

Control mechanisms

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1. Overview

This document sets out Energex Limited (Energex) and Ergon Energy Corporation Limited's (Ergon Energy) compliance proposals in relation to:

- Control mechanisms
- Designated pricing proposal charges (DPPC), and
- Jurisdictional scheme amounts.

2. Control mechanisms

Control mechanisms impose constraints on the revenues that we derive from, or the prices that we charge for, direct control services. Direct control services (i.e. standard control services or alternative control services) are distribution services that the Australian Energy Regulator (AER) proposes to classify and therefore regulate.

2.1 NER and RIN Requirements

The National Electricity Rules (NER) requirements relating to control mechanisms are outlined in clauses 6.2.5, 6.2.6, 6.8.1, 6.8.2, 6.12.1, 6.12.3.

In summary, these clauses provide that:

- A distribution determination must impose controls over the prices of direct control services, the revenue to be derived from direct control services or both¹
- For standard control services, the control mechanism must be of the prospective CPI minus X form, or some incentive-based variant of the prospective CPI minus X form²
- For alternative control services, the control mechanism must have a basis stated in the distribution determination³
- The framework and approach (F&A) paper must set out, amongst other things, the AER's proposed:⁴
 - form (or forms) of the control mechanisms, and
 - formulae that give effect to the control mechanisms
- The regulatory proposal must contain:⁵
 - for alternative control services – a demonstration of the application of the control mechanism, as set out in the F&A paper, and the necessary supporting information
- A distribution determination is predicated on, amongst other things, the AER's decisions on:⁶
 - The forms of the control mechanisms for standard control services and alternative control services and on the formulae that give effect to those control mechanisms, and
 - how compliance with a relevant control mechanism is to be demonstrated
- The form of the control mechanism must be as set out in the relevant F&A paper unless the AER:⁷

¹ NER Cl 6.2.5 (a)

² NER Cl 6.2.6 (a)

³ NER Cl 6.2.6 (b)

⁴ NER Cl 6.8.1 (b)

⁵ NER Cl 6.8.2 (c) (3)

⁶ NER Cl 6.12.1

- has departed from the classification of a distribution service as set out in that paper in accordance with paragraph, and
- considers that no form of control mechanism set out in that paper should apply to that distribution service, and
- The formulae that give effect to the control mechanisms set out in the relevant F&A paper must be as set out in that paper unless the AER considers that a material change in circumstances justify departing from the formulae as set out in that paper.⁸

The Regulatory Information Notice (RIN) requires that:⁹

- For the forecast revenues that Energex and Ergon Energy propose to recover from providing direct control services over the forthcoming regulatory control period, we provide:
 - formulaic expressions for the basis of control mechanisms for standard control services and for alternative control services, and
 - a detailed explanation and justification for each component that makes up the formulaic expression, and
- Energex and Ergon Energy demonstrate:
 - how Energex and Ergon Energy considers the control mechanisms are compliant with the F&A paper, and
 - for standard control services, how Energex and Ergon Energy considers the control mechanisms are also compliant with clause 6.2.6 and Part C of Chapter 6 of the NER.

2.2 Forms of control

In its final F&A paper for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020, published in July 2018, the AER proposed the following forms of control:

- Revenue cap – for services classified as standard control services, and
- Caps on the prices of individual services – for services classified as alternative control services.

We accept the application of these forms of control in the 2020-25 regulatory control period. This is a continuation of current regulatory arrangements.

2.3 Basis of the control mechanisms

The NER prescribes the basis of the control mechanism applied to standard control services; it must be a building block approach of the prospective CPI minus X form, or some incentive-based variant.¹⁰

By contrast, the NER provide discretion regarding the basis of the control mechanism for alternative control services. The basis of control mechanism may, but need not, utilise elements of the building block approach.¹¹ The F&A paper also states that we have discretion regarding the approach used to develop initial prices.¹² Consequently, we propose the following basis of control mechanism for alternative control services:

- a limited building block approach to develop prices in the first year and then a price path for the remaining years of the regulatory control period for:

⁷ NER CI 6.12.3(c)

⁸ NER CI 6.12.3(c1)

⁹ RIN, Schedule 1 Section 3

¹⁰ NER CI 6.2.6 (a)

¹¹ NER CI 6.2.6 (c)

¹² AER, *Final F&A, Energex and Ergon Energy*, July 2018 p.54

- public lighting services, and
- default type 6 metering services
- a formula-based approach (cost-build up approach) in the first year and then a price path for the remaining years of the regulatory control period for:
 - fee based network ancillary services
 - fee based connection services, and
 - fee based metering related services
- a formula-based approach (cost-build up approach) for the **labour rates** in the first year and then a price path for the **labour rates** in the remaining years of the regulatory control period for:
 - quoted network ancillary services
 - quoted connection services, and
 - quoted metering related services

2.4 Formulae for control mechanisms

2.4.1 Formulae for control mechanisms – standard control services

In accordance with the NER, in making distribution determination, the formulae that give effect to the control mechanisms must be as set out in the F&A paper unless the AER considers that a material change in circumstances justify departing from the formulae in the F&A paper. We propose to depart from the formulae in the F&A paper following the publication of the revised Service Target Performance Incentive Scheme (STPIS) on 14 November 2018. Figure 1 below, sets out our proposed revenue cap formulae for our standard control services.

Figure 1 Revenue cap formulae

- | | |
|---|---|
| (i) $TAR_t \geq \sum_{i=0}^n \sum_{j=1}^m p_t^{ij} q_t^{ij}$ | i=1,...,n and j =,...,m and t = 1,2,...,5 |
| (ii) $TAR_t = AAR_t + I_t + B_t + C_t$ | t = 1,2,...,5 |
| (iii) $AAR_t = AR_t$ | t = 1 |
| (iv) $AAR_t = AAR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t)$ | t = 2,...,5 |

Where:

TAR_t is the total allowable revenue in year t

p_t^{ij} is the price of component 'j' of tariff 'i' in year t

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t

t is the regulatory year

AR_t is the annual smoothed revenue requirement in the post-tax revenue model (PTRM)

AAR_t is the adjusted annual smoothed revenue requirement for year t

I_t is the sum of incentive scheme adjustments in year t. To be decided in the distribution determination, but likely to include:

- the final carryover amount from the application of the demand management innovation allowance (DMIA) from the 2015-20 distribution determination. This amount will be deducted from or added to allowed revenue in the 2021-22 pricing proposal
- approved demand management incentive scheme (DMIS) incentive payments, and

- approved service target performance incentive scheme (STPIS) payments.

B_t is the sum of annual adjustment factors in year t. To be decided in the distribution determination, but likely to include:

- any under or over recovery of actual revenue collected through DUOS charges in regulatory year t-2

C_t is the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER. It will also include any end-of-period adjustments in year t. To be decided in the distribution determination, but includes:

- any AER approved cost pass through amounts during 2020-25 regulatory control period

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2

minus one.

For example, for 2020-21, year t-2 is the December quarter 2018 and year t-1 is the December quarter 2019.

X_t is the X-factor in year t, incorporating annual adjustments to the PTRM for the trailing average cost of debt where necessary. To be decided in the distribution determination.

2.4.2 Formulae for control mechanisms – alternative control services

Energex and Ergon Energy accept the formulae in the F&A paper for alternative control services, as set out below.

Figure 2 Formulae for metering, public lighting and fee-based ancillary services

$$(i) \bar{p}_t^i \geq p_t^i \quad i=1, \dots, n \text{ and } t = 1, 2, \dots, 5$$

$$(ii) \bar{p}_t^i \geq \bar{p}_{t-1}^i \times (1 + \Delta CPI_t) \times (1 - X_t^i) + A_t^i$$

Where:

\bar{p}_t^i is the cap on the price of service i in year t

p_t^i is the price of service i in year t. The initial value is to be decided in the distribution determination

t is the regulatory year

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2

minus one.

For example, for 2020-21, year t-2 is the December quarter 2018 and year t-1 is the December quarter 2019

X_t^i is the X factor for service i in year t

A_t^i is the sum of any adjustments for service i in year t. Likely to include, but not limited to adjustments for any approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

Figure 3 Formulae for quoted services

(i) *Price = Labour + Contractor Services + Materials*

Where:

Labour consists of all labour costs directly incurred in the provision of the service which may include on-costs, fleet on-costs and overheads. Labour is escalated annually by $(1 + \Delta CPI_t) \times (1 - X_t^i)$ where:

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2

minus one.

For example, for 2020-21, year t-2 is the December quarter 2018 and year t-1 is the December quarter 2019.

X_t^i is the X factor for service i in year t.

Contractor Services reflects all costs associated with the use of external labour including overheads and any directs incurred. The contracted services charge applies the rates under existing contractual arrangements. Direct costs incurred are passed on to the customer.

Materials reflects the cost of materials directly incurred in the provision of the service, material storage and logistics on-costs and overheads.

2.5 Demonstrating compliance with control mechanisms

Energex and Ergon Energy accept the control mechanisms proposed by the AER in the F&A paper and we also propose to annually demonstrate compliance with control mechanisms, as part our annual pricing proposals.

3. Designated pricing proposal charges

DPCC are transmission-related costs, which include costs associated with:

- the use of transmission network to deliver high voltage electricity from generators to our distribution network
- avoided transmission (TUOS) charges paid to eligible embedded generators, and
- payments made to other DNSPs for the supply of distribution services.

The NER requires, amongst other things, that:

- a distribution determination must set out how the DNSP is to report to the AER on its recovery of DPPC charges for each regulatory year of the regulatory control period and on the adjustments to be made to subsequent pricing proposals to account for over or under recovery of those charges, and¹³
- a pricing proposal must set out, amongst other things, how DPPC charges are to be passed on to customers and any adjustments to tariffs resulting from over or under recovery of those charges in the previous regulatory year.¹⁴

To comply with the NER requirements outlined above, we propose to specify the following in our annual pricing proposals:

- Payments:
 - regulated transmission charges paid to TNSPs
 - avoided DPPC payments to embedded generators, and
 - payments made to other DNSPs for use of their network.
- Receipts:
 - payments received from network users, and
 - payments received from other DNSPs, and
- Adjustments for over/under recovery:
 - difference between receipts and payments.

4. Jurisdictional scheme amounts

Jurisdictional scheme amounts relate to the recovery of costs associated with specific obligations placed on distribution network service providers (DNSP) by state governments.

The NER requires that:

- a distribution determination must set out how the DNSP is to report to the AER on its recovery of jurisdictional schemes amounts for each regulatory year of the regulatory control period and on the adjustments to be made to subsequent pricing proposals to account for over or under recovery of those charges, and¹⁵
- a pricing proposal must set out, amongst other things, how jurisdictional scheme amounts are to be passed on to customers and any adjustments to tariffs resulting from over or under recovery of those charges in the previous regulatory year.¹⁶

In Queensland, the following jurisdictional schemes may apply:

- the Solar Bonus Scheme which obligates Energex and Ergon Energy to make FiT payments for energy supplied into our distribution network from specific micro-embedded generators, and
- the energy industry levy covering a proportion of the Queensland Government's funding commitments for the Australian Energy Market Commission which, under our Distribution Authority we have been obligated to pay since 2016.

To comply with the NER requirements outlined above, we propose to specify the jurisdictional scheme amounts applicable in the relevant regulatory year in our annual pricing proposals.

¹³ NER, CI 6.12.1(19)

¹⁴ NER, CI 6.18.2(b)(6)

¹⁵ NER, CI 6.12.1(20)

¹⁶ NER, CI 6.18.2(b)(6A)

5. Definitions, acronyms, and abbreviations

This section contains definitions for all acronyms, technical terms, and abbreviations used in the document.

Acronym	Definition
ABS	Australian Bureau of Statistics
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ARR	Annual Revenue Requirement
CPI	Consumer Price Index
DMIA	Demand Management Innovation Allowance
DMIS	Demand Management Incentive Scheme
DNSP	Distribution Network Service Provider
DPPC	Designated Pricing Proposal Charges
DUOS	Distribution Use of System
EBSS	Efficiency Benefit Sharing Scheme
Ergon Energy	Ergon Energy Corporation Limited
FiT	Feed in Tariff
NER	National Electricity Rules
PTRM	Post Tax Revenue Model
RIN	Regulatory Information Notice
STPIS	Service Target Performance Incentive Scheme
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System