has not previously applied to Directlink. In its letter to us, Directlink has pointed out that the application of this scheme to an interconnector may not deliver any benefit. We reached a similar conclusion in our recent draft decision on the 2023–28 revenue determination for the Murraylink interconnector. It is open to us to not to apply the DMIAM to Directlink.

In light of these changes, and because incentive schemes operate in combination to drive desired behaviours within a revenue determination, we consider that the application of all incentive schemes should be reviewed in finalising the F&As for the 2025–30 period.

2.5 Expenditure forecast assessment guidelines

Our F&As for Ergon, Energex, SAPN and Directlink will set out our proposed approach to the application of our Expenditure Forecast Assessment Guidelines to each business.[19] These guidelines describe the process, techniques and associated data requirements for our approach to setting efficient expenditure allowances for network businesses.

The Guidelines applied to Ergon, Energex and SAPN in our assessment of proposals for the current, 2020–25 period, and these businesses have indicated they plan to continue to apply and align them with the AER's Better Resets Handbook[20] for the 2025–30 period.

Given the smaller scale of Directlink's assets and the nature of its network operations, our F&A for the current period confirmed that we would apply the Guidelines, but did not intend to use standardised benchmarking analysis or predictive modelling in assessing its capital

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15 NER, cll. 6.8.1((b)(2)(iv); 6A.10.1A(b)(2).

16 NER, cll. 6.8.1(b)(2)(v); 6A.10.1A(b)(3).

17 NER, cll. 6.8.1(b)(2)(vi); 6A.10.1A(b)(7).

18 NER, cl. 6.8.1(b)(2)(vii).

19 NER, cll. 6.8.1(b)(2)(viii); 6A.10.1A(b)(5).

20 AER, *Better Resets Handbook – Towards consumer-centric network proposals*, December 2021.

and operating expenditure forecasts, instead relying on our judgement to determine the extent to which we use particular techniques to assess regulatory proposals.[21]

To ensure this approach is still appropriate and to review alignment with the Better Resets Handbook, we consider the application of the Guidelines should be reviewed for all four businesses in finalising the F&As for the 2025–30 period.

2.6 Establishing the opening regulatory asset base for the 2030–35 regulatory control period

Our F&As for Ergon, Energex, SAPN and Directlink will set out whether regulatory depreciation for establishing the opening regulatory asset base for the 2030–35 regulatory control period, commencing 1 July 2030, is to be based on actual or forecast capital expenditure.[22]

For the 2025–30 period, we will establish the opening regulatory asset base using forecast capital expenditure.[23] While Ergon, Energex, SAPN and Directlink have indicated they are open to maintaining this approach, they have noted potential interrelationships with any amendments made to the CESS as part of the review mentioned in section 2.4.

While the outcomes of that review remain open, we consider the question of whether actual or forecast capital expenditure is used to determine the opening regulatory asset base on 1 July 2030 should also remain open in finalising the F&A for the 2025–30 period.

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21 AER, *Directlink 2020-25 - Final F&A*, July 2018, p. 19.

22 NER, cll. 6.8.1(b)(2)(ix); 6A.10.1A(2)(6).

23 AER, *Directlink 2020-25 - Final F&A*, July 2018, p. 22; AER, *Queensland 2020–25, Final framework and approach for Energex and Ergon Energy*, July 2018, p. 80; AER, *SA Power Networks 2020-25, Final framework and approach*, July 2018, p. 82.

Glossary

Term	Definition
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
CER	Consumer Energy Resources
CESS	Capital Expenditure Sharing Scheme
CSIS	Customer Service Incentive Scheme
DMIAM	Demand Management Innovation Allowance Mechanism
DMIS	Demand Management Incentive Scheme
EBSS	Efficiency Benefit Sharing Scheme
Ergon	Ergon Energy Corporation Ltd
Energex	Energex Limited
F&A	Framework and Approach
NEO	National Electricity Objective
NEL	National Electricity Law
NER	National Electricity Rules
SAPN	SA Power Networks
SAPS	Stand Alone Power Systems
STPIS	Service Target Performance Incentive Scheme