

Proposal: Services Classification and Control Mechanism



AER

**Distribution
Determination**

2010

**Ergon Energy
Corporation Limited**

31 March 2008



everything in our power

**Services Classification and Control Mechanisms
Proposal
Australian Energy Regulator
31 March 2008**

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Executive Summary

Background

Ergon Energy is currently regulated by the Queensland Competition Authority (QCA) with respect to certain economic elements of its operations, under Chapter 6 of the National Electricity Rules (Rules). New Rules commenced on 1 January 2008, which provide that, for future regulatory periods, the Australian Energy Regulator (AER) will take over responsibility for economic regulation of distribution entities. A single regulator is intended to introduce a consistent national approach to the application of the Rules.

Economic regulation relates to:

- Distribution services – the Rules define the scope of services that may be regulated by the AER;
- The categorisation of distribution services – the Rules provide for the way in which distribution services are categorised by the AER;
- The method for recording assets, forecasting future capital expenditure, forecasting future operating expenditure – the Rules provide specific methods based on economic and financial principles;
- The method of price or revenue ‘capping’ – the Rules provide a range of options for controlling distribution entities’ prices or revenues; and
- The method of price setting and price movements within the cap – the Rules provide the principles for price development.

The AER, when exercising its functions under the Rules’ Chapter 6, does not decide:

- The technical and minimum service standards to which Ergon Energy must build and operate its distribution network;
- The guaranteed service levels Ergon Energy targets for its customer service;
- The way in which Ergon Energy delivers its distribution services e.g. whether it performs the work itself or whether other parties perform the work;
- Safety standards for both Ergon Energy and the public; and
- Licensing and statutory obligations that are attributable to Ergon Energy.

Stage 1 Framework and Approach Proposal

The AER published a Market Notice on 29 February 2008 advising that it is preparing to undertake consultation and distribution determinations for the Queensland distribution network service providers (DNSPs) for the period 1 July 2010 to 30 June 2015 and describing the nature of a specific Queensland transitional arrangement in the Rules which provides that the DNSPs may lodge a proposal with respect to two issues by 31 March 2008:

- Classification of Services; and
- Control Mechanisms

Ergon Energy considers that this proposal is an important step in ensuring an orderly transition from the previous Rules applied by the QCA to the amended Rules and associated guidelines, models and schemes that the AER will apply.

In this proposal Ergon Energy recommends a classification of services and the price control mechanisms for the next regulatory control period.

Ergon Energy currently has:

- Prescribed distribution services regulated under a fixed revenue cap; and
- Excluded distribution services regulated under a variant of a schedule of fixed charges.

This proposal recommends 10 groups of standard control services, regulated under a:

- *Revenue Cap* – covering Ergon Energy’s network services. Network services relate to the ‘shared’ network used to service all users connected to it. Network services comprise the majority of Ergon Energy’s regulated services. Under a revenue cap, the AER would specify a cap on Ergon Energy’s allowed revenue each year. The application of a revenue cap to network services is intended to provide revenue certainty for the core distribution activities of shared network operation, maintenance and augmentation; and
- *Weighted Average Price Cap* – this will comprise two tariff baskets:
 - Ergon Energy’s connection services and customer services -
 - Connection services relate to building individual customers’ connection assets as well as connecting those connection assets to the distribution network or premises. Connection services are dedicated to a particular network user, and not shared with other network users;
 - Customer services relate to a range of services that Ergon Energy undertakes as part of its service obligations under statutory instruments, for which a customer-specific charge cannot be determined (e.g. scheduled meter reads); and
 - All remaining standard control services provided by Ergon Energy (e.g. de-energisations and re-energisations, additions and alterations, and quoted services).

Ergon Energy does not propose to classify any of its services as negotiated distribution services or alternative control services. This is because Ergon Energy does not believe that any of its distribution services can successfully meet the various criteria in the Rules in order to be classified otherwise than as standard control services.

Ergon Energy’s proposed classification of services and control mechanism framework means there would be three material changes from the existing regime regulated by the QCA:

- *The classification of excluded distribution services as standard control services* – Ergon Energy has reviewed all services which are currently classified as excluded distribution services to determine if alternative providers currently exist or if legislation allows competition to be developed. Ergon Energy has concluded that no viable alternative providers exist for the suite of services and that only Ergon Energy can provide these services. These services, according to the criteria in the Rules, should therefore be classified as standard control services;
- *Changing from a revenue cap to a weighted average price cap for connection services and customer services* – Ergon Energy is proposing to separate (by use of a different control mechanism) the more volatile and user-specific connection services and customer services from its network services in order to better attribute the costs of providing these services to the parties who request them, or benefit from them; and
- *Changing from prescribed distribution services regulated under a revenue cap to unregulated activities for street light services* – Street lighting provision and maintenance does not fall within the Rules' definition of a 'distribution service'. Furthermore, the provision and maintenance of street lights is able to be, and is, provided by numerous parties other than Ergon Energy under a competitive market that is operating effectively in Queensland. Ergon Energy therefore proposes to align the regulatory regime with the established practices of end-users and Ergon Energy, and to treat street lighting as an unregulated activity.

Conclusion

While ultimately it is a decision for the AER whether to accept the classification and control mechanism framework proposed by Ergon Energy, it is important to note that the framework only determines part of the economic regulatory approach that is to be applied to Ergon Energy's services. The matters under consideration in this proposal do not:

- Affect the underlying nature or scope of the services that Ergon Energy currently provides. Ergon Energy will continue to physically provide its existing services and will undertake these in the same manner; and
- Involve setting the terms and conditions of supply, including actual prices, for individual services. This will occur through a subsequent detailed process under the economic regulatory framework that will involve Ergon Energy submitting a Regulatory Proposal to the AER no later than 31 May 2009 and the AER making a distribution determination with respect to that Regulatory Proposal following public consultation.

The AER's decisions about this proposal, together with its final decision about the Regulatory Proposal, in combination establish the economic regulatory framework that will apply to Ergon Energy for the next regulatory period. Ergon Energy has structured this proposal in such a way as to provide certainty for network users about matters that are critical to them (e.g. security of the network, quality of supply, timely responses and reasonable lead-time for extending and augmenting the network) whilst enabling Ergon Energy to lead the introduction of strategies to meet network users' emerging priorities such as demand management, efficient

investment in alternative supply options and the introduction of innovation in customer information (e.g. smart meters, in-house displays and load control).

Ergon Energy believes that this proposal achieves the appropriate balance between providing consistency and stability as it emerges from the QCA's regime. It also ensures that Ergon Energy progresses to the new Rules in a compliant manner. Importantly, Ergon Energy has sought to ensure that this proposal does not diminish the scope for inclusion of new policies and initiatives that are currently under consideration by the Ministerial Council on Energy and the Standing Committee of Officials which may ultimately result in future Rules changes.

1 Introduction

Ergon Energy's distribution services for its national electricity grid connected network¹ are currently regulated by the QCA under the Rules.² Following the making of the National Electricity (Economic Regulation of Distribution Services) Amendment Rules 2007 on 16 December 2007, the AER will replace the QCA as Ergon Energy's economic regulator for its next regulatory control period, commencing 1 July 2010.

To assist in the smooth transition to a national framework, the Queensland DNSPs were granted transitional arrangements outlined in clause 11.16.6 of the Rules, which provide for them to make a specific proposal to the AER about the classification of their services and control mechanisms for the next regulatory control period, by 31 March 2008.

This proposal is made under this transitional clause 11.16.6 of the Rules. It considers in detail the nature of the services provided by Ergon Energy as well as the rationale supporting the proposed classification of these services and the control mechanisms to be applied. In the interest of maintaining consistency in the Queensland jurisdiction, Ergon Energy and ENERGEX have worked closely together to, where possible, identify and classify similar services in a uniform manner and to apply similar control mechanisms.

It is anticipated that the AER's partial framework and approach paper on the classification of services and control mechanism applicable to Ergon Energy will be published in August 2008. This decision will inform the development of Ergon Energy's Regulatory Proposal.

Chapter 6 of the Rules requires the AER to publish (the balance of) its framework and approach paper by November 2008. The framework and approach papers (in combination) will include the AER's likely approach and reasons to the classification of distribution services, the control mechanisms that will apply, the service target performance incentive scheme, the efficiency benefit sharing scheme, the demand management incentive scheme and any other matters on which the AER thinks fit to give an indication of its likely approach.

2 About Ergon Energy

Ergon Energy is incorporated under the *Corporations Act 2001* (Cth) and is a wholly Government-owned 'company GOC', for the purposes of the *Government Owned Corporations Act 1993* (Qld).³

¹ The economic regulation of Ergon Energy's 34 isolated networks are not captured by the Rules. The QCA currently has responsibility for the economic regulation of the Mount Isa-Cloncurry network under a direction from the Minister pursuant to section 89B(2) of the *Electricity Act 1994* (Qld). Ergon Energy's remaining isolated networks are overseen by the Department of Mines and Energy.

² The National Electricity Code version 9.4 was in force at the time of the QCA's 2005 Final Determination.

³ *Government Owned Corporations Act 1993* (Qld), section 7(3).

Ergon Energy's principal activity is the operation of an electricity distribution system and it holds a Distribution Authority that is administered by the Director-General of the Queensland Department of Mines and Energy to supply electricity using its distribution system throughout regional Queensland.

Ergon Energy's service area under its Distribution Authority effectively covers 97% of Queensland – an area representing over one million square kilometers. This includes the management 34 isolated systems (and associated generation for 33 isolated systems) that provide supply to communities in Western Queensland, Gulf of Carpentaria, Cape York, various Torres Strait Islands, as well as Palm and Mornington Islands.⁴

Appendix A of this document provides a map of Ergon Energy's area of supply.⁵

Ergon Energy's responsibilities under its Distribution Authority and the *Electricity Act 1994* (Qld), include to:

- Allow, as far as technically and economically practicable, a person to connect supply to its supply network, or take electricity from its supply network, on fair and reasonable terms;⁶ and
- Operate, maintain (including to repair and replace as necessary) and protect its supply network to ensure the adequate, economic, reliable and safe connection and supply of electricity to its customers.⁷

2.1 Ergon Energy's Customers

Ergon Energy provides distribution services to:

- *Electricity Retailers* – Retailers purchase wholesale energy that is transported through Powerlink's transmission system and Ergon Energy's distribution system to end-use customers. Ergon Energy currently provides distribution services to:
 - Ergon Energy's subsidiary, Ergon Energy Queensland Pty Ltd (Ergon Energy Queensland). Ergon Energy Queensland is a non-competing electricity retailer, providing customer retail services at the uniform tariff (Notified Prices) to customers in Ergon Energy's distribution area under an area Retail Authority issued by the Queensland Department of Mines and Energy;⁸ and
 - A small number of competing electricity retailers. Although there are over 20 retailers licensed to provide customer retail services in Queensland, the economics of supply mean that currently only a small number of these retailers are actively competing for customers in Ergon Energy's distribution area;⁹

⁴ Refer http://www.ergon.com.au/network_info/isolated_and_remote_power_stations/default.asp#map

⁵ Ergon Energy, Network Management Plan 2007/2012 – Part A, page 9, found at http://www.ergon.com.au/about_us/network_management_plan.asp

⁶ *Electricity Act 1994* (Qld), section 43(1).

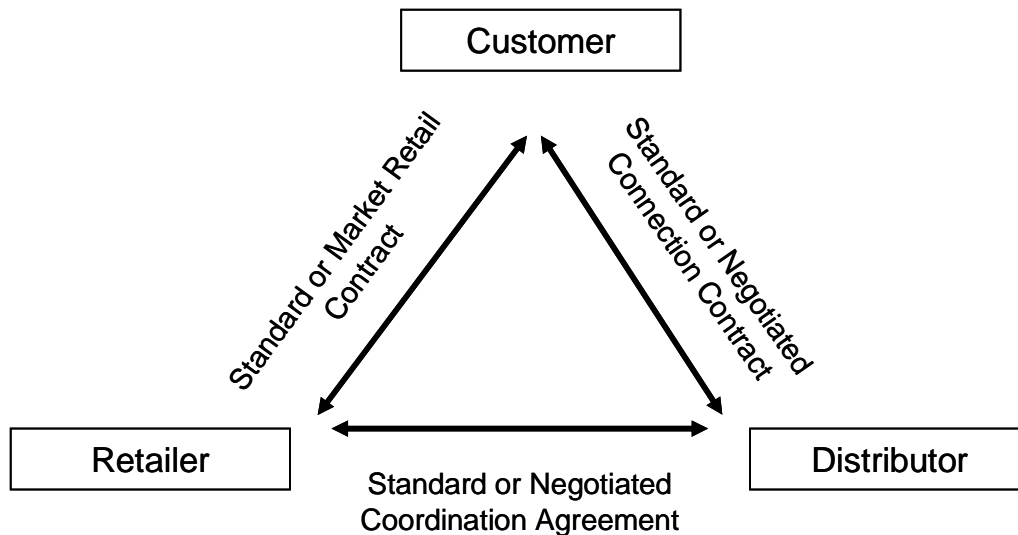
⁷ *Ibid*, section 42(a)(b).

⁸ Refer http://www.dme.qld.gov.au/zone_files/Electricity/list_lic_elec_retailers.pdf

⁹ *Ibid*.

- *End-Use Customers* – Ergon Energy provides ‘customer connection services’ to over 600,000 premises in its distribution area. Customer connection services include the connection of the premises to a supply network as well as the supply of electricity from the supply network to the premises;¹⁰ and
- *Community* – About 1.4 million¹¹ people currently rely on Ergon Energy every day for the safety, quality, reliability and availability of their electricity supply.

A tripartite contractual relationship was established between Ergon Energy, end-use customers and retailers upon the introduction of full retail competition (FRC) in Queensland on 1 July 2007. The nature of this relationship is illustrated in the following diagram:



Ergon Energy provides customer connection services to customers under either a Standard or Negotiated Connection Contract. The interaction with retailers is managed through a Standard or Negotiated Coordination Agreement which sets out how Ergon Energy and the electricity retailer agree to streamline their respective relationship with customers and coordinate with each other in the performance of certain functions and obligations.

Ergon Energy also provides certain distribution services directly to the customer’s connection point, with no involvement from a retailer as an intermediary.

Ergon Energy’s Standard Connection Contract and Standard Coordination Agreement are detailed in Annexures A and C (respectively) of the Queensland Electricity Industry Code.¹²

¹⁰ *Electricity Act 1994* (Qld), Schedule 5 – definition ‘customer connection services’.

¹¹ Derived from information contained at <http://www.oesr.qld.gov.au/queensland-by-theme/demography/population/index.shtml>

¹² Queensland Government, *Electricity Industry Code* (Third Edition), found at http://www.dme.qld.gov.au/Energy/electricity_industry_code.cfm

2.2 Ergon Energy's Distribution System

An inevitable feature of the development and expansion of the regional electricity network in Queensland over the last 63¹³ years has been that:

- Larger industrial loads and higher density areas (typically coastal) have tended to be served by more reliable systems; whereas
- Network expansion into lower density rural areas has tended to be rolled out using technology such as Single Wire Earth Return (SWER), which is capable of spanning long distances at minimal cost.

As a consequence, Ergon Energy's electricity distribution system is characterised by:

- A low load density and high geographic spread of customers. Ergon Energy has the lowest customer density of any network in the western world for the 100,000 kilometres of line west of the Great Dividing Range;¹⁴
- A large radial network, including approximately 65,000 kms of SWER lines, operating at three voltage levels (11, 12.7 and 19.1 kV) and servicing around 26,000 customers.¹⁵ Over 68% of Ergon Energy's feeder powerlines are classified as non-urban;¹⁶ and
- Connection to Powerlink's high voltage transmission network at 48 Transmission Network Connection Points and direct connection to and supply from a small number of embedded generators.¹⁷

The following table provides a statistical summary of Ergon Energy's distribution system in 2005/06¹⁸ and has been updated with the September 2007 quarterly service quality statistics:

¹³ Legislation that consolidated previous arrangements and commenced co-ordinated electricity network development in Queensland commenced in 1945.

¹⁴ Ergon Energy, Network Management Plan 2007/2012 – Part A, page 7.

¹⁵ Ibid, page 79.

¹⁶ Ergon Energy, Annual Report 2006/07, at page 13.

¹⁷ Ergon Energy, Network Management Plan 2007/2012 – Part A, page 8.

¹⁸ Ergon Energy, Annual Service Quality Report (July 2005 – June 2006), found at

<http://www.qca.org.au/files/Ergon%20Energy%20-%20Annual%20Service%20Quality%20Report%202005-06.PDF> (this is the most recent publication)

Item	Value / Unit
Network service area (sq kms)	1,698,100 sq kms
Total length of lines (kms) - distribution and subtransmission	142,793 kms
Customers per kilometer of line ¹⁹	5.2
Total distribution customers. ²⁰	615,046
<i>Urban feeder</i>	243,376
<i>Short rural feeder</i>	300,019
<i>Long rural feeder</i>	68,796
Number of poles	880,000
Distribution losses	6.59%
Number and capacity of transformers (MVA):	
<i>Sub-transmission</i>	560 / 6,811 MVA
<i>Distribution</i>	80,216 / 5,720 MVA

2.3 Ergon Energy's Operating Environment

Ergon Energy's operating environment presents a range of challenges that impact on the provision of its services. These include:

- High numbers of customer connections, due to strong population growth and high levels of investment in the industrial and mining sectors. This results in increased pressures to meet customer expectations regarding connection times and, for major customer loads, difficulties in predicting the timing and magnitude of the load to be serviced;²¹
- Shifts in end-usage patterns to include larger loads (e.g. air conditioning) and sophisticated and complex electronic equipment. The standards and technologies upon which the network is based may not be capable of meeting customer expectations as to reliability and quality of supply;²²

¹⁹ QCA, Ergon Energy's Financial and Service Quality Performance (2005 – 2006), March 2007, page 2, found at <http://www.qca.org.au/files/E%20-%20Financial%20and%20Service%20Quality%20Reports%20-%202005-06%20Att%2020.pdf> (this is the most recent quarterly publication)

²⁰ Ergon Energy, Quarterly Service Quality Report (July 2007 – September 2007), found at <http://www.qca.org.au/files/E-Ergon-ServiceQual-Sept2007.PDF>

²¹ Ergon Energy, Network Management Plan 2007/2012 – Part A, page 19.

²² Ibid, page 6.

- A sustained increase in maximum demand. Maximum demand for Ergon Energy's grid connected network is forecast to grow rapidly, increasing markedly from the 2006-07 maximum demand level of 2,584 MW. Capital investment is required to ensure that network utilisation remains within appropriate bounds; and
- Climatic conditions. Ergon Energy experiences:
 - A high probability and high exposure to cyclones;
 - High storm and lightening activity; and
 - Significant summer-winter and day-night temperature variations.

These conditions influence the design criteria for infrastructure, as well as the ability to respond to incidents on the distribution system as and when they occur.

These factors are continuing to drive a significant increase Ergon Energy's capital expenditure. Over the current five year regulatory period, from 1 July 2005 to 30 June 2010, Ergon Energy expects to spend over \$3 billion on its distribution system.

3 This Proposal

3.1 Background

Clause 6.8.1 of the Rules requires the AER to prepare a framework and approach paper in anticipation of its distribution determination for Ergon Energy's next regulatory control period. This paper will include the AER's likely approach to the classification of distribution services, the form or forms of control mechanisms that will apply in the next regulatory control period and the AER's reasons for deciding on these control mechanisms.

Clause 6.8.2(b)(1) of the Rules requires Ergon Energy to submit a Regulatory Proposal to the AER for the next regulatory control period by no later than 13 months before the expiry of the current determination, being 31 May 2009.

Clause 6.8.2(c)(1)(i) and (ii) of the Rules requires that:

- Ergon Energy's Regulatory Proposal must include a proposal for classifying its services in accordance with Chapter 6 of the Rules; and
- Ergon Energy must justify the reasons for any differences in its services classification from the classification suggested in the AER's relevant framework and approach paper.

The transitional arrangements in clause 11.16.6 of the Rules give Ergon Energy an opportunity to submit a specific proposal to the AER about the classification of its services and its control mechanisms for the next regulatory control period by 31 March 2008. If Ergon Energy makes such a proposal, this clause requires the AER to publish its framework and approach paper under clause 6.8.1 of the Rules in relation to these two issues within five months of receiving Ergon Energy's proposal. This would therefore allow Ergon Energy to understand the AER's views regarding its services classification and control mechanisms earlier than would otherwise be the case under clause 6.8.2 of the Rules.

3.2 Purpose of this proposal

The classification of services and choice of control mechanisms will be cornerstone features of Ergon Energy's forthcoming Regulatory Proposal and of the AER's subsequent distribution determination. Ergon Energy will be among the first DNSPs to submit a Regulatory Proposal to the AER under the amended Rules. No precedent exists for applying the service classification framework under the new Chapter 6 of the Rules or of the revised basis on which a control mechanism is chosen to apply to direct control services.

Ergon Energy therefore considers it important to understand at an early stage, the AER's approach to determining the services classification and control mechanisms for the next regulatory control period. The Queensland transitional arrangements at clause 11.16.6 of the Rules envisage this need and provide an opportunity for Ergon Energy to make a proposal to the AER in advance of the AER issuing its framework and approach paper under clause 6.8.1 of the Rules.

Accordingly, this document is a proposal to the AER under clause 11.16.6 of the Rules. It:

- Proposes a basis for classifying Ergon Energy's distribution services, and for establishing the associated control mechanisms, for the next regulatory control period commencing 1 July 2010; and
- Justifies Ergon Energy's proposed service classification and control mechanisms for each subclass of direct control services on the basis of the matters that the AER must have regard to under Chapter 6 of the Rules. Specifically, this proposal addresses:
 - Clause 6.2.1, which sets out the matters that the AER must have regard to when classifying distribution services as direct control services or negotiated services;
 - Clause 6.2.2, which sets out the matters that the AER must have regard to when classifying direct control services as standard control services or alternative control services; and
 - Clause 6.2.5(c), which sets out the matters that the AER must have regard to when deciding on the control mechanism for standard control services.

Ergon Energy seeks the AER's consideration and acceptance of its proposed services classification and control mechanisms, and requests that Ergon Energy's proposal be reflected in the AER's framework and approach paper. This will enable Ergon Energy's Regulatory Proposal to reflect the services classification and to demonstrate the application of the control mechanisms, in accordance with the requirements of clauses 6.8.2(c)(1) and (3) respectively of the Rules.

This proposal has been prepared following various meetings between Ergon Energy and the AER in late 2007 and early 2008 that sought to clarify:

- The nature of the information that the AER expects Ergon Energy's proposal will contain; and
- How the AER expects Ergon Energy will address specified provisions of the Rules, including clauses 6.2.1 and 6.2.2 in relation to services classification and clause 6.2.5 of the Rules in relation to the control mechanism.

3.3 Structure of this proposal

The remainder of this document is structured as follows:

- Section 4 examines the service classification and control mechanisms that apply to Ergon Energy in the current regulatory control period;
- Section 5 identifies the key provisions of the new Chapter 6 of the Rules that are relevant to this proposal;
- Section 6 overviews the nature of Ergon Energy's distribution services;
- Section 7 details Ergon Energy's proposed classification of distribution services between direct control and negotiated services;
- Section 8 details Ergon Energy's proposed classification of direct control services between standard control services and alternative control services;
- Section 9 details Ergon Energy's proposed control mechanisms to apply to its direct control services;

- Section 10 summarises Ergon Energy's proposed classification of services and control mechanism for its distribution services;
- Section 11 examines the impacts of this proposal on network users;
- Appendix A is a map of Ergon Energy's supply area; and
- Appendix B provides an overview of Ergon Energy's unregulated activities, for information purposes.

4 Current Service Classification and Control Mechanisms

Ergon Energy currently has:

- Various prescribed distribution use of system (DUOS) services that are regulated under a fixed revenue cap;
- Various excluded distribution services that are regulated under a variant of a schedule of fixed charges; and
- Various unregulated services, most of which are not distribution services.

This section details how Ergon Energy came to have these service classifications and control mechanisms for its distribution services.

4.1 Current Types of Distribution Services

Ergon Energy's distribution services were classified for the current regulatory control period under the previous National Electricity Code (old Code)²³. The new Rules Version 18, which commenced on 1 January 2008 contain a number of significant changes to the way the distribution regulatory regime operates and changes to definitions.

Clause 6.10.4 of the old Code provided that all distribution services should be classified as either prescribed distribution services or excluded distribution services. Determining this classification was the responsibility of the jurisdictional regulator, (the QCA).

The old Code defined "distribution service" as:

The services provided by a distribution system which are associated with the conveyance of electricity through the distribution system. Distribution services include entry services, distribution network use of system services, exit services and network services which are provided by part of a distribution system.

"Prescribed distribution services" were defined in the old Code as being:

Distribution services provided by distribution network assets or associated connection assets which are determined by the jurisdictional regulator as those which should be subject to economic regulation under clause 6.10.4(a).

"Excluded distribution services" were defined in the old Code as being:

Distribution services the costs of and revenue for which are excluded from the revenue cap or price cap which applies to prescribed distribution services.

²³ The National Electricity Code version 9.4 was in force at the time of the QCA's 2005 Final Determination.

4.2 The QCA's regulatory determinations

4.2.1 Classification of Services

The QCA issued its "Electricity Distribution: Determination of Prescribed Services"²⁴ in September 2000. This determination declared all of the distribution services performed by Ergon Energy to be prescribed distribution services. The QCA stated that:

Initially, all services performed by each DNSP²⁵ that are associated with, or ancillary to, access to that DNSP's network for the supply of electricity within that DNSP's service area are to be declared as 'prescribed services' and therefore subject to economic regulation by the Authority.²⁶

The QCA provided that either Ergon Energy or any other interested party could apply, on a case by case basis, to have prescribed distribution services reclassified as excluded distribution services. It established a test whereby a service could only be re-classified:

where it can be demonstrated that the market for such services is 'contestable', that is subject to potential – if not actual – competition.²⁷

In particular, the QCA required that any application to reclassify prescribed distribution services as excluded distribution services must:

Demonstrate that the current level of competition or, alternatively, the lack of significant barriers to entry mean that the DNSP lacks substantial influence in the market.²⁸

The QCA applied its September 2000 determination for the purposes of regulating Ergon Energy's distribution services in the regulatory control period 1 July 2001 to 30 June 2005. The QCA determined that all of Ergon Energy's distribution services were to be classified as prescribed distribution services and that there would be no excluded distribution services.

In its 2005 Final Determination, the QCA reapplied its September 2000 determination that all distribution services, including network services, connection services and customer support services would be prescribed distribution services for the regulatory control period 1 July 2005 to 30 June 2010. The QCA detailed a "list of prescribed distribution services used in the preparation of this Final Determination"²⁹.

The QCA separated Ergon Energy's prescribed distribution services into two sub-categories: prescribed DUOS services and prescribed non-DUOS services.

The QCA's 2005 Final Determination stated that prescribed DUOS services:

²⁴ Found at: <http://www.qca.org.au/files/ElectricityDistributionPrescribedServicesFinal.pdf>

²⁵ Ergon Energy and ENERGEX

²⁶ Ibid, page 8

²⁷ Ibid, page 8

²⁸ Ibid, page 11

²⁹ QCA, "Final Determination – Regulation of Electricity Distribution", pages 54 – 55,

<http://www.qca.org.au/files/ACF14.pdf>

*means those prescribed distribution services provided by distribution use of system assets (as defined in the Code) and whose revenue is earned from distribution use of system charges.*³⁰

The QCA stated that prescribed non-DUOS services:

*means those prescribed distribution services that are not DUOS Services and whose revenue is earned from miscellaneous charges. For Energex these services are: recoverable works not subject to legislative provision; temporary builders services; and subdivision fees. For Ergon these services are: recoverable works not subject to legislative provision; temporary builders services; subdivision fees; and reconnection/disconnection services.*³¹

All of the prescribed non-DUOS services relate to services provided to retailers, customers and/or contractors that are non-recurrent services in nature and priced on a fee for service basis, outside of the network tariff. Since the introduction of FRC on 1 July 2007, a number of these services are requested and delivered through business-to-business (B2B) service order requests. The types of prescribed non-DUOS services covered by the B2B procedures include:

- Re-energisations;
- De-energisations;
- Special meter reads;
- Additions and alterations to customer connections;
- Meter re-configurations;
- Meter investigations;
- Supply abolishments; and
- Miscellaneous services.

In August 2007, the QCA released its Final Decision to an amendment to its September 2000 Final Determination "Electricity Distribution: Determination of Prescribed Services". The amendment established broader criteria for excluding services on the basis of clause 6.2.4(a) of the old Code whereby the QCA may deem a service to be excluded having regard to criteria set out in clause 6.2.4(a). These new criteria allowed the QCA to deem a service to be excluded and to apply a "light handed" form of regulation even where a contestable market cannot be demonstrated.

Following the August 2007 Final Decision, the QCA consulted on and confirmed in December 2007 its Final Decision "Electricity Distribution: Review of Excluded Distribution Services"³². On the basis of the broader criteria, rather than the market test, in this Final Decision, the QCA reclassified all of Ergon Energy's prescribed non-DUOS services as excluded distribution services. The driver for this decision was the introduction of FRC in Queensland. FRC was expected to trigger an increase in the demand for these prescribed non-DUOS services, which could lead

³⁰ Ibid, page 268

³¹ Ibid, page 270

³² <http://www.qca.org.au/electricity/prescribed-service/ExcludeDistServices.php>

to inappropriate cross-subsidisation between these services and prescribed DUOS services under a fixed revenue cap. As a result, Ergon Energy currently has:

- Various prescribed DUOS services;
- No prescribed non-DUOS services; and
- Various excluded distribution services.

4.2.2 Control mechanism

The QCA applied a fixed revenue cap control mechanism to all prescribed distribution services in both its 2001 and 2005 Final Determinations.

The QCA, in adopting a fixed revenue cap in its 2001 Final Determination stated that:

*By controlling the amount of revenue each DNSP is able to raise during a year, the Authority aims to remove the possibility for the DNSPs to use their monopoly position to extract more than a fair price for the services they provide.*³³

The QCA made a decision in June 2003 to retain a fixed revenue cap for the regulatory control period 1 July 2005 to 30 June 2010. It stated that:

....this reflected the (QCA's) reluctance to move away from the current fixed revenue cap arrangements so soon after implementing them and with only one year of data and experience to assess how the current regulatory regime was functioning and upon which to base its decision.

*...The (QCA) consider(ed) that the lack of certainty about the appropriateness of existing distribution prices and the continued removal of monopoly rents while ensuring the financial viability of the distributors (were) important reasons for maintaining the fixed revenue cap arrangements for the next regulatory period.*³⁴

In their respective submissions, Ergon Energy and ENERGEX highlighted the risks of retaining a fixed revenue cap and proposed the following alternatives:

- Ergon Energy recommended that a hybrid revenue cap be adopted in order to address the risks of forecasting error;³⁵ and
- ENERGEX recommended that the QCA adopt a weighted average price cap (WAPC).³⁶

As noted above, the QCA's December 2007 Final Decision "Electricity Distribution: Review of Excluded Distribution Services" reclassified Ergon Energy's prescribed non-DUOS services as excluded distribution services. As a result, the QCA changed the control mechanism for these services from a revenue cap to a variant of a schedule of fixed charges. The QCA considered that approving prices based on an approved pricing principles statement (a variant on a schedule of fixed charges) would be a more appropriate control mechanism than a revenue cap for

³³ <http://www.qca.org.au/files/ACF895.pdf>, page 3

³⁴ QCA, Final Decision - Form of Regulation of Electricity Distribution to commence from 1 July 2005, (June 2003) page 1

³⁵ <http://www.qca.org.au/files/ACFED5.pdf> page 3

³⁶ http://www.qca.org.au/files/EnergexSubmission_reviewofformofregdraft.pdf page 2

Ergon Energy's excluded distribution services. The driver for this decision was the same as the re-classification decision for excluded distribution services i.e. the introduction of FRC in Queensland.

As a result, Ergon Energy's:

- Prescribed DUOS services are currently regulated under a fixed revenue cap; and
- Excluded distribution services are currently regulated under a variant of a schedule of fixed charges.

5 Requirements of Chapter 6 of the Rules

This section details the provisions of the new Chapter 6 of the Rules that are relevant to this proposal.

5.1 Definitions

The Rules and the Law define the following terms that are particularly relevant to this proposal:

- *Alternative control service* – The Rules state that this is “A distribution service that is a direct control service but not a standard control service”;
- *Connection assets* – The Rules state that these are “Those components of a transmission or distribution system which are used to provide connection services”;
- *Direct control service* – Section 2B of the Law states that “A direct control network service is an electricity network service —
 - (a) the Rules specify as a service the price for which, or the revenue to be earned from which, must be regulated under a distribution determination or transmission determination; or
 - (b) if the Rules do not do so, the AER specifies, in a distribution determination or transmission determination, as a service the price for which, or the revenue to be earned from which, must be regulated under the distribution determination or transmission determination.”

The Rules state that a direct control service is “A distribution service that is a direct control network service within the meaning of section 2B of the Law”.

- *Distribution network* – the Rules state that this is “A network that is not a transmission network”;
- *Distribution network service provider* – The Rules state that this is “A person who engages in the activity of owning, controlling, or operating a distribution system”;
- *Distribution service* – The Rules state that this is “A service provided by means of, or in connection with, a distribution system”;³⁷
- *Distribution system* – The Rules state that this is “A distribution network, together with the connection assets associated with the distribution network, which is connected to another transmission or distribution system. Connection assets on their own do not constitute a distribution system”.
- *Framework and approach paper* – The Rules state that this is “A document prepared and issued as a framework and approach paper under clause 6.8.1”;
- *Negotiated distribution service* – Section 2C of the Law states that “A negotiated network service is an electricity network service —
 - (a) that is not a direct control network service; and

³⁷ Note that this definition is different to that which applied under the old Code and the QCA’s Determinations.

- (b) that —
- (i) the Rules specify as a negotiated network service; or
 - (ii) if the Rules do not do so, the AER specifies as a negotiated network service in a distribution determination or transmission determination.”

The Rules state that a negotiated distribution service is “A distribution service that is a negotiated network service within the meaning of section 2C of the Law”.

- *Network* – The Rules state that this is “The apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers (whether wholesale or retail) excluding any connection assets. In relation to a Network Service Provider, a network owned, operated or controlled by that Network Service Provider”;
- *Regulatory Proposal* – The Rules state that this is “A proposal (by a Distribution Network Service Provider) under rule 6.8”; and
- *Standard control service* – The Rules state that this is “A direct control service that is subject to a control mechanism based on a Distribution Network Service Provider’s total revenue requirement”.

Neither the Rules nor the Law define “non-distribution services” or “unregulated activities”. These are services and activities that are provided by Ergon Energy which are not “distribution services” and are therefore not subject to economic regulation by the AER under Chapter 6 of the Rules. The nature of the unregulated activities is discussed in Appendix B of this document.

5.2 Distinguishing between Direct Control and Negotiated Distribution Services

Clause 6.2.1(a) of the Rules requires that distribution services be classified as either direct control services or negotiated distribution services and clause 6.2.1(b) of the Rules allows a DNSP’s services to be grouped together for the purposes of classification.

Clause 6.2.1(c) of the Rules sets out the matters that the AER must consider when assessing a DNSP’s classification of services between direct control services or negotiated distribution services:

The AER must, in classifying a distribution service, have regard to:

- (1) *the form of regulation factors; and*
- (2) *the form of regulation (if any) previously applicable to the relevant service or services and, in particular, any previous classification under the present system of classification or under the previous regulatory system (as the case requires); and*
- (3) *the desirability of consistency in the form of regulation for similar services (both within and beyond the relevant jurisdiction); and*
- (4) *any other relevant factor.*

The form of regulation factors referred to in 6.2.1(c)(1) of the Rules are set out in section 2F of the Law. These factors are:

- (a) *the presence and extent of any barriers to entry in a market for electricity network services;*
- (b) *the presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a network service provider and any other electricity network service provided by the network service provider;*
- (c) *the presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a network service provider and any other service provided by the network service provider in any other market;*
- (d) *the extent to which any market power possessed by a network service provider is, or is likely to be, mitigated by any countervailing market power possessed by a network service user or prospective network service user;*
- (e) *the presence and extent of any substitute, and the elasticity of demand, in a market for an electricity network service in which a network service provider provides that service;*
- (f) *the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be);*
- (g) *the extent to which there is information available to a prospective network service user or network service user, and whether that information is adequate, to enable the prospective network service user or network service user to negotiate on an informed basis with a network service provider for the provision of an electricity network service to them by the network service provider.*

Clauses 6.2.1(d) and (e) of the Rules state that:

- (d) *In classifying distribution services that have previously been subject to regulation under the present or earlier legislation, the AER must act on the basis that, unless a different classification is clearly more appropriate:*
 - (1) *there should be no departure from a previous classification (if the services have been previously classified); and*
 - (2) *if there has been no previous classification – the classification should be consistent with the previously applicable regulatory approach.*
- (e) *If the Rules, however, require that a particular classification be assigned to a distribution service of a specified kind, a distribution service of the relevant kind is to be classified in accordance with that requirement.*

5.3 Distinguishing between Standard Control and Alternative Control Services

Clause 6.2.2 of the Rules requires that direct control services be further classified between two subclasses of distribution services. These subclasses are subject to regulation by the AER under clause 6.5.2 and the nature of this regulation may differ between the subclasses as provided in clause 6.2.6:

- *Standard Control Services* – These services must be regulated via a building block approach based on arrangements defined in the Rules. Ergon Energy must prepare a revenue proposal that sets out each element of the building block methodology in order to derive the annual revenue requirement (ARR) for each year of the regulatory period for these services; and
- *Alternative Control Services* – These services can be regulated via a building block approach or an alternative method, such as a ‘fair and reasonable’ test, a schedule of fees or some other approach. Importantly, the revenue from these services does not form part of Ergon Energy’s ARR.

Clause 6.2.2(c) of the Rules requires that in classifying services between standard control and alternative control the AER must have regard for:

- (1) *the potential for development of competition in the relevant market and how the classification might influence that potential; and*
- (2) *the possible effects of the classification on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and*
- (3) *the regulatory approach (if any) applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made; and*
- (4) *the desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction); and*
- (5) *the extent the costs of providing the relevant service are directly attributable to the customer to whom the service is provided; and*
- (6) *any other relevant factor.*

5.4 Determining Control Mechanisms for Direct Control Services

Clause 6.8.1(c) of the Rules provides that “The framework and approach paper must state the form (or forms) of the control mechanisms to be applied by the distribution determination and the AER’s reasons for deciding on control mechanisms of the relevant form (or forms)”. Clause 6.12.3(c) of the Rules provides that, for the purposes of the AER’s distribution determination, “The control mechanisms must be as set out in the relevant framework and approach paper”. This means that Ergon Energy must apply the control mechanism in its Regulatory Proposal that is set out in the AER’s framework and approach paper.

There are six control mechanisms that can be applied to direct control services. Clause 6.2.5(b) of the Rules states that:

- (b) *the control mechanism for direct control services may consist of:*

- (1) *A schedule of fixed prices; or*
- (2) *Caps on the prices of individual services; or*
- (3) *Caps on the revenue to be derived from a particular combination of services; or*
- (4) *Tariff basket price control; or*
- (5) *Revenue yield control; or*
- (6) *A combination of any of the above.*

In deciding on a control mechanism for standard control services, the AER must have regard to the following requirements of clause 6.2.5(c) of the Rules:

- (1) *the need for efficient tariff structures; and*
- (2) *the possible effects of the control mechanism on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and*
- (3) *the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination; and*
- (4) *the desirability for consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and*
- (5) *Any other relevant factor.*

In deciding on a control mechanism for alternative control services, the AER must have regard to the following requirements of clause 6.2.5(d) of the Rules:

- (1) *the potential for development of competition in the relevant market and how the control mechanism might influence that potential; and*
- (2) *the possible effects of the control mechanism on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and*
- (3) *the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination; and*
- (4) *the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and*
- (5) *any other relevant factor.*

Clause 6.2.6 of the Rules goes on to state that:

- (a) *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 form, in accordance with Part C.*
- (b) *For alternative control services, the control mechanism must have a basis stated in the distribution determination.*
- (c) *The control mechanism for alternative control services may (but need not) utilise elements of Part C (with or without modification).*

6 Nature of Services Provided by Ergon Energy

This section describes the range of distribution services and unregulated activities that Ergon Energy provides to retailers and end customers. It identifies the key Queensland and national non-economic legislative and regulatory instruments that define the nature of Ergon Energy's groups of services and the basis on which it provides them.

6.1 Distribution Services

The Rules define a distribution service as "A service provided by means of, or in connection with, a distribution system". The distribution system is "A distribution network, together with the connection assets associated with the distribution network, which is connected to another transmission or distribution system. Connection assets on their own do not constitute a distribution system".

Ergon Energy has the following ten groups of distribution services:

- Network Services;
- Connection Services;
- Customer Services;
- De-energisations and re-energisations;
- Additions and alterations;
- Ancillary metering services;
- Supplementary services;
- Enhanced services;
- Quoted services; and
- Temporary supply services.

The nature of these groups of services is described below.

6.1.1 Network Services

Section 10 of the Queensland *Electricity Act 1994* defines "network services" as "services for electricity transfer provided by transmission entities and distribution entities to persons connected to a transmission grid or supply network". The Rules define a "network service" as a "distribution service associated with the conveyance, and controlling the conveyance, of electricity through the network".

Network services involve Ergon Energy:

- Providing electricity transfer capacity for its shared distribution network;
- Extending the distribution network for small network users (for which capital contributions may be payable);
- Augmenting the distribution network;
- Controlling and regulating the characteristics (e.g. voltage and harmonics) of the electricity being transferred; and

- Undertaking associated activities to ensure the shared distribution network is fit for purpose, secure from interference, reliable in function and safe in operation. These activities may include conducting load and voltage checks, monitoring the operation of lines and substations, pole inspections, and carrying out maintenance.

Network services predominantly relate to the 'shared' network used to service all network users connected to it. Network services are delivered through the operation of assets such as substations, power lines, communication and control systems, and involve activities such as repairs, maintenance, vegetation clearing, asset replacement/refurbishment and construction of new assets.

The *Electricity Act 1994* grants Ergon Energy a legislative monopoly to provide network services:

- Section 42 provides that it is a condition of a distribution authority that the entity "...operate, maintain (including repair and replace as necessary) and protect its supply network to ensure the adequate, economic, reliable and safe connection and supply of electricity to its customers". This imposes an obligation on Ergon Energy to operate the network in a way that facilitates the provision of network services to customers;
- Section 44 states that ".....it is a condition of a distribution authority that the entity must provide, as far as technically and economically practicable, network services, on fair and reasonable terms, for persons authorised to connect supply of electricity to the network or take electricity from the network". This imposes an obligation on Ergon Energy to provide network services to authorised persons; and
- Section 230 provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works". This means that no third party:
 - Can interfere with Ergon Energy's provision of network services through its shared distribution network; and
 - Can offer any services that involve them doing any activity on Ergon Energy's network unless Ergon Energy authorises them to do so.

This clause therefore reinforces the monopoly nature of Ergon Energy's obligations to provide network services.

These services involve the construction or installation of new assets and Ergon Energy incurring capital expenditure which generally results in changes to its regulated asset base or involves Ergon Energy undertaking works on, or in relation to, the existing regulated asset base. For this reason, costs for these services relate to operating, maintenance and capital expenditure.

6.1.2 Connection Services

Connection services relate to building individual customers' connection assets as well as connecting those connection assets to the distribution network or premises. Connection services are dedicated to a particular customer, and not shared with other customers. Connection services entail a broad range of activities from establishing a simple service line connection for a small domestic customer, to sub-transmission connections, including establishing zone substations with dedicated transformers for large network users. The assets that are built and energised through this service include:

- Small distribution network users:
 - Connection assets (e.g. service lines, terminations, transformers etc);
 - Type 5 to 7 metering installations;
 - Permanent unmetered connections; and
 - Load control equipment.
- Large distribution network users:
 - Dedicated lines and transformers (within and outside the network user's land);
 - Connection assets; and
 - Metering (if a Type 5 to 7 metering installation is used).

Ergon Energy is the nominated Responsible Person for Type 5 to 7 metering installations in its supply area in accordance with Chapter 7 of the Rules. The *Electricity Act 1994* grants Ergon Energy a legislative obligation to provide its other connection services:

- Section 40 sets out the circumstances in which a customer who owns or occupies premises may apply to Ergon Energy for the provision of connection services. Section 40A of the *Electricity Act 1994* imposes a "connection obligation" on Ergon Energy to provide customer connection services, that have been applied for, to the premises, subject to certain qualifications that are detailed in sections 40C and 40D;
- Section 42 provides that it is a condition of a distribution authority that the entity "...operate, maintain (including repair and replace as necessary) and protect its supply network to ensure the adequate, economic, reliable and safe connection and supply of electricity to its customers";
- Section 43 states that "...it is also a condition of a distribution authority that the distribution entity must allow as far as technically and economically practicable for the distribution entity, a person to connect supply to its supply network, or to take electricity from its supply network, on fair and reasonable terms...";
- Section 230 provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works"; and
- Section 232 provides that "A person must not unlawfully connect or disconnect supply electricity to a customer or interfere with supply of electricity to a customer".

In addition, clause 5.1 of Ergon Energy's Standard Connection Contract³⁸, which is annexed to the Queensland Electricity Industry Code, provides that, subject to relevant electricity legislation and various qualifications detailed in clause 5.2 of the Standard Connection Contract, Ergon Energy will provide for:

- (i) *connection of the premises to the supply network to allow the supply of electricity from the supply network to the premises; and*
- (ii) *supply of electricity from the supply network to the premises.*

³⁸ This contract was initially approved by the Queensland Government, and any amendments must now be approved by the QCA.

Clause 5.2 of the Standard Connection Contract goes on to state that:

- (a) *Subject to the electricity legislation, we (Ergon Energy) must provide, install and maintain equipment for the provision of customer connection services at the premises in a manner which is safe and in accordance with the electricity legislation.*
- (b) *Our (Ergon Energy's) obligations extend up to the supply point for the delivery of electricity from the supply network for the premises and not beyond.*

This means that only Ergon Energy can connect new assets to the distribution network. The newly connected assets become part of the distribution system to enable customers to take supply.³⁹

Connection services generally involve the construction or installation of any new assets and therefore involve additions to Ergon Energy's regulated asset base. Costs for these services relate to capital expenditure.

6.1.3 Customer Services

Customer services relate to a range of services that Ergon Energy undertakes as part of its service obligations under statutory instruments, for which a customer-specific charge cannot be determined. These services are provided:

- On an on-going basis, such as scheduled meter reads and populating and maintaining NMI standing data in MSATS;
- At the request of retailers acting in their own right, without a direct request for the service from the customer or on behalf of end customers. An example of this kind of service is a request for historical data (within a two year period); and
- At the request of end customers directly. Examples of these services include call outs to attend a loss of supply or a cold water investigation where Ergon Energy's network is at fault.

These services do not generally involve the construction or installation of new assets and therefore do not change Ergon Energy's regulated asset base. Rather, these services involve undertaking works on, or in relation to, the existing regulated asset base. For this reason, costs for these services relate to operating and maintenance expenditure.

Ergon Energy's monopoly obligation to provide customer services derives from section 230 of the *Electricity Act 1994*, which states that "A person must not wilfully and unlawfully interfere with an electricity entity's works". The way in which Ergon Energy must undertake its customer services is set out in various regulatory instruments, including the *Electricity Act 1994*, the *Electricity Regulation 2006*, the *Electrical Safety Act 2002*, the *Electrical Safety Regulation 2002* and the Queensland Electricity Industry Code.

³⁹ Together, the connection assets and the distribution network comprise the distribution system.

In addition, as the Responsible Person (and nominated Metering Data Provider) in accordance with Chapter 7 of the Rules, Ergon Energy has a monopoly obligation to provide metering reading services for Type 5 to 7 metering installations in its supply area.

6.1.4 De-energisations and re-energisations

A de-energisation service relates to the disconnection of an existing premises of Ergon Energy's own volition, such as a result of a need to address safety concerns, or at the request of a retailer or a customer, for which there is a customer-specific charge. It does not relate to a supply dismantling or abolishment.

A re-energisation service relates to the re-connection of an existing premises at the request of a retailer or a customer after it has previously been disconnected through a de-energisation.

The *Electricity Act 1994*, the *Electricity Regulation 2006*, the Queensland Electricity Industry Code, the Standard Connection Contract (between Ergon Energy and each of its customers) and the Standard Retail Contract (between a customer and its retailer) set out the circumstances in, and procedures by, which Ergon Energy may de-energise and re-energise a customer's premises. Only Ergon Energy can undertake the physical de-energisation and re-energisation in its supply area. Ergon Energy must also act in accordance with the national "B2B Procedure – Service Order Process" or permissible alternative arrangements agreed between Ergon Energy and a retailer in relation to these services.⁴⁰

De-energisations and re-energisations occur at the customer's connection point. Ergon Energy's monopoly obligation to provide these services is therefore reinforced by Section 230 of the *Electricity Act 1994* which states that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

These services do not generally involve the construction or installation of any new assets and therefore do not change Ergon Energy's regulated asset base. Rather, these services involve undertaking works on, or in relation to, the existing regulated asset base. For this reason, costs for these services relate to operating and maintenance expenditure.

6.1.5 Additions and alterations

Additions and alterations relate to modifications to existing connection assets at the request of a retailer or a customer, for which there is a customer-specific charge. These services do not relate to the shared network. Examples of these services include:

- Exchanging an existing meter;
- Moving a meter;
- Moving a customer's point of attachment to the network; and
- A supply abolishment.

⁴⁰ Clause 7.2A.4(k) of the Rules.

The *Electricity Act 1994*, the *Electricity Regulation 2006*, the Queensland Electricity Industry Code and the Standard Connection Contract (between Ergon Energy and each of its customers) set out the circumstances in, and procedures by which, Ergon Energy may undertake additions and alterations. Only Ergon Energy can undertake the additions and alterations in its supply area. Ergon Energy must also act in accordance with the national “B2B Procedure – Service Order Process” or permissible alternative arrangements agreed between Ergon Energy and a retailer in relation to these services.

Additions and alterations occur at the customer’s connection point. Ergon Energy’s monopoly obligation to provide these services is therefore reinforced by Section 230 of the *Electricity Act 1994*, which states that “A person must not wilfully and unlawfully interfere with an electricity entity’s works”.

Some of these services involve the construction or installation of new assets and thereby may change Ergon Energy’s regulated asset base, whereas others of these services do not. For this reason, costs for these services relate to operating, maintenance and capital expenditure.

6.1.6 Ancillary metering services

Ergon Energy is the Responsible Person for all Type 5 to 7 metering installations within its distribution area in accordance with clause 7.2.3(d) of the Rules and section 9.1.4(b) of the Queensland Electricity Industry Code. As the Responsible Person, it is the:

- Metering Provider for all Type 5 to 7 metering installations in accordance with clause 7.2.5(a) of the Rules and section 9.3.2(c) of the Queensland Electricity Industry Code; and
- Metering Data Provider for all Type 5 to 7 metering installations in accordance with section 7.2.5(d) of the Rules and section 9.2.4(c) of the Queensland Electricity Industry Code.

Ergon Energy is accredited by NEMMCO to undertake both of these roles.

Ergon Energy provides and installs new Type 5 to 7 metering installations as a connection service, as discussed in section 6.1.2. The scheduled reading of these meters, meter inspections and meter tampering services are undertaken as customer services, as discussed in section 6.1.3.

Ergon Energy classifies all of its other metering-related services for which there is a customer-specific charge, as ancillary metering services. These services include:

- Customer requested meter tests;
- Changing the time switch settings on a meter;
- Meter removals; and
- Special meter reads.

The circumstances in, and procedures by, which Ergon Energy may undertake ancillary metering services are established through:

- The *Electricity Regulation 2006*;
- The Rules;

- Queensland Electricity Industry Code;
- National Electricity Market (NEM) Metrology Procedure;
- B2B Procedures – Meter Data Process or permissible alternative arrangements agreed between Ergon Energy and a retailer; and
- B2B Procedure – Service Order Process or permissible alternative arrangements agreed between Ergon Energy and a retailer.

Only Ergon Energy can provide ancillary metering services within its supply area because:

- It is the nominated Responsible Person (and Metering Provider and Metering Data Provider) for Types 5 to 7 metering installations;
- Section 230 of the *Electricity Act 1994* states that “A person must not wilfully and unlawfully interfere with an electricity entity’s works”. Because ancillary metering services relate to the customer’s meter, no third party can provide them without Ergon Energy’s approval; and
- Section 42 of the *Electricity Regulation 2006* states that, where a Responsible Person has provided a meter or links for the premises, and there is a seal on the meter or links “A person (the first person) must not break or interfere with the seal unless the responsible person has permitted the first person to do so”.

Some ancillary metering services involve changes to the existing asset base whereas others do not. For this reason, costs for these services relate to operating, maintenance and capital expenditure.

6.1.7 Supplementary services

Supplementary services are services that are provided by Ergon Energy in the event that it cannot perform certain customer services due to the customer’s action or inaction or where the customer is at fault, for which there is a customer-specific charge. In this sense, these services are derivative services. Examples of these services include a charge for:

- A wasted truck visit (to re-visit a premises in the event that the premises is not ready for the original service to be provided, such as a connection service); and
- Attending a loss of supply complaint where the customer is at fault.

Because these services relate entirely to Ergon Energy’s network, or are ancillary to the provision of a customer service in relation to its network, only Ergon Energy can provide supplementary services.

These services do not involve the construction or installation of any new assets and therefore do not change Ergon Energy’s regulated asset base. Rather, these services involve undertaking works on, or in relation to, the existing regulated asset base. For this reason, costs for these services relate to operating and maintenance expenditure.

6.1.8 Enhanced services

Enhanced services are services that are provided:

- At a higher standard than the minimum regulatory requirements; or
- Through a non-standard process at a customer's or retailer's request.

These services attract a customer-specific charge for the incremental cost of providing the service – the cost of the basic level of service is recovered through the network tariff.

Examples of these enhanced services include the provision of:

- Connection services above minimum requirements or through non-standard processes (including after-hours work); and
- Customer services above minimum requirements or through non-standard processes (including after-hours work).

Because these services relate entirely to Ergon Energy's network and involve enhanced levels of, or non-standard processes for delivering, other distribution services, only Ergon Energy can provide these enhanced services.

Some of these services involve the construction or installation of new assets and thereby change Ergon Energy's regulated asset base whereas others do not. For this reason, costs for these services relate to operating, maintenance and capital expenditure.

6.1.9 Quoted services

Quoted services are services for which Ergon Energy must make an assessment of the works required in order to determine the cost associated with its delivery, and therefore the price that is to be charged.

These services are requested by retailers or customers and attract a customer-specific charge.

Examples of these quoted services include:

- The provision of emergency recoverable works on Ergon Energy's network, such as where a car hits an electricity pole; and
- Removal or relocation of Ergon Energy's assets at a customer's request.

As these services relate entirely to Ergon Energy's network, only Ergon Energy can provide these quoted services. This is reinforced by section 230 of the *Electricity Act 1994* which states that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

Some of these services involve the construction or installation of new assets and thereby change Ergon Energy's regulated asset base whereas others do not. For this reason, costs for these services relate to operating, maintenance and capital expenditure.

6.1.10 Temporary supply services

Temporary supply services are sought by a customer that requires a temporary connection to Ergon Energy's network. Temporary supplies may be metered, or unmetered. Examples of customers that receive this service include mobile blood bank vans, other health check vans and temporary supply to decorative lights (e.g. Christmas lights). Temporary builders' supplies⁴¹ are metered⁴². Costs for these services relate to operating, maintenance and capital expenditure.

These services do not include permanent unmetered connections (e.g. telephone booths, barbeques in parks), which are classified as connection services under section 6.1.2 above.

6.2 Unregulated Activities

Ergon Energy performs a range of activities, most of which are not distribution services within the meaning of the Rules i.e. activities that are not provided by means of, or in connection with, Ergon Energy's distribution system. These activities are not regulated by the AER. Examples of these activities, some of which have historically been associated with distribution services, include:

- Construction and on-going maintenance of existing and new street lighting assets;
- Provision and maintenance of watchman lights;
- Provision of high load escorts;
- Metering Data Agent services for Type 1 to 4 metering installations;
- Coverage of mains ("Tiger Tails");
- Erection of extra poles on customers' premises; and
- Location of underground cables.

Further description of these activities and the rationale for why these activities are not classified as a 'distribution service' under the Rules is provided in Appendix B.

⁴¹ This does not include the provision of temporary builders' poles.

⁴² This is a requirement of the Queensland Government's Gazette (fixing retail prices).

7 Proposed Classification between Direct Control and Negotiated Services

This section classifies Ergon Energy's ten distribution services described in section 6 against the criteria in clause 6.2.1(c) of the Rules.

7.1 Requirements of the Rules

Clause 6.2.1(a) of the Rules requires that distribution services be classified as either direct control services or negotiated distribution services and clause 6.2.1(b) of the Rules allows a DNSP's services to be grouped together for the purposes of this classification.

Clause 6.2.1(c) of the Rules sets out the matters that the AER must have regard for when assessing a DNSP's classification of services between direct control services or negotiated distribution services:

The AER must, in classifying a distribution service, have regard to:

- (1) the form of regulation factors; and*
- (2) the form of regulation (if any) previously applicable to the relevant service or services and, in particular, any previous classification under the present system of classification or under the previous regulatory system (as the case requires); and*
- (3) the desirability of consistency in the form of regulation for similar services (both within and beyond the relevant jurisdiction); and*
- (4) any other relevant factor.*

The form of regulation factors referred to in 6.2.1(c)(1) of the Rules are set out in section 2F of the Law. These factors are:

- (a) the presence and extent of any barriers to entry in a market for electricity network services;*
- (b) the presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a network service provider and any other electricity network service provided by the network service provider;*
- (c) the presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a network service provider and any other service provided by the network service provider in any other market;*
- (d) the extent to which any market power possessed by a network service provider is, or is likely to be, mitigated by any countervailing market power possessed by a network service user or prospective network service user;*
- (e) the presence and extent of any substitute, and the elasticity of demand, in a market for an electricity network service in which a network service provider provides that service;*

- (f) *the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be);*
- (g) *the extent to which there is information available to a prospective network service user or network service user, and whether that information is adequate, to enable the prospective network service user or network service user to negotiate on an informed basis with a network service provider for the provision of an electricity network service to them by the network service provider.*

Clauses 6.2.1(d) and (e) of the Rules state that:

- (d) *In classifying distribution services that have previously been subject to regulation under the present or earlier legislation, the AER must act on the basis that, unless a different classification is clearly more appropriate:*
 - (3) *there should be no departure from a previous classification (if the services have been previously classified); and*
 - (4) *if there has been no previous classification – the classification should be consistent with the previously applicable regulatory approach.*
- (e) *If the Rules, however, require that a particular classification be assigned to a distribution service of a specified kind, a distribution service of the relevant kind is to be classified in accordance with that requirement.*

7.2 Interpreting the Form of Regulation Factors

Neither the Law nor the Rules provide any guidance as to the way in which the form of regulation factors should be applied when classifying distribution services between direct control services and negotiated services. In particular, it is not clearly stated that the presence of market power in the provision of a service means that the service should be classified as a direct control service as opposed to a negotiated service. Rather:

- The Rules simply require the AER to “have regard to” the form of regulation factors in classifying services; and
- The form of regulation factors list a series of market characteristics but do not explicitly say that the presence of particular market characteristics means that a service should be classified as either a direct control service or a negotiated service.

Further, neither the Law nor the Rules provide any guidance as to the way in which the form of regulation factors should be weighted between:

- Each other; and
- The other classification criteria in clause 6.21(c)(2) to (4) of the Rules.

Given this, Ergon Energy has had regard for the Expert Panel on Energy Access Pricing’s (Expert Panel) April 2006 “Report to the Ministerial Council on Energy”, which set out the economic rationale for the form of regulation factors that were subsequently reflected into the Law. The Expert Panel stated that:

..... the form of regulation that is likely to be most cost-efficient for different classes of regulated service should be decided on the basis of the degree of market power involved in the supply of relevant services. The general principle to be applied is that more intrusive and potentially costly forms of regulation (principally direct price or revenue controls) will only be warranted where substantial market power is involved. Where the market conditions involve the reality of, or potential for, a measure of contestability or the prospect of meaningful commercial negotiation, less intrusive and costly forms of regulation are likely to be warranted.⁴³

The Expert Panel went on to say that:

The Panel considers that the following factors are relevant for making an assessment of the extent of market that is associated with the supply of a network service:

- *presence of entry barriers;*
- *presence of network externalities;*
- *presence of countervailing power;*
- *presence of competitive substitution possibilities; and*
- *degree of information asymmetry.*⁴⁴

These factors were used as the basis for developing the form of regulation factors in section 2F of the Law.

Ergon Energy has drawn upon the discussion in the Expert Panel's report to form the following views on the way in which the form of regulation factors should be applied.

The presence and extent of any barriers to entry in a market for electricity network services – section 2F(a) of the Law.

Ergon Energy interprets this clause to mean that a distribution service should be subject to a direct control form of regulation, and should therefore be classified as a direct control service, if the DNSP:

- Has a natural monopoly in the supply of that service;
- Has substantial market power in the supply of that service, which Ergon Energy interprets to mean that the DNSP has more than 40%⁴⁵ of the market share for the service;
- Has a monopoly based in legislation so that no other party can be authorised to provide the service; and
- There are other significant legislative barriers that prevent other parties from providing the service.

The presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a network service provider and any other electricity network service provided by the network service provider – section 2F(b) of the Law.

⁴³ Expert Panel, "Report to the Ministerial Council on Energy", April 2006, page 47.

⁴⁴ Ibid, page 47.

⁴⁵ 40% is the level QCA adopted in its September 2000 Final Determination "Electricity Distribution: Determination of Prescribed Services", page 15.

The presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a network service provider and any other service provided by the network service provider in any other market – section 2F(c) of the Law.

Ergon Energy interprets the network externality to be the benefit that is attributed to the other service from the provision of the primary service. For Ergon Energy, this benefit may arise from operational and economic efficiencies (interdependencies) which by default results in the other service attracting lower costs, enabling the other service to be provided at a lower price.

Ergon Energy interprets these clauses to mean that a distribution service should be subject to a direct control form of regulation, and should therefore be classified as a direct control service, if:

- The network services that the DNSP offers through its shared network give it a material advantage in the provision of other distribution services and thereby limit competition in the market for these other distribution services;
- The non-network services that the DNSP offers give it a material advantage in the provision of distribution services and thereby limit competition in the market for these distribution services; and
- It is difficult to quantify the incremental and stand alone costs and benefits for users of providing the services.

These factors can each create additional barriers to new entrant suppliers of distribution services that may prevent them competing against the DNSP.

The extent to which any market power possessed by a network service provider is, or is likely to be, mitigated by any countervailing market power possessed by a network service user or prospective network service user – section 2F(d) of the Law.

Ergon Energy interprets this clause to mean that a distribution service should be subject to a direct control form of regulation, and should therefore be classified as a direct control service, if:

- There are no large or concentrated groups of customers that have substantial power in negotiating the terms and conditions of supply, including prices, with the DNSP in relation to a service;
- Customers generally do not have a credible ability to by-pass or avoid the provision of the service being provided by the DNSP. This means that customers cannot fulfil their needs in any other way than acquiring the service from the DNSP; and
- The characteristics of the assets that are used to supply the service, and the customer base, are such that there is a low potential for full or partial asset stranding from reduced demand for that service.

The presence and extent of any substitute, and the elasticity of demand, in a market for an electricity network service in which a network service provider provides that service – section 2F(e) of the Law.

The presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be) – section 2F(f) of the Law.

Ergon Energy interprets these clauses to mean that a distribution service should be subject to a direct control form of regulation, and should therefore be classified as a direct control service, if:

- Customers' demand for the service is relatively price inelastic (i.e. demand does not fall significantly as the price increases);
- There is limited scope for demand side management as a means of reducing the customer's total cost of acquiring the service;
- The service being acquired is not a product of choice for the customer; and
- Customers do not have options for sourcing the service from a supplier other than the DNSP.

The extent to which there is information available to a prospective network service user or network service user, and whether that information is adequate, to enable the prospective network service user or network service user to negotiate on an informed basis with a network service provider for the provision of an electricity network service to them by the network service provider – section 2F(g) of the Law.

Ergon Energy interprets this clause to mean that a distribution service should be subject to a direct control form of regulation, and should therefore be classified as a direct control service, if the DNSP's knowledge of its costs, services, infrastructure and market creates a substantial negotiating power imbalance in dealing with customers. As a direct control service, the regulatory framework requires significant disclosure of costs to the market, which addresses any information asymmetry.

7.3 Application of clause 6.2.1 criteria

7.3.1 Network Services

Ergon Energy proposes that Network Services satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.1 of this proposal, Ergon Energy's legislative monopoly to provide network services is specified in:

- The conditions of its distribution authority issued under the *Electricity Act 1994*;
- The *Electricity Act 1994* section 42 which requires "a distribution entity to operate, maintain (including repair and replace as necessary) and protect its supply network to ensure the adequate, economic, reliable and safe connection and supply of electricity to its customers";
- The *Electricity Act 1994* section 44 which states that ".....it is a condition of a distribution authority that the entity must provide, as far as technically and economically practicable, network services, on fair and reasonable terms, for persons authorised to connect supply of electricity to the network or take electricity from the network";
- The *Electricity Act 1994* section 230 which provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works"; and

- The *Electrical Safety Act 2002* section 29 which places specific obligations on Ergon Energy to ensure that its works are electrically safe and operated in a way that is electrically safe.

In reference to the form of regulation factors, Ergon Energy believes that network services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide network services within its existing supply area. The *Electricity Act 1994* would need to be amended for competition to occur;
- Network externalities arising from the difficulty in quantifying the incremental and stand alone costs and benefits for users of Ergon Energy providing network services. This is because these services involve the use of a shared network;
- No customers with counter-veiling market power given that:
 - No customers have substantial power in negotiating the terms and conditions of supply with Ergon Energy;
 - Customers generally do not have a credible ability to by-pass or avoid the provision of the service once connected to the network; and
 - There is generally low potential for full or partial asset stranding from reduced demand for network services given the distributed connection nature of the supply network;
- Very limited competitive or substitution possibilities given that:
 - Customers' demand for the service is price inelastic – without a direct control form of regulation Ergon Energy could potentially increase prices without impacting significantly on customer demand; and
 - Customers are unable to entirely substitute network services with another service that effectively meets their needs. This means that customers have no choice but to purchase network services from Ergon Energy;
- Ergon Energy considers that significant information asymmetries may exist between Ergon Energy's and its customers that would create a sufficient imbalance in negotiating the supply of network services.

The network externalities criteria have not been applied as network services is the predominant service provided by Ergon Energy. For this criteria to be meaningful, the predominant service is a regulated service, and therefore no network externalities exist in relation to network services.

The proposal to classify network services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's network services as regulated Prescribed Distribution Services; and
- The form of regulation for network services in other jurisdictions (NSW, the ACT, Victoria and South Australia) where they are universally subjected to direct controls.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying network services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.2 Connection Services

Ergon Energy proposes that Connection Services satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.2 of this proposal, Ergon Energy's legislative obligation to provide connection services is specified by the following:

- Ergon Energy is the nominated Responsible Person for Type 5 to 7 metering installations in its supply area in accordance with Chapter 7 of the Rules;
- The *Electricity Act 1994* imposes a legislative obligation on Ergon Energy to provide its other connection services:
 - Section 40 sets out the circumstances in which a customer who owns or occupies premises may apply to Ergon Energy for the provision of connection services. Section 40A of the *Electricity Act 1994* imposes a "connection obligation" on Ergon Energy to provide customer connection services that have been applied for to the premises, subject to certain qualifications that are detailed in sections 40C and 40D;
 - Section 42 requires "a distribution entity to operate, maintain (including repair and replace as necessary) and protect its supply network to ensure the adequate, economic, reliable and safe connection and supply of electricity to its customers". This imposes an obligation on Ergon Energy to provide connection services;
 - Section 43 states that "...it is also a condition of a distribution authority that the distribution entity must allow as far as technically and economically practicable for the distribution entity, a person to connect supply to its supply network, or to take electricity from its supply network, on fair and reasonable terms...";
 - Section 230 provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works";
 - Section 232 provides that "A person must not unlawfully connect or disconnect supply electricity to a customer or interfere with supply of electricity to a customer"; and
- The *Electrical Safety Regulation 2002* (various sections⁴⁶) places specific obligations on Ergon Energy with respect to the electrical safety of connections and reconnections, including responsibilities for service lines.

In reference to the form of regulation factors, Ergon Energy believes that connection services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide connection services within its existing supply area. The *Electricity Act 1994* would need to be amended for another party to energise connection assets

⁴⁶ *Electrical Safety Regulation 2002* sections 72, 74, 75, 143, 146, 147, 151, 152, 163, 205 and 208.

and the Rules would need to be amended to enable another party to be the Responsible Person for Type 5 to 7 metering installations;

- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide connection services to customers. Specifically, Ergon Energy can use the same assets, labour and materials to provide connection and network services;
- Limited opportunities for customers to exert counter-veiling market power because, even though other parties can build un-energised connection assets, only Ergon Energy can connect assets to the distribution network. This means that:
 - No customers have substantial power in negotiating the terms and conditions of connection with Ergon Energy; and
 - Customers must be connected to the network by Ergon Energy in order to receive supply;
- Very limited competitive or substitution possibilities for connection services given that it is an offence for any other party than Ergon Energy to connect unenergised connection assets to Ergon Energy's distribution network.

Ergon Energy does not consider that significant information asymmetries exist given that there is information available in the market about the costs of new connections. Ergon Energy considers that this would not outweigh the above assessment against the other form of regulation factors.

The proposal to classify connection services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's connection services as regulated Prescribed Distribution Services; and
- The classification of connection services in Victoria, South Australia and the ACT where these service are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying connection services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.3 Customer Services

Ergon Energy proposes that Customer Services satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.3 of this proposal, Ergon Energy has a monopoly obligation to provide customer services for the benefit of both customers (i.e. network users) and retailers.

In reference to the form of regulation factors, Ergon Energy believes that customer services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide customer services within its existing supply area:

- Section 230 of the Electricity Act 1994 provides that “A person must not wilfully and unlawfully interfere with an electricity entity’s works”;
- The Electricity Act 1994 would need to be amended for another party to provide services using Ergon Energy’s assets; and
- The Rules would need to be amended to allow another party to be the Responsible Person for Type 5 to 7 metering installations;
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide customer services. Specifically, Ergon Energy can use the same assets, labour and materials to provide customer and network services;
- No real opportunities for network users or retailers to exert counter-veiling market power because customer services involve either one-off, or recurrent but infrequent, interactions that only Ergon Energy can provide given the legislative restrictions on other suppliers. Opportunities are further limited because, for Ergon Energy, these services are:
 - High volume;
 - Provided at a relatively low cost; and
 - Charged as part of the standard network tariff, rather than through a customer-specific charge.

This means that, in a practical sense, Ergon Energy does not negotiate with network users or retailers in the provision of these services; and

- No real competitive or substitution possibilities for customer services given that it is an offence for any other party than Ergon Energy to interfere with Ergon Energy’s distribution network.

Ergon Energy considers that significant information asymmetries may exist. The majority of customer services are provided without the network user’s or retailer’s express request (e.g. a scheduled meter read) and the remaining services are not negotiated with customers. In any event, all customer services can only be provided by Ergon Energy under the current legislative framework.

The proposal to classify customer services as direct control services is consistent with:

- The QCA’s current treatment of Ergon Energy’s customer services as regulated Prescribed Distribution Services; and
- Ergon Energy’s understanding of the treatment of customer services in other NEM jurisdictions.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying customer services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.4 De-energisations and re-energisations

Ergon Energy proposes that De-energisations and Re-energisations satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.4 of this proposal, Ergon Energy has a monopoly obligation to provide de-energisations and re-energisations because they relate to works on Ergon Energy's assets. This is because section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

In reference to the form of regulation factors, Ergon Energy believes that de-energisations and re-energisations should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide de-energisations and re-energisations within its existing supply area given the existing provisions of the *Electricity Act 1994*, the *Electricity Regulation 2006*, the Queensland Electricity Industry Code, the Standard Connection Contract, the *Electrical Safety Act 2002*, the *Electrical Safety Regulation 2002* and the "B2B Procedure – Service Order Process";
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide de-energisations and re-energisations. Specifically, Ergon Energy can use the same assets, labour and materials to provide de-energisations and re-energisations and network services;
- No real opportunities for customers to exert counter-veiling market power in relation to de-energisations and re-energisations given that:
 - Customers do not always initiate the service – de-energisations and re-energisations can be initiated by a retailer, a DNSP or a customer;
 - Customers generally do not request more than one service at a time nor can requests readily be aggregated; and
 - These services are high volume and individually relatively low cost to provide.

This means that, in a practical sense, Ergon Energy does not negotiate with customers and retailers in the provision of these services; and

- No real competitive or substitution possibilities for de-energisations and re-energisations given that it is an offence for any other party than Ergon Energy to interfere with Ergon Energy's distribution network.

Ergon Energy considers that significant information asymmetries may exist as these services can be initiated by a retailer or Ergon Energy without the customer's express request (e.g. a disconnection for debt).

The proposal to classify de-energisations and re-energisations as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's de-energisations and re-energisations as regulated excluded distribution services; and

- Other NEM jurisdictions where de-energisations and re-energisations are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying de-energisations and re-energisations under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.5 Additions and alterations

Ergon Energy proposes that Additions and Alterations satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.5 of this proposal, Ergon Energy has a monopoly obligation to provide additions and alterations because they relate to works on Ergon Energy's assets. This is because section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

In reference to the form of regulation factors, Ergon Energy believes that additions and alterations should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide additions and alterations within its existing supply area given the existing provisions of the *Electricity Act 1994*, the *Electricity Regulation 2006*, the Queensland Electricity Industry Code, the Standard Connection Contract, the *Electrical Safety Act 2002*, the *Electrical Safety Regulation 2002* and the "B2B Procedure – Service Order Process";
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide additions and alterations. Specifically, Ergon Energy can use the same assets, labour and materials to provide additions and alterations and network services;
- No real opportunities for customers to exert counter-veiling market power in relation to additions and alterations given that:
 - Customers do not always initiate the service – different additions and alterations can be initiated by a retailer, a DNSP or a customer;
 - Customers generally do not request more than one service at a time nor can requests readily be aggregated; and
 - These services are sought infrequently by customers and are individually relatively low cost to provide.

This means that, in a practical sense, Ergon Energy does not negotiate with customers in the provision of these services; and

- No real competitive or substitution possibilities for additions and alterations given that it is an offence for any other party than Ergon Energy to interfere with Ergon Energy's distribution network.

Ergon Energy considers that significant information asymmetries may exist given that there is little information available in the market about additions and alterations. Individual customers have limited capacity or incentive to investigate alternative arrangements, because they individually avail themselves of the service only on an infrequent basis.

The proposal to classify additions and alterations as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's additions and alterations as regulated excluded distribution services; and
- Other NEM jurisdictions where additions and alterations are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying additions and alterations under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.6 Ancillary metering services

Ergon Energy proposes that Ancillary Metering Services satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.6 of this proposal, Ergon Energy has a monopoly obligation to provide ancillary metering services because:

- These services relate to works on Ergon Energy's assets. As noted above, section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works"; and
- It is the nominated Responsible Person (and Metering Provider and Metering Data Provider) for Types 5 to 7 metering installations, which means that no other person can provide services in relation to these metering assets.

In reference to the form of regulation factors, Ergon Energy believes that ancillary metering services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide ancillary metering services within its existing supply area given the existing provisions of the Rules, the Queensland Electricity Industry Code, the NEM Metrology Procedure, the "B2B Procedure – Service Order Process" and the "B2B Procedure – Meter Data Process";
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide ancillary metering services. Specifically, Ergon Energy can use the same assets, labour and materials to provide ancillary metering services and network services;
- No real opportunities for customers to exert counter-veiling market power in relation to ancillary metering services given that:
 - Customers do not always initiate the service – different ancillary metering services can be initiated by a retailer, a DNSP or a customer;

- Customers generally do not request more than one service at a time nor can requests readily be aggregated; and
- These services are sought infrequently by customers and are individually relatively low cost to provide.

This means that, in a practical sense, Ergon Energy does not negotiate with customers or retailers in the provision of these services; and

- No real competitive or substitution possibilities for ancillary metering services given that Ergon Energy has regulated monopoly obligations to provide these services and it is an offence for any other party than Ergon Energy to interfere with Ergon Energy's distribution network, including its metering.

Ergon Energy considers that significant information asymmetries may exist given that there is little information available in the market about ancillary metering services. Individual customers have limited capacity or incentive to investigate alternative arrangements, because they individually avail themselves of the service only on an infrequent basis.

The proposal to classify ancillary metering services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's ancillary metering services as regulated excluded distribution services; and
- Other NEM jurisdictions where ancillary metering services are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying ancillary metering services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.7 Supplementary services

Ergon Energy proposes that Supplementary Services satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.7 of this proposal, supplementary services are services that are provided by Ergon Energy in the event that it cannot perform certain customer and connection services due to the customer's action or inaction or where the customer is at fault.

In reference to the form of regulation factors, Ergon Energy believes that supplementary services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide customer services, as was discussed in section 7.3.3, and supplementary services are derivatives of these services;
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide supplementary services. Specifically, Ergon Energy can use the same assets, labour and materials to provide supplementary and network services;

- No real opportunities for customers to exert counter-veiling market power because supplementary services are derivatives of customer services which are high volume and can be provided at a relatively low cost. This means that, in a practical sense, Ergon Energy does not negotiate with customers in the provision of supplementary services; and
- No real competitive or substitution possibilities for supplementary services given that no party can provide these services other than Ergon Energy.

Ergon Energy considers that significant information asymmetries may exist. The majority of supplementary services are provided without the customer's express request (e.g. a charge for a wasted truck visit) and are not consulted with customers.

The proposal to classify supplementary services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's supplementary services as regulated excluded distribution services; and
- Other NEM jurisdictions where supplementary services are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying supplementary services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.8 Enhanced services

Ergon Energy proposes that Enhanced Services satisfy the criteria in the Rules to be classified as a direct control service.

As noted in section 6.1.8 of this proposal, enhanced services are services that relate to the provision of connection services and customer services:

- At a higher standard than the minimum regulatory requirements; or
- Through a non-standard process at the customer's or retailer's request.

In reference to the form of regulation factors, Ergon Energy believes that enhanced services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide connection services, customer services and network services, as was discussed in sections 7.3.2 and 7.3.3. Supplementary services are simply variations of these services provided at a higher standard or through a non-standard process;
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide enhanced services. Specifically, Ergon Energy can use the same assets, labour and materials to provide enhanced and network services;

- No real opportunities for customers to exert counter-veiling market power because, even though customers can define the alternative standard of, and process for delivering, the service will still be delivered via Ergon Energy's network. This means that only Ergon Energy can provide these services and therefore, in a practical sense, it does not negotiate with customers in the provision of enhanced services; and
- No real competitive or substitution possibilities for enhanced services given that no party can provide these services other than Ergon Energy.

Ergon Energy considers that significant information asymmetries may exist as customers are not in a position to assess the incremental cost of providing enhanced services compared with 'standard' connection services and 'standard' customer services.

The proposal to classify enhanced services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's enhanced services. These services are classified as excluded distribution services; and
- Other NEM jurisdictions where enhanced services are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying enhanced services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.9 Quoted services

Ergon Energy proposes that Quoted Services satisfy the criteria in the Rules to be classified as a direct control service.

Quoted services are services for which Ergon Energy must make an assessment of the works required before the service can be delivered in order to determine the cost associated with its delivery, and therefore the price that is to be charged.

As noted in section 6.1.9 of this proposal, Ergon Energy has a monopoly obligation to provide quoted services because they relate to works on Ergon Energy's assets. This is because section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

In reference to the form of regulation factors, Ergon Energy believes that quoted services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide quoted services within its existing supply area given Ergon Energy's role as the distribution authority holder for 97% of Queensland and the existing provisions of the *Electricity Act 1994*;
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide quoted services. Specifically, Ergon Energy can use the same assets, labour and materials to provide quoted services and network services;

- No real opportunities for customers to exert counter-veiling market power because, even though customers can define the nature of the service that is required, the service will still be delivered by Ergon Energy using its assets and will be in relation to its distribution network. This means that only Ergon Energy can provide these services and therefore, in a practical sense, it does not negotiate with customers in the provision of quoted services; and
- No real competitive or substitution possibilities for quoted services given that it is an offence for any other party than Ergon Energy to interfere with Ergon Energy's distribution network.

Ergon Energy considers that significant information asymmetries may exist given that there is little information available in the market about quoted services. Individual customers have limited capacity or incentive to investigate alternative arrangements, because they individually avail themselves of the service only on an infrequent basis.

The proposal to classify quoted services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's quoted services as regulated excluded distribution services; and
- Other NEM jurisdictions where quoted services are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying quoted services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.10 Temporary supply services

Ergon Energy proposes that Temporary Supply Services satisfy the criteria in the Rules to be classified as a direct control service.

Temporary supply services are sought by customers that require a temporary connection to Ergon Energy's network. These temporary connections can be metered or unmetered.

Under the *Electricity Act 1994*, Ergon Energy has a legislative monopoly obligation to provide temporary supply services:

- Section 40 sets out the circumstances in which a customer who owns or occupies premises may apply to Ergon Energy for the provision of connection services. Section 40A of the *Electricity Act 1994* imposes a "connection obligation" on Ergon Energy to provide customer connection services, that have been applied for, to the premises, subject to certain qualifications that are detailed in sections 40C and 40D; and
- Section 230 provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

In reference to the form of regulation factors, Ergon Energy believes that temporary supply services should be classified as direct control services based on the existence of:

- High barriers to a new entrant competing with Ergon Energy to provide unmetered and temporary supply services within its existing supply area. The *Electricity Act 1994* would need to be amended for another party to energise these assets;
- Network externalities given that Ergon Energy can use factors of production that relate to its shared network to provide unmetered and temporary supply services to customers. Specifically, Ergon Energy can use the same assets, labour and materials to provide unmetered and temporary supply services and network services;
- Limited opportunities for customers to exert counter-veiling market power because only Ergon Energy can connect assets to the distribution network. Moreover, individual customers have no real negotiating power because the NEM Metrology Procedure and the Queensland Government's Gazette (for fixing retail prices) set the rules for these services; and
- Very limited competitive or substitution possibilities for temporary supply services given that it is an offence for any other party than Ergon Energy to connect assets to Ergon Energy's distribution network.

Ergon Energy considers that significant information asymmetries may exist given that there is little information available in the market about unmetered and temporary supply services. Individual customers also have limited capacity or incentive to familiarise themselves with Ergon Energy's underlying cost structure because these services are relatively low cost and infrequently demanded.

The proposal to classify temporary unmetered services as direct control services is consistent with:

- The QCA's current treatment of Ergon Energy's unmetered and temporary supply services as regulated excluded distribution services; and
- The classification of unmetered and temporary supply services in the other NEM jurisdictions where these services are treated as regulated services.

Ergon Energy does not consider there to be any other relevant factors that need to be considered in classifying temporary unmetered services under clause 6.2.1(c) of the Rules.

Ergon Energy also considers that, as there is not a different classification proposed, clause 6.2.1(d) of the Rules has been addressed.

7.3.11 Conclusion

On the basis of the above assessment against the criteria in clause 6.2.1(c) of the Rules, Ergon Energy considers that all of its ten distribution services set out in section 6.1 of this proposal should be classified as direct control services. None of its distribution services should be classified as negotiated distribution services.

8 Proposed Classification between Standard Control and Alternative Control Services

This section classifies Ergon Energy's ten direct control services described in section 6, and analysed in section 7, as either standard control services or alternative control services on the basis of the criteria in clause 6.2.2(c) of the Rules.

8.1 Requirements of the Rules

Clause 6.2.2(a) of the Rules requires that direct control services be classified as either standard control services or alternative control services and clause 6.2.2(b) of the Rules allows a DNSP's services to be grouped together for the purposes of classification.

Clause 6.2.2(c) of the Rules sets out the following matters that the AER must have regard for in classifying services between standard and alternative control services:

- (1) *the potential for development of competition in the relevant market and how the classification might influence that potential; and*
- (2) *the possible effects of the classification on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and*
- (3) *the regulatory approach (if any) applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made; and*
- (4) *the desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction); and*
- (5) *the extent the costs of providing the relevant service are directly attributable to the customer to whom the service is provided; and*
- (6) *any other relevant factor.*

8.2 Interpreting the criteria in Clause 6.2.2(c)

The Rules do not provide clear guidance on the way in which the criteria set out in clause 6.2.2(c) of the Rules should be applied in classifying direct control services. In particular, the Rules do not indicate which service classification should be adopted once the service has been assessed against the criteria.

For clarity, Ergon Energy has set out below its interpretation as to when a service should be classified as a standard control service or an alternative control service based on the criteria in clause 6.2.2(c) of the Rules.

The potential for development of competition in the relevant market and how the classification might influence that potential – clause 6.2.2(c)(1) of the Rules

Ergon Energy interprets this to mean that a direct control service should be classified as a standard control service if:

- There is no potential for the development of competition in the market for that service or, even if a competitor was to enter, the DNSP would inevitably retain a very dominant position in the market; or

- The classification of the service as a standard control service could result in the DNSP offering the service on a basis that could prevent a potential competitor entering the market for that service.

The possible effects of the classification on administrative costs of the AER, the Distribution Network Service Provider and users or potential users – clause 6.2.2(c)(2) of the Rules

Ergon Energy interprets this to mean that a direct control service should be classified as a standard control service if the administrative costs of being classified as an alternative control service exceed the administrative costs of being classified as a standard control service, having regard for the assessment against the other criteria in clause 6.2.2(c) of the Rules.

The regulatory approach (if any) applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made – clause 6.2.2(c)(3) of the Rules

Ergon Energy interprets this to mean that a direct control service should be classified as a standard control service if the service was previously classified for the DNSP as a prescribed distribution service, the basis of that classification was consistent with the criteria in clause 6.2.2(c) of the Rules, and if the market for that service has not materially changed.

Ergon Energy submits that, if the criteria used for the classification under the previous regulatory regime conflicts with the criteria in clause 6.2.2(c) of the Rules, then less emphasis should be placed on the previous regulatory approach for the service.

The desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction) – clause 6.2.2(c)(4) of the Rules

Ergon Energy interprets this to mean that a direct control service should be classified as a standard control service if the service is currently classified as a prescribed distribution service in Queensland or other jurisdictions and:

- The basis of that classification was consistent with the criteria in clause 6.2.2(c) of the Rules; and
- The underlying legislative framework for the service, and the nature of the market in which the service is provided, are sufficiently similar to enable a meaningful comparison to be made.

Ergon Energy submits that, if the service was classified elsewhere using criteria that conflicts with the criteria in clause 6.2.2(c) of the Rules, or the nature of the legislative framework or market is not similar to Ergon Energy's, then less emphasis should be placed on the desirability of a consistent regulatory approach.

The extent the costs of providing the relevant service are directly attributable to the customer to whom the service is provided – clause 6.2.2(c)(5) of the Rules

Ergon Energy interprets this to mean that a direct control service should be classified as an alternative control service if, other things being equal, all of the costs of providing that service are directly attributable to the individual customer that is being charged for the service.

This means that a service should be classified as a standard control service if, other things being equal, the costs involve allocations of costs.

Any other relevant factor – clause 6.2.2(c)(1) of the Rules.

Ergon Energy does not believe that there are any other relevant factors that need to be taken into account by the AER in determining the classification of direct control services into standard control and alternative control services.

8.3 Application of clause 6.2.2(c) criteria

8.3.1 Network Services

Ergon Energy proposes that Network Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.1 of this proposal, Ergon Energy has legislative monopoly obligations to provide network services as specified in the *Electricity Act 1994*:

- Section 44 states that “.....it is a condition of a distribution authority that the entity must provide, as far as technically and economically practicable, network services, on fair and reasonable terms, for persons authorised to connect supply of electricity to the network or take electricity from the network”; and
- Section 230 provides that “A person must not wilfully and unlawfully interfere with an electricity entity’s works”.

Ergon Energy believes that network services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994* would need to be amended in order for any other party than Ergon Energy to provide these services;
- The classification of Ergon Energy’s network services as a standard control service would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;
- Classifying network services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- This is consistent with the QCA’s current treatment of Ergon Energy’s network services as prescribed distribution services;

- This is consistent with the classification of network services in NSW, Victoria, South Australia and the ACT, where these services are universally currently classified as prescribed distribution services;⁴⁷ and
- The costs of providing network services are not directly attributable to individual customers, and involve extensive allocations of costs for pricing purposes. This means the basis for the calculation does not reflect the precise costs of any particular customer. Network prices are instead based upon the characteristics of groups of users at a general level.

8.3.2 Connection Services

Ergon Energy proposes that Connection Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.2 of this proposal, Ergon Energy has legislative obligations as set out below to provide connection services:

- Ergon Energy is the nominated Responsible Person for Type 5 to 7 metering installations in its supply area in accordance with Chapter 7 of the Rules; and
- The *Electricity Act 1994* imposes legislative obligations on Ergon Energy to provide its other connection services:
 - Section 40 sets out the circumstances in which a customer who owns or occupies premises may apply to Ergon Energy for the provision of connection services. Section 40A of the *Electricity Act 1994* imposes a “connection obligation” on Ergon Energy to provide customer connection services, that have been applied for, to the premises, subject to certain qualifications that are detailed in sections 40C and 40D; and
 - Section 230 provides that “A person must not wilfully and unlawfully interfere with an electricity entity’s works”.

Ergon Energy believes that connection services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994* would need to be amended in order for any other party than Ergon Energy to provide these services;
- The classification of Ergon Energy’s connection services as a standard control service would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;
- Classifying connection services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of

⁴⁷ Prescribed services have been mapped as standard control services under the transitional provisions for NSW and ACT.

the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;

- This is consistent with the QCA's current treatment of Ergon Energy's connection services as prescribed distribution services where initial connections have always been charged for as part of the network tariff, rather than through a customer-specific charge;
- This is consistent with the classification of connection services in the ACT, however is inconsistent with the approach in NSW⁴⁸, Victoria⁴⁹, and South Australia⁵⁰ where connection services are classified as excluded distribution services. This inconsistency results from the existence of legislative prohibitions on third parties undertaking these services in Queensland under section 230 of the *Electricity Act 1994*; and
- The total costs of providing the majority of connection services cannot be directly attributed to individual customers and are therefore determined through a cost allocation process.

8.3.3 Customer Services

Ergon Energy proposes that Customer Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.3 of this proposal, Ergon Energy has a monopoly obligation to provide customer services.

Ergon Energy believes that customer services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994* would need to be amended in order for any other party than Ergon Energy to provide these services;
- The classification of Ergon Energy's customer services as a standard control service would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;
- Classifying customer services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;

⁴⁸ <http://www.ipart.nsw.gov.au/files/op-23.pdf> , page 23

⁴⁹ <http://www.esc.vic.gov.au/NR/rdonlyres/AF67E65E-9F47-4139-9702-58471B03A9DD/0/FinalDecisionVolume1StatementPurposeOct05.pdf>

⁵⁰ http://www.escosa.sa.gov.au/webdata/resources/files/050405-EDPD_Part_A_StatementofReasons_Final.pdf, page 26

- This is consistent with the QCA's current treatment of Ergon Energy's customer services as prescribed distribution services where the cost of maintaining the customer's connection to the network has always been charged for as part of the network tariff, rather than through a customer specific charge;
- This is consistent with the classification of customer services in NSW, Victoria, South Australia and the ACT, where these services are currently universally classified as prescribed distribution services where the cost of maintaining the customer's connection to the network is included as part of the network tariff, rather than through a customer specific charge; and
- The costs of providing customer services are not all directly attributable to all individual customers and are largely determined through a cost allocation process.

8.3.4 De-energisations and re-energisations

Ergon Energy proposes that De-energisation and Re-energisation satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.4 of this proposal, Ergon Energy has a monopoly obligation to provide de-energisations and re-energisations.

Ergon Energy believes that de-energisations and re-energisations should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994*, *Electrical Safety Act 2002* and *Electricity Safety Regulation 2002* would need to be amended in order for any other party than Ergon Energy to provide these services;
- The classification of Ergon Energy's de-energisations and re-energisations as standard control services would not, of itself, impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;
- Classifying de-energisations and re-energisations as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- Although this is inconsistent with the QCA's current treatment of Ergon Energy's de-energisations and re-energisations as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including de-energisations and re-energisations, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC.⁵¹ The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for de-energisations and re-energisations would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- This is consistent with the classification of de-energisations and re-energisations in NSW and the ACT, and re-energisations in South Australia, where these services are currently classified as prescribed distribution services. This is inconsistent with the approach in Victoria and South Australia (de-energisations only), where these services are classified as excluded distribution services; and
- The costs of providing network services are mainly directly attributable to customers, and involve limited allocations of costs for pricing purposes. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative changes would be required to enable competition.

8.3.5 Additions and alterations

Ergon Energy proposes that Additions and Alterations satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.5 of this proposal, Ergon Energy has a monopoly obligation to provide additions and alterations because they relate to works on Ergon Energy's assets. This is because section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

Ergon Energy believes that additions and alterations should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994* would need to be amended in order for any other party than Ergon Energy to provide these services;
- The classification of Ergon Energy's additions and alterations as a standard control service would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;
- Classifying additions and alterations as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER.

⁵¹ The commencement of FRC on 1 July 2007, mid-way through Ergon Energy's current regulatory period (2005-10), was not anticipated at the time the QCA fixed Ergon Energy's revenue cap in April 2005.

Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;

- Although this is inconsistent with the QCA's current treatment of Ergon Energy's additions and alterations as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including additions and alterations, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC. The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for additions and alterations would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- Although this is inconsistent with the classification of additions and alterations in NSW, Victoria, South Australia, this inconsistency results from the existence of legislative prohibitions on third parties undertaking these services in Queensland under section 230 of the *Electricity Act 1994*; and
- The costs of providing additions and alterations are mainly directly attributable to customers. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative changes would be required to enable competition.

8.3.6 Ancillary metering services

Ergon Energy proposes that Ancillary Metering Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.6 of this proposal, Ergon Energy has a monopoly obligation to provide ancillary metering services because:

- These services relate to works on Ergon Energy's assets and section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works"; and
- It is the nominated Responsible Person (and Metering Provider and Metering Data Provider) for Types 5 to 7 metering installations, which means that no other person can provide services in relation to these metering assets.

Ergon Energy believes that ancillary metering services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994* and the Rules would need to be amended in order for any other party than Ergon Energy to provide these services;

- The classification of Ergon Energy's ancillary metering services as a standard control service would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;
- Classifying ancillary metering services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- Although this is inconsistent with the QCA's current treatment of Ergon Energy's ancillary metering services as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including ancillary metering services, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC. The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for ancillary metering services would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- A review of the interstate treatment of ancillary metering services indicates that the services within this grouping are classified in a variety of ways within each jurisdiction.

While there is therefore no single regulatory approach to classifying these services across NEM jurisdictions, Ergon Energy understands that where the service can only be provided by the DNSP it is typically classified as a prescribed distribution service. Ergon Energy understands that the classifications were not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules; and

- The costs of providing ancillary metering services are mainly directly attributable to customers, and involve limited allocations of costs. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative and Rule changes would be required to enable competition.

8.3.7 Supplementary services

Ergon Energy proposes that Supplementary Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.7 of this proposal, supplementary services are services that are provided by Ergon Energy in the event that it cannot perform certain customer services due to the customer's action or inaction or where the customer is at fault.

Ergon Energy believes that supplementary services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. These services are derivative to the supply of network, connection and customer services, and can only be provided by Ergon Energy under the *Electricity Act 1994*;
- The classification of Ergon Energy's supplementary services as standard control services would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, these services cannot be provided by any other party than Ergon Energy;
- Classifying supplementary services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- Although this is inconsistent with the QCA's current treatment of Ergon Energy's supplementary services as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including supplementary services, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC. The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for supplementary services would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- This is consistent with other NEM jurisdictions where supplementary services are generally classified in the same manner as the related service. That is, where a service is supplementary to another prescribed distribution service then the supplementary service will also be classified as a prescribed distribution service; and

- The costs of providing supplementary services are mainly directly attributable to customers, and involve limited allocations of costs for pricing purposes. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative changes would be required in order to enable competition.

8.3.8 Enhanced services

Ergon Energy proposes that Enhanced Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.8 of this proposal, enhanced services are services that relate to the provision of connection services and customer services:

- At a higher standard than the minimum regulatory requirements; or
- Through a non-standard process at the customer's or retailer's request.

Ergon Energy believes that enhanced services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. These services are enhanced variations of connection and customer services, and can only be provided by Ergon Energy under the *Electricity Act 1994* and the Rules;
- The classification of Ergon Energy's enhanced services as standard control services would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, these services cannot be provided by any other party than Ergon Energy;
- Classifying enhanced services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- Although this is inconsistent with the QCA's current treatment of Ergon Energy's enhanced services as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including enhanced services, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC. The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for enhanced services would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- This is consistent with other NEM jurisdictions where enhanced services are generally classified in the same manner as the related base level of service. That is, where a service is an enhanced variation of a current prescribed distribution service, for example a more frequent meter read or a higher level of metering data than would otherwise have been provided, then the enhanced service would also be classified as a prescribed distribution service; and
- The costs of providing enhanced services are mainly directly attributable to customers, and involve limited allocations of costs. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative changes would be required in order to enable competition.

8.3.9 Quoted services

Ergon Energy proposes that Quoted Services satisfy the criteria in the Rules to be classified as a standard control service.

Quoted services are services for which Ergon Energy must make an assessment of the works required before the service can be delivered in order to determine the cost associated with its delivery, and therefore the price that is to be charged.

As noted in section 6.1.9 of this proposal, Ergon Energy has a monopoly obligation to provide quoted services because they relate to works on Ergon Energy's assets. This is because section 230 of the *Electricity Act 1994* provides that "A person must not wilfully and unlawfully interfere with an electricity entity's works".

Ergon Energy believes that quoted services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. Prices for these services cannot be set in advance as costs are determined by the customer's specific requirements. In all cases, quoted services can only be provided by Ergon Energy under the *Electricity Act 1994* and the Rules, and therefore are not competitive;
- The classification of Ergon Energy's quoted services as standard control services would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, these services relate to Ergon Energy's assets and Ergon Energy's distribution system, and therefore cannot be provided by a party other than Ergon Energy;
- Classifying quoted services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- Although this is inconsistent with the QCA's current treatment of Ergon Energy's quoted services as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including quoted services, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC. The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for quoted services would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- Although this is inconsistent with the current classification of quoted services in NSW, Victoria, and South Australia, where these services are classified as excluded, this inconsistency results from the existence of legislative prohibitions on third parties undertaking these services in these jurisdictions, as there is in Queensland under section 230 of the *Electricity Act 1994*; and
- The costs of providing quoted services are mainly directly attributable to customers, and involve limited allocations of costs. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative changes would be required in order to enable competition.

8.3.10 Temporary supply services

Ergon Energy proposes that Temporary Supply Services satisfy the criteria in the Rules to be classified as a standard control service.

As noted in section 6.1.10 of this proposal, Ergon Energy has legislative monopoly obligations to provide temporary supply services arising from the *Electricity Act 1994*:

- Section 40 sets out the circumstances in which a customer who owns or occupies premises may apply to Ergon Energy for the provision of connection services. Section 40A of the *Electricity Act 1994* imposes a “connection obligation” on Ergon Energy to provide customer connection services that have been applied for to the premises, subject to certain qualifications that are detailed in sections 40C and 40D; and
- Section 230 provides that “A person must not wilfully and unlawfully interfere with an electricity entity’s works”.

Ergon Energy believes that temporary supply services should be classified as standard control services because:

- There is neither competition nor the potential for the development of competition for these services. The *Electricity Act 1994* would need to be amended in order for any other party than Ergon Energy to provide these services;
- The classification of Ergon Energy’s temporary supply services as a standard control service would not impede a new entrant from providing these services in competition with Ergon Energy. Regardless of the service classification, without legislative amendments, these services cannot be provided by any other party than Ergon Energy;

- Classifying temporary supply services as standard control services will involve no significant change in administrative costs for Ergon Energy and the AER. Additional costs would be involved with classifying these services as alternative control services. Ergon Energy also considers that the benefits of the protection that standard control services provide to customers by virtue of the application of Part C of the Rules, exceed the costs that would be involved with changing to alternative control services;
- This is consistent with the QCA's current treatment of Ergon Energy's temporary supply services (such as mobile blood banks) as prescribed distribution services;
- Although this is inconsistent with the QCA's current treatment of Ergon Energy's temporary supply services as excluded distribution services, the QCA's classification decision was not made on the same basis as the criteria set out in clause 6.2.2(c) of the Rules.

Rather, the QCA deemed that non-DUOS services, including temporary supply services, are excluded on the basis that a contestable market cannot be demonstrated. This reclassification was implemented due to the expected increase in service volumes under FRC. The QCA considered that, if these services continued to be regulated under the revenue cap, the increased demand for temporary supply services would result in unintended cross-subsidisation of other prescribed distribution services.

As a result, Ergon Energy does not consider that the AER needs to have regard for the current classification of these services in deciding on the appropriate classification for the next regulatory control period;

- This is consistent with the classification of temporary supply services in NSW, Victoria and South Australia; and
- The costs of providing temporary supply services are mainly directly attributable to customers, and involve limited allocations of costs for pricing purposes. Ergon Energy considers that this would not outweigh the assessment against the other criteria given that Ergon Energy is the only party that can currently provide these services and that legislative changes would be required to enable competition.

8.3.11 Conclusion

On the basis of the above assessment against the criteria in clause 6.2.2(c) of the Rules, Ergon Energy considers that all ten of its direct control services set out in section 8.3 of this proposal should be classified as standard control services.

9 Proposed Control Mechanisms

This section sets out the control mechanism that Ergon Energy proposes to apply to its standard control services and alternative control services.

9.1 Requirements of the Rules

The Rules provide that, in deciding on a control mechanism for standard control services, the AER must have regard to the following requirements of clause 6.2.5(c) of the Rules:

- (1) *the need for efficient tariff structures; and*
- (2) *the possible effects of the control mechanism on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and*
- (3) *the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination; and*
- (4) *the desirability for consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and*
- (5) *Any other relevant factor.*

In deciding on a control mechanism for alternative control services, the AER must have regard to the following requirements of clause 6.2.5(d) of the Rules:

- (1) *the potential for development of competition in the relevant market and how the control mechanism might influence that potential; and*
- (2) *the possible effects of the control mechanism on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and*
- (3) *the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination; and*
- (4) *the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and*
- (5) *any other relevant factor.*

Clause 6.2.6 of the Rules goes on to state that:

- (a) *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 form, in accordance with Part C.*
- (b) *For alternative control services, the control mechanism must have a basis stated in the distribution determination.*
- (c) *The control mechanism for alternative control services may (but need not) utilise elements of Part C (with or without modification).*

9.2 Interpreting clause 6.2.5

Clause 11.16.6(a) of the Rules allows Ergon Energy to propose the control mechanism that will apply to its direct control services. Without this clause, the AER would publish the control mechanism(s) in its framework and approach paper in accordance with clause 6.8.1(c).

Ergon Energy has interpreted that the Rules do not apply any ranking to the possible control mechanisms and therefore the control mechanisms will be decided on the basis of appropriate regard for the matters detailed in clause 6.2.5(c) and 6.2.5(d).

Ergon Energy also believes that clause 6.2.5 of the Rules requires that, if a single control mechanism is proposed for all standard control services, then there is only a need for a single assessment of that control mechanism against the matters detailed in clause 6.2.5(c).

However, Ergon Energy considers that clause 6.2.5 is intended to allow more than one control mechanism to be applied to standard control services, demonstrated by the reference in clause 6.5.9(b)(3)(ii) of the Rules to “separate control mechanisms for different standard control services”.

If multiple control mechanisms are proposed then there is a need to assess the control mechanism that will apply to each group of standard control services against the matters detailed in clause 6.2.5(c).

As a result, the remainder of this section sets out the control mechanisms that Ergon Energy proposes for its direct control services and why it believes that these are appropriate given the matters detailed in clauses 6.2.5(c) and 6.2.5(d) of the Rules.

9.2.1 Proposed control mechanisms for standard control services

Ergon Energy proposes a combination of control mechanisms⁵² for standard control services:

- *Revenue Cap* – this will cover only Ergon Energy’s network services;
- *Weighted Average Price Cap* -
 - Tariff basket for Ergon Energy’s connection services and customer services; and
 - Tariff basket for all remaining standard control services for Ergon Energy.

These control mechanisms for standard control services are proposed to be applied as three caps based on the nature of the services with similar services having been grouped together, and the way in which charges will be developed and levied.

9.2.2 Interpreting clause 6.2.5(c) criteria

For clarity, Ergon Energy has set out below its interpretation of clause 6.2.5(c) of the Rules, which details the matters to be considered by the AER in deciding on a control mechanism for standard control services.

The need for efficient tariff structures – clause 6.2.5(c)(1) of the Rules

⁵² Rules section 6.2.5(b)(6) states “a combination of any of the above”.

Ergon Energy interprets this to mean that a proposed control mechanism is acceptable if it would not result in inefficient tariff structures. Ergon Energy proposes that efficient tariff structures:

- Promote the efficient use of the network and include appropriate signalling to users of their impact on existing and future network capacity and costs;
- Promote cost reflectivity, where the tariff for the service reflects the actual cost of providing the service; and
- Minimise cost averaging or cross-subsidy, where the services and costs can be attributed to users or groups of users based on utilisation or demand for the services.

The possible effects of the control mechanism on administrative costs of the AER, the Distribution Network Service Provider and users or potential users – clause 6.2.5(c)(2) of the Rules

Ergon Energy interprets this to mean that a proposed control mechanism is acceptable if the administrative costs of the mechanism are less than or comparative to the administrative costs of other mechanisms, which may include the existing mechanism, having regard for the assessment against the other criteria in clause 6.2.5(c) of the Rules.

The regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination – clause 6.2.5(c)(3) of the Rules

Ergon Energy interprets this to mean that, other things being equal, the AER will be predisposed to retaining the current revenue cap that applies to prescribed distribution services for standard control services in the next regulatory control period unless there is an appropriately clear reason to change control mechanisms.

The desirability for consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction) – clause 6.2.5(c)(4) of the Rules

Ergon Energy interprets this to mean that, other things being equal, the AER will be predisposed to aligning the control mechanisms that apply to Ergon Energy with that applied to equivalent services for other DNSPs in the NEM.

Any other relevant factor – clause 6.2.5(c)(5) of the Rules

The Electricity Distribution and Service Delivery Review (EDSD Report) resulted in a number of recommendations to ensure reliable networks for the 21st Century. In response to the EDSD report the Queensland Government, Ergon Energy, ENERGEX and the QCA developed an action plan for Queensland Electricity Distribution⁵³. This action plan is still being progressed.

Ergon Energy submits that the AER should consider the recommendations of the EDSD Report and the status of the Queensland Government's action plan in determining the control mechanisms that are to apply to standard control services.

⁵³ http://www.dme.qld.gov.au/zone_files/Electricity/action_plan.pdf

9.2.3 Interpreting clause 6.2.5(d) criteria

Ergon Energy does not propose having any alternative control services. However for clarity, Ergon Energy has set out below its interpretation of clause 6.2.5(d) of the Rules, which are the matters to be considered by the AER in deciding on a control mechanism for alternative control services.

The potential for development of competition in the relevant market and how the control mechanism might influence that potential – clause 6.2.5(d)(1) of the Rules

Ergon Energy interprets this to mean that a proposed control mechanism is acceptable if it would either:

- Assist to develop competition in the relevant market; or
- Not detract from other factors that may assist to develop competition in the relevant market.

The possible effects of the control mechanism on administrative costs of the AER, the Distribution Network Service Provider and users or potential users – clause 6.2.5(d)(2) of the Rules

Ergon Energy interprets this to mean that a proposed control mechanism is acceptable if the administrative costs of the mechanism do not exceed the benefits of changing the control mechanism, having regard for the assessment against the other criteria in clause 6.2.5(d) of the Rules.

The regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination – clause 6.2.5(d)(3) of the Rules

Alternative control services do not exist in the current regulatory control period. Therefore, Ergon Energy interprets this clause to mean that, other things being equal, the AER will be predisposed to retaining the current control mechanisms that apply to Ergon Energy's distribution services, being a revenue cap for prescribed distribution services and a variant of a schedule of fixed prices for excluded distribution services.

The desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction) – clause 6.2.5(d)(4) of the Rules

With the AER's recent decision under the transitional rules, the ACT and NSW are the only jurisdictions to have alternative control services.⁵⁴ Therefore, Ergon Energy interprets this clause to mean that, other things being equal, the AER will be predisposed to aligning the control mechanisms that apply to Ergon Energy's distribution services with those applied to equivalent services for other DNSPs in the NEM.

Any other relevant factor – clause 6.2.5(d)(5) of the Rules

Ergon Energy does not believe that there are any other relevant factors that need to be taken into account by the AER in determining the control mechanism that is to apply to alternative control services.

⁵⁴ Street lighting in NSW and metering in ACT were deemed under the transitional rules for ACT/NSW to be alternative control services.

9.3 Application of clause 6.2.5(c) criteria for standard control services

9.3.1 Justification of revenue cap for Network Services (Service 1)

Ergon Energy believes that a revenue cap is an appropriate control mechanism for its network services. Under a revenue cap, the AER would specify a cap on Ergon Energy's allowed revenue for each year of the regulatory control period.

The revenue that Ergon Energy would receive under this control mechanism is the actual tariff (and components of tariffs) escalated by the CPI-X mechanism, multiplied by the actual volume for that year. Revenue derived under this control mechanism is capped at the maximum allowable revenue.

The basic form of the revenue control is:

$$\sum_{i=1}^n \sum_{j=1}^m p_{ij}^{t+1} * q_{ij}^{t+1} \leq MAR^{t+1}$$

Where:

- "MAR" is the value of the revenue constraint (maximum allowable revenue);
- "p" are prices (dollars and cents);
- "q" are quantities (e.g. kWh delivered);
- "t" is the current year of the regulatory period;
- "i" denotes each tariff classification (e.g. residential) of a total "n" classifications; and
- "j" denotes tariff components (e.g. fixed monthly charge) of a total "m" components.

Ergon Energy believes that a revenue cap is an appropriate control mechanism for its network services on the basis of clause 6.2.5(c) of the Rules because:

- It is one of the control mechanisms that is allowed under clause 6.2.5(b)(3) of the Rules;
- Although applying a revenue cap will involve administrative costs for Ergon Energy and the AER, Ergon Energy considers that these costs are not greater than the administrative costs of other mechanisms. Ergon Energy also considers that the revenue cap control mechanism will provide revenue certainty that will ensure Ergon Energy can invest in necessary network infrastructure regardless of volume fluctuations;
- It would not result in inefficient tariff structures given that the revenue cap control mechanism allows the DNSP to propose individual tariffs in order to recover the revenue cap, subject to any specific side-constraints that may be imposed by the AER, including determining the split between fixed, demand and volume components of tariffs. Under a revenue cap, Ergon Energy would also be allowed to introduce new tariffs throughout the regulatory control period as required, subject to the AER's approval.

Ergon Energy also notes that its network tariffs have been approved by the QCA for the past two regulatory control periods on the basis that the pricing principles of cost reflectivity and efficiency have been met;

- It is consistent with the current control mechanism that is applied to network services, which is a fixed revenue cap. Ergon Energy considers that the concerns raised by the Independent Panel that undertook the review of “Electricity Distribution and Service Delivery for the 21st Century” (EDSD review) and the QCA about the forecasting risks inherent in a revenue cap control mechanism have been addressed through improved operational procedures. Ergon Energy believes it can now forecast its investment requirements with reasonable confidence. This means that there is no appropriately clear reason to change the current control mechanism that is applied to network services; and
- There is no one single form of control mechanism across all the NEM jurisdictions. The proposed revenue control is consistent with the control mechanism that has been used for network services in Tasmania and the ACT, but is inconsistent with that used in Victoria, NSW and South Australia.

When considered on an overall basis, Ergon Energy proposes the application of a revenue cap control mechanism for network services in the next regulatory control period.

It is also noted that there is a similarity between network services in distribution and transmission shared network. Revenue caps are the prescribed form of control mechanism for transmission network service providers. Ergon Energy’s proposal for a revenue cap for network services is therefore consistent with the transmission regulation framework.

9.3.2 Justification of weighted average price cap for Connection and Customer Services (Services 2 and 3)

Ergon Energy believes that a WAPC is an appropriate control mechanism for connection and customer services. Under a WAPC, also known as a tariff basket, a cap is placed on a weighted average of the prices of a basket of services, rather than the revenue received for the services.

Under a WAPC, the revenue derived by Ergon Energy would be the approved tariff (and tariff components) escalated by CPI-X, multiplied by the actual tariff for that year. The most common form of a WAPC is represented as:

$$\frac{\sum_{i=1}^n \sum_{j=1}^m p_{ij}^{t+1} * q_{ij}^{t-1}}{\sum_{i=1}^n \sum_{j=1}^m p_{ij}^t * q_{ij}^{t-1}} \leq (1 + CPI) - X$$

The left hand side of this constraint represents the ratio of prices weighted by quantity and the right hand side specifies the amount by which prices can move. Prices would therefore move by inflation minus an X factor determined by the AER.

Ergon Energy believes that a WAPC is an appropriate control mechanism for connection and customer services on the basis of clause 6.2.5(c) of the Rules because:

- It is the same as a “tariff basket price control”, which is one of the control mechanisms that is allowed under clause 6.2.5(b)(4) of the Rules;
- Although applying a WAPC will involve administrative costs for Ergon Energy and the AER, Ergon Energy considers that these costs are comparative to other mechanisms, including the existing mechanism of a Revenue Cap. Ergon Energy also considers that a WAPC control mechanism will provide additional benefits of tariff flexibility and the ability to deal with unexpected volume variations;
- It would not result in inefficient tariff structures because:
 - Subject to any side-constraints, the WAPC allows individual tariffs (and components of individual tariffs) to be rebalanced each year by more or less than the overall CPI-X constraint on the basis of variations in demand or customer numbers, provided that the average tariff is not escalated by more than CPI-X. This would allow Ergon Energy to ensure that tariffs remain efficient throughout a regulatory control period; and
 - Subject to the AER’s approval, the WAPC also allows new tariffs to be introduced during the revenue control period where variations in underlying customer demand or numbers are significant enough that the existing tariffs are no longer efficient. The conventional method for introducing new tariffs requires proxy historic data to be developed for new tariffs, and back casting of the previous year’s data for the purposes of estimating consumption. This method has been used extensively in Victoria and NSW;
- Although these services are currently subject to a revenue cap, Ergon Energy believes that a WAPC is more appropriate given the circumstances in which Ergon Energy operates and the services to which it will apply. This matter was considered by the Independent Panel in the ESDS review.

In relation to connection services, the Independent Panel found that *“In times of volatile load growth, the revenue cap approach has serious shortcomings because the facts on which the original submissions and determination are based can change significantly during the period. This results in the revenue cap being below what it should be”*.⁵⁵

In particular, the Independent Panel recommended that: *“Government and the QCA consider alternative arrangements for increasing ENERGEX and Ergon Energy’s investment certainty during a regulatory period, including but not limited to the possibility of mid-period re-openings, flexible revenue caps and rulings issued by the QCA in relation to new investments”*.⁵⁶

The application of a WAPC to connection services is consistent with this recommendation.

- It is consistent with the control mechanism that has been used for prescribed distribution services in Victoria and NSW, where a WAPC has been applied for

⁵⁵ Independent Panel, “Detailed Report of the Independent Panel - Electricity Distribution and Service Delivery for the 21st Century”, April 2004, page 9

⁵⁶ Ibid, page 57

the last two regulatory control periods. But is not consistent with Tasmania and the ACT where a revenue cap is applied.

On this basis, Ergon Energy proposes the application of a WAPC control mechanism for connection and customer services in the next regulatory control period.

9.3.3 Justification of weighted average price cap for all other Standard Control Services (Services 4-10)

Ergon Energy believes that a WAPC is an appropriate control mechanism for all other standard control services (services 4-10). Under a WAPC, also known as a tariff basket, a cap is placed on a weighted average of the prices of a basket of services, rather than the revenue received for the services.

Under a WAPC, the revenue derived by Ergon Energy would be the approved tariff (and tariff components) escalated by CPI-X, multiplied by the actual tariff for that year. The most common form of a WAPC is represented as:

$$\frac{\sum_{i=1}^n \sum_{j=1}^m p_{ij}^{t+1} * q_{ij}^{t-1}}{\sum_{i=1}^n \sum_{j=1}^m p_{ij}^t * q_{ij}^{t-1}} \leq (1 + CPI) - X$$

The left hand side of this constraint represents the ratio of prices weighted by quantity and the right hand side specifies the amount by which prices can move. Prices would therefore move by inflation minus an X factor determined by the AER.

Ergon Energy believes that a WAPC is an appropriate control mechanism for all other standard control services on the basis of clause 6.2.5(c) of the Rules because:

- It is the same as a “tariff basket price control”, which is one of the control mechanisms that is allowed under clause 6.2.5(b)(4) of the Rules;
- Although applying a WAPC will involve administrative costs for Ergon Energy and the AER, Ergon Energy considers that these costs are comparative to other mechanisms, including the existing mechanism of a variant of a schedule of prices. Ergon Energy also considers that the WAPC control mechanism will provide tariff flexibility and the ability to deal with unexpected volume variations that this control mechanism provides;
- It would not result in inefficient tariff structures because:
 - Subject to any side-constraints, the WAPC allows individual tariffs (and components of individual tariffs) to be rebalanced each year by more or less than the overall CPI-X constraint on the basis of variations in demand or customer numbers, provided that the average tariff is not escalated by more than CPI-X. This would allow Ergon Energy to ensure that tariffs remain efficient throughout a regulatory control period; and

- Subject to the AER's approval, the WAPC allows new tariffs to be introduced during the revenue control period where variations in underlying customer demand or numbers are significant enough that the existing tariffs are no longer efficient. The conventional method for introducing new tariffs requires proxy historic data to be developed for new tariffs, and back casting of the previous year's data for the purposes of estimating consumption. This method has been used extensively in Victoria and NSW;
- The application of a WAPC to these services is consistent with the QCA's 2007 decision to re-classify these services as excluded distribution services in order to apply a schedule of prices control mechanism rather than a revenue cap, to better accommodate volume variations and so avoid cross-subsidisation of other services; and
- It is consistent with the control mechanism that has been used for prescribed distribution services in Victoria and NSW, where a WAPC has been applied for the last two regulatory control periods.

On this basis, Ergon Energy proposes the application of a WAPC control mechanism for all other standard control services (services 4-10) in the next regulatory control period.

10 Summary of Ergon Energy's Classification of Services and Control Mechanisms

The following table summarises Ergon Energy's proposed classification of services and control mechanism for its distribution services on the basis of the outcomes detailed in sections 7 to 9 of this document.

Service Number	Service Title	Classification	Control Mechanism*
1	<p>Network Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Shared network assets Augmentation Shared network extensions for small network users Maintenance, vegetation clearing, asset inspection Delivery of energy to all connection points including Street Lighting & permanent unmetered supplies Network control systems and equipment 	Standard Control Services	Revenue Cap
2	<p>Connection Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Connection assets dedicated to network users including: <ul style="list-style-type: none"> - small users' service lines and meters (currently Types 5-7) and load control equipment - large users' dedicated lines, transformers and meters (if Types 5-7) NMI creation for new connections 	Standard Control Services	WAPC
3	<p>Customer Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Scheduled meter reading Final meter reading Meter removals Electrical installation & meter inspections, tampering investigations Inspection NMI Discovery and NMI maintenance 	Standard Control Services	WAPC
4	<p>De-energisations and Re-energisations</p> <p>Includes:</p> <ul style="list-style-type: none"> De-energisation by physical disconnection De-energisation at the fuse, meter, switchboard All re-energisation, including after debt 	Standard Control Services	WAPC
5	<p>Additions and Alterations</p> <p>Includes:</p> <ul style="list-style-type: none"> Moving meters Overhead service replacement Moving point of attachment Supply abolishment 	Standard Control Services	WAPC

Service Number	Service Title	Classification	Control Mechanism *
6	<p>Ancillary Metering Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Customer requested testing (Metering types 5-7) Changing tariffs, time switches MDP services (but not scheduled & final meter reading) Special meter reading (off-cycle) 	Standard Control Services	WAPC
7	<p>Supplementary Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Attend loss of supply Wasted truck visit Re-test fee Fees for subdivisions 	Standard Control Services	WAPC
8	<p>Enhanced Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Connection Services above minimum standards Customer Services above minimum standards 	Standard Control Services	WAPC
9	<p>Quoted Services</p> <p>Includes:</p> <ul style="list-style-type: none"> Temporary disconnection & reconnection Emergency recoverable works Conversion of aerial bundled cables Removal/relocation of assets at user's request Provision of a service crew Overhead to Underground conversion 	Standard Control Services	WAPC
10	<p>Temporary Supply Services (including Temporary Unmetered Supplies)</p> <p>Includes:</p> <ul style="list-style-type: none"> Metered temporary builders' supplies Unmetered temporary supplies 	Standard Control Services	WAPC

* It is considered that Services 1 – 3 will be recovered through network tariff and Services 4 – 10 will be recovered through fee for service. This advice is indicative only. Details on pricing methods will be included in the Pricing Proposal submitted with the Regulatory Proposal (to be lodged with the AER by 31 May 2009).

10.1 Mapping Existing (QCA) Regime to the new (AER) Regime

In summary, the mapping of existing services to the new arrangements in the Rules is proposed to be:

Existing Control Mechanism (QCA)	Existing Services (QCA)	Proposed Services Classification (AER)	Proposed Control Mechanism (AER)
Revenue Cap	Prescribed DUOS Services	Standard Control Services – Shared Network	Revenue Cap
		Standard Control Services – Connection Services & Customer Services	Weighted Average Price Cap
		Unregulated - Street Lighting Services	Unregulated
Schedule of Rates (for quoted) and Review of average prices (for non-quoted)	Previous - Prescribed Non-DUOS Services Now - Excluded Distribution Services	Standard Control Services – De-energisations/Re-energisations, Additions & Alterations, Ancillary Metering Services, Supplementary Services, Enhanced Services, Quoted Services and Temporary Supply Services.	Weighted Average Price Cap
N/A	Unregulated Activities	Unregulated Activities	N/A

The most significant changes from the existing arrangements are:

- Classification of excluded distribution services to standard control services;
- Changing from a revenue cap to a WAPC for connection services and customer services; and
- Changing from prescribed distribution services regulated under a revenue cap to unregulated activities for street light services.

These are discussed further below.

10.2 Classification of Excluded Distribution Services to Standard Control Services

The potential for development of competition is a key distinguishing feature between standard control services and alternative control services in the Rules. The same test was applied by the QCA for distinguishing between prescribed distribution services and excluded distribution services. If this test was applied and satisfied, it could be assumed that excluded distribution services would be classified as

alternative control services under the Rules⁵⁷, however the test for competition was not the deciding factor in the QCA's decision to classify some services as excluded distribution services.

When deciding on the classification for existing excluded distribution services, the QCA's first step was to determine if competition, or potential for competition, for these services existed. As noted in section 4.2.1, the QCA in December 2007 deemed the services to be excluded on the basis of clause 6.2.4(a) of the previous Rules. This allows the QCA to deem a service to be excluded and apply a "light handed" regulation where a contestable market cannot be demonstrated. This decision by the QCA suggests that competition, or potential for competition, for these services do not exist. Ergon Energy submits that the basis of the QCA's decision to exclude some distribution services means that these services should not be classified as alternative control services under the amended Rules.

Ergon Energy has reviewed all its excluded distribution services to determine if alternative providers currently exist or if legislation allows competition to be developed. For the services identified in sections 8.3.4 to 8.3.10, Ergon Energy concluded that no viable alternative providers exist for the suite of services and that only Ergon Energy can provide these services. These services, according to the criteria in the Rules, should therefore be classified as standard control services.

10.3 From Revenue Cap to WAPC for Connection Services and Customer Services

Ergon Energy's understanding of the Rules' requirements and of the decisions the AER must make in choosing a control mechanism is set out in section 9.2. These criteria include a predisposition to retaining the current revenue cap for what will be standard control services.

Ergon Energy is proposing to retain a revenue cap for network services, which account for the majority of the existing revenue cap services thus providing revenue certainty for the core distribution activities of shared network operation, maintenance and augmentation.

Ensuring the integrity of the shared network was a key feature of the ESDS review. This ESDS review was sought by the Queensland Government following community concerns about service and reliability of both Queensland DNSPs' networks. Ergon Energy agreed to the recommendations in the ESDS Report, including improving performance of long rural feeders and SWER lines, eliminating load and voltage constraints in the sub-transmission and high voltage networks, and moving to N-1 security for bulk supply and large zone substations and critical high voltage feeders. Ergon Energy therefore seeks to preserve its ability to appropriately budget and forecast expenditure on its shared network by retaining a revenue cap for network services, and by keeping this aspect of its distribution business separate from its other distribution services.

The ESDS review found that, specifically in relation to connection services, in times of volatile growth (i.e. growth in both load and customer numbers), the revenue cap approach has serious shortcomings because the facts on which the original submissions and regulatory determination are based can change unexpectedly and significantly within the regulatory period. The ESDS review stated "*This results in*

⁵⁷ Section 6.2.2(c)(1) of the Rules.

the revenue cap being below what it should be".⁵⁸ The ESDS review also included a recommendation that the Queensland Government and the QCA consider alternatives, including "*flexible revenue caps*".⁵⁹

Ergon Energy is proposing to separate (by use of a different control mechanism) its network services from the more volatile and customer-specific connection services and customer services. This 'hybrid' approach is permissible under the Rules.⁶⁰

It is Ergon Energy's view that the WAPC control mechanism for connection services and customer services will more clearly attribute costs of these services to the service user's type, rather than apportion the cost of these services across all customers.

10.4 Prescribed Distribution Services to Unregulated for Street Lighting

Street lighting services are currently regulated by the QCA as prescribed distribution services under the revenue cap, and street lighting assets are included in the regulatory asset base. For Ergon Energy, street lighting assets are approximately 1% of the regulatory asset base.

The reason street lighting has been included as prescribed distribution services until now arises from historical practices whereby the vertically integrated electricity entities (Ergon Energy's and ENERGEX's predecessor entities) provided the majority of street lights. However, over the last several decades, parties with responsibility for providing lighting to public carriage-ways (mainly Local Government and Queensland Department of Main Roads) have exercised choice of providers. For example, Queensland DNSPs provide a relatively small proportion of street lighting for major roads under the control of Queensland Department of Main Roads.

Ergon Energy believes that street lighting services (relating to construction and maintenance of street lighting assets) fall outside the definition of 'distribution services' in Chapter 10 of the Rules⁶¹ (refer to the definitions are set out in section 5.1). Consequently street lighting services should not be classified by the AER.

⁵⁸ "Detailed Report of the Independent Panel for Electricity Distribution and Service Delivery for the 21st Century – July 2004" – page 9

⁵⁹ Ibid – page 57

⁶⁰ Rules clause 6.2.5(a) and (b)(6)

⁶¹ The conveyance of electricity to street lights is proposed to continue as a network service under a revenue cap.

Given that the regulatory regime has evolved, and in particular distribution services have become more clearly defined, it is now appropriate to match the regulatory regime with what are now the well established practices of end-users and the DNSPs - i.e. street lighting is currently provided by alternative providers in a competitive market that is operating effectively.

It is therefore proposed that street lighting not be classified by the AER, and instead be treated as unregulated activities.

Ergon Energy can undertake the provision of street lighting services on request and on a competitive basis. In addition, Ergon Energy would enter into arrangements with other providers under a co-ordination agreement to perform street lighting activities (such as construction, maintenance, lamp changes etc) if they need to work on Ergon Energy's assets or within the safety approach zones.

11 Impacts of Proposal

Under Ergon Energy's proposed classification of services and control mechanisms, Ergon Energy's services remain subject to regulation, with the exception of street lighting, with limited material change to the current regulatory arrangements. In this way, Ergon Energy's proposal for the classification of services and control mechanism to apply to direct control services will have minimal impact on its customers.

11.1 Impact of the Regulatory Approach

The services classification and control mechanism framework determines the regulatory approach that is to be applied to Ergon Energy's services. The regulatory approach does not:

- Affect the underlying nature or scope of the services that Ergon Energy currently provides. Ergon Energy will continue to physically provide its existing services and will undertake these in the same manner;
- Impact on Ergon Energy's ability to sub-contract third parties to assist it to provide some, or all, of its distribution services;
- Determine who is permitted to provide different distribution and non-distribution services in Ergon Energy's distribution area. This is determined through a suite of national and Queensland-specific legislative and regulatory instruments, including the Rules, national B2B Procedures, *Electricity Act 1994* and Queensland Electricity Industry Code;
- Change Ergon Energy's service obligations to its customers. Ergon Energy's service obligations and the service levels that are to apply to their delivery are determined in the non-economic regulatory framework; and
- Involve setting the terms and conditions of supply, including actual prices, for individual services. This will occur through a subsequent detailed process under the economic regulatory framework that will involve Ergon Energy submitting a Regulatory Proposal to the AER and the AER making a regulatory determination with respect to that Regulatory Proposal.

11.2 Continuing to Deliver EDSD Recommendations

The proposed framework is consistent with the recommendations of the EDSD review as to the measures that should be adopted by Ergon Energy to address community concerns regarding network integrity and service delivery. In particular:

- Ergon Energy is proposing to retain a revenue cap form of price control for network services, which account for the majority of the existing revenue cap services. There will therefore be no change in the way the shared network activities are regulated; and
- Ergon Energy is proposing to apply a WAPC form of price control to the more volatile and customer-specific connection services and customer services.

This proposed framework will therefore:

- Enable Ergon Energy to separate its 'shared' distribution network assets and activities from customer-specific assets and activities by utilising two different caps;
- Assist Ergon Energy to appropriately budget and forecast expenditure for the core distribution activities of shared network operation, maintenance and augmentation; and
- Implement a user-pays philosophy where appropriate, rather than apportioning the cost of these services across all customers.

11.3 Service Clarity

The proposed framework increases clarity for end-users regarding the nature and underlying characteristics of the services provided. In particular:

- Whether the services are provided by means of, or in connection with, a distribution system; and thereby
- Whether the services are to be the subject of regulation.

For example, with respect to street lighting, it is proposed to clarify that:

- The ongoing conveyance of electricity to an unmetered connection point (such as street lighting), is a distribution service and therefore subject to regulation by the AER;
- The construction, operation and on-going maintenance of existing and new street lighting assets are not distribution services within the meaning of the Rules and are therefore not the subject of regulation by the AER. Local Authorities and the Queensland Department of Main Roads, as the parties who are mainly responsible for the lighting of public carriage-ways, currently have the ability to source alternative service providers for the construction, operation and on-going maintenance of street lighting. A market for the provision of these services currently exists with a variety of service provider used by Local Authorities and the Queensland Department of Main Roads; and
- Ergon Energy will continue to provide street lighting assets and maintain them on an as-requested and commercial basis.

Ergon Energy will discuss the impact of changes in the street lighting arrangement in an appropriate way with affected parties. This process of consultation will include the Local Government Association of Queensland, individual Local Authorities and the Queensland Department of Main Roads.

11.4 Preservation of Chapter 5 Technical and Non-Economic Matters

The proposed framework fully preserves the technical and non-economic principles and guidelines governing connection and access to a distributor's network contained within Chapter 5 of the Rules.

In particular, the proposal does not in any way impact:

- The opportunity to form a connection to a network and obtain access to network services under the Rules;
- The terms and conditions on which connection to a network and the provision of network services will be granted, including that these are to be set out in commercial agreements and are to be provided on reasonable terms; or
- The technical terms and conditions of connection agreements, including with respect to the minimum, automatic and negotiated access standards⁶² relating to new connections and the performance required to ensure that the power system operates securely and reliably.

11.5 De-Coupling Network Services Revenue from Energy Throughput

The proposed framework, and in particular the retention of a revenue cap for network services (which comprise the bulk of Ergon Energy's assets and activities), supports the notion of de-coupling revenue from energy throughput. This means that scope for demand side management and related initiatives can be pursued without the need for other compensating revenue offsets (such as are being debated for price capped businesses).

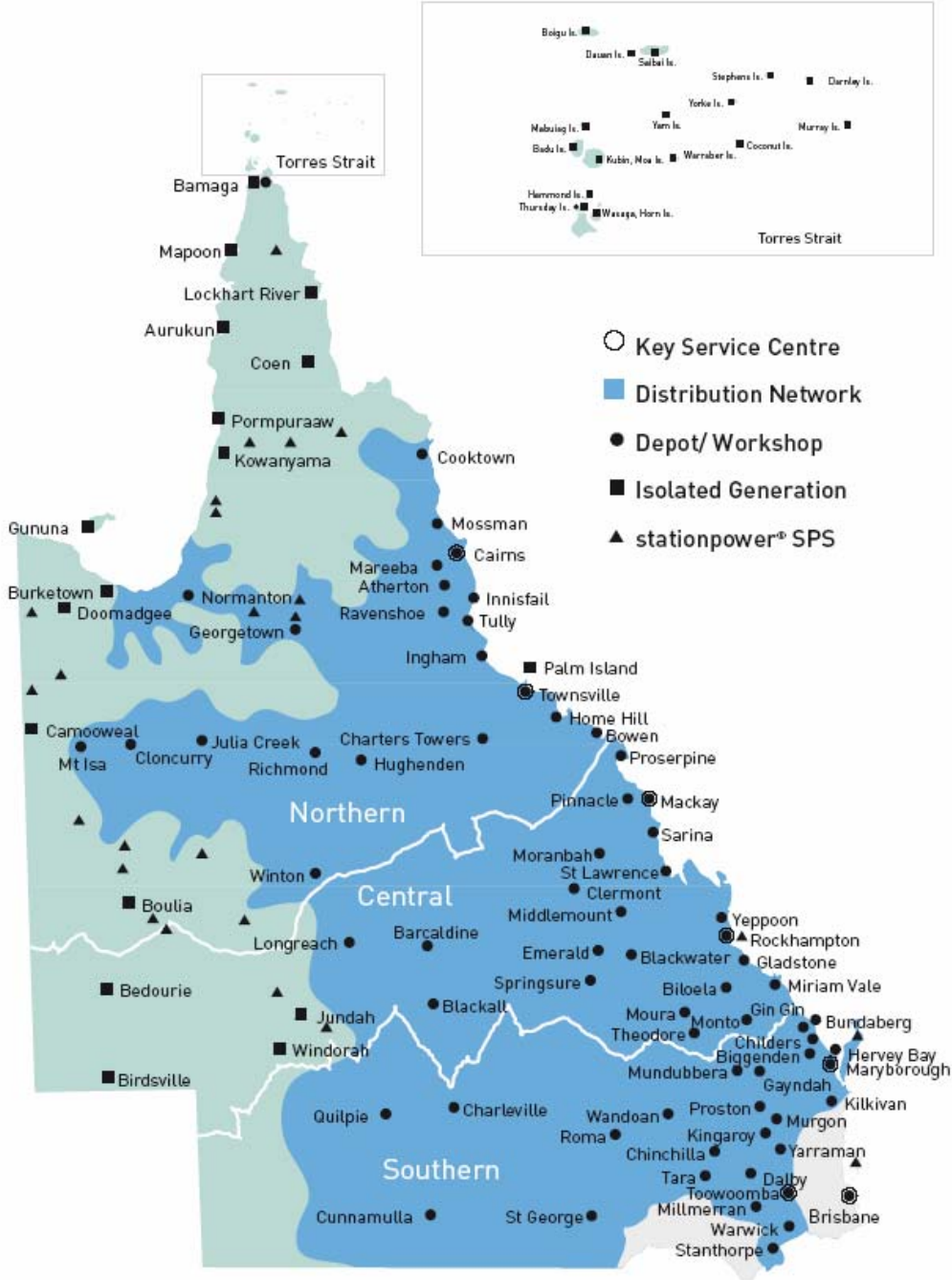
It is Ergon Energy's view that climate change initiatives, including initiatives that better manage demand, improve network utilisation, foster small-scale generation, etc, will become embedded in the operational day-to-day activities of NEM participants over the course of the next regulatory period. DNSPs are key proponents of these types of initiatives and are seeking to ensure that the economic regulatory regime enables DNSPs to harness the maximum overall benefits for all parties.

11.6 Consultation

Ergon Energy has had limited time to fully consult interested parties in relation to this proposal. However the Rules make provision for consultation and stakeholder feedback to be incorporated into the AER's process of approving Ergon Energy's Regulatory Proposal. Ergon Energy would welcome the opportunity to work with the AER as it analyses issues that may arise in the course of this consultation process.

⁶² In accordance with Chapter 5 of the Rules – in particular with respect to establishing a new connection.

A. Map of Ergon Energy's Supply Area



B. Unregulated Activities

In relation to the treatment of unregulated activities:

- Clause 6.1.1 of the Rules provides that:

“The AER is responsible, in accordance with this Chapter for the economic regulation of distribution services provided by means of, or in connection with, distribution systems that form part of the national grid.”

The AER’s responsibilities with respect to economic regulation of services, including their classification, only apply to services which are distribution services, i.e. services which are provided by means of, or in connection with, a distribution system.

- The note to clause 6.2.1 of the Rules further states that:

“If the AER decides against classifying a distribution service, the service is not regulated under the Rules.”

Ergon Energy considers that this note is intended to clarify that the AER has the flexibility to determine that a distribution service is to be an unregulated service in circumstances where it decides against classifying the distribution service as a direct control or a negotiated distribution service.

Ergon Energy provides a range of services that are not distribution services within the meaning of the Rules and accordingly, are not subject to regulation by the AER. While unregulated activities are not required to be considered for the purposes of this proposal, Ergon Energy acknowledges that:

- Some of these services have traditionally been treated as prescribed distribution services. Examples of such unregulated activities include the provision, operation and maintenance of street lighting; and
- Some of these services are currently classified as distribution services in other jurisdictions, for example, watchman lighting and the travelling with and lifting of power lines for high load escorts.

Ergon Energy considers that a number of these services have been classified as distribution services more as a consequence of historical practices or industry structures, than as a reflection of the nature of the service provided or the ability of end-users to exercise choice of providers. Now that the regulatory regime has become more defined, Ergon Energy is proposing to align the regulatory regime with the established practices of end-users and the DNSPs.

For the sake of completeness and to assist in understanding the nature of the services provided by Ergon Energy, the following table identifies the major categories of unregulated activities undertaken by Ergon Energy and provides a brief rationale supporting their treatment:

Unregulated Activities	Reasons
<p>Street Lighting</p> <p>Provision Operation & Maintenance including lamp replacements</p>	<p>Street Lighting provision, operation and maintenance is not a <i>distribution service</i> as defined in the Rules. DNSPs are not obligated to provide street lighting – instead it is an obligation on the party responsible for the carriage-way (usually Local Authorities or Queensland Department of Main Roads). There is already a market operating for the provision, operation and maintenance of street lighting by parties other than the DNSPs. Furthermore, Local Authorities and Queensland Department of Main Roads have for many years had the capability to choose alternative providers for street lighting.</p>
<p>Watchman Lighting (e.g. unmetered flood lighting at car yards)</p> <p>Provision Operation & Maintenance including lamp replacements</p>	<p>Watchman Lighting is not a <i>distribution service</i> as defined in the Rules. Any party can provide, operate and maintain watchman lighting and a market already exists for these activities.</p>
<p>High Load Escorts</p> <p>Scoping the route Travelling with the load and lifting power lines Approving/authorising contractors</p>	<p>High Load Escorting is not a <i>distribution service</i> as defined in the Rules. Other parties can be authorised by the relevant DNSP to perform work in close proximity to its power lines, including lifting. There is already a market operating for the provision of high load escort services by parties other than the DNSPs.</p>
<p>Meter Data Agent (MDA)</p> <p>Data collection for metering types 1-4</p>	<p>MDA services have always been 'contestable' and competitive in the National Electricity Market. These services have always been outside the economic regulatory regime for Ergon Energy and ENERGEX.</p>
<p>Non-distribution services at customers' request</p> <p>Erection of additional poles within customers' premises/land Location of underground cables Electrical inspection, voltage and load checks where problem/fault is on the customers' installation</p>	<p>These services are not a <i>distribution service</i> as defined in the Rules. Other parties (such as electrical contractors, power line construction contractors) can, and do, provide these services.</p>

Unregulated Activities	Reasons
<p>The Ergon Energy group of companies comprise the following entities:</p> <ul style="list-style-type: none"> • Ergon Energy Corporation Limited • Ergon Energy Queensland Pty Ltd • Ergon Energy Telecommunications Pty Ltd • SPARQ Solutions Pty Ltd (Joint Venture company with ENERGEX Ltd) <p>These companies perform activities that are Unregulated Services including:</p> <p>Ownership and operation of 33 Isolated Systems Generators;</p> <p>Ownership and operation of 34 Isolated Systems Networks;</p> <p>Ownership and operation of a network in the North West Minerals Province (near Mount Isa);</p> <p>An undersea cable;</p> <p>Works for Powerlink;</p> <p>Certain electrical assets within customers' electrical installations;</p> <p>Sale of Remote Area Power Stations and Solar PV Systems;</p> <p>Non-competing Retail entity selling to retail customers on Qld gazetted Notified Prices only;</p> <p>Wholesale fibre telecommunications services;</p> <p>IT Services to support Ergon Energy and ENERGEX's business operations.</p>	<p>These services either do not relate to the national interconnected grid or are not distribution services (because they are generation, retail or other non-electricity industry activities).</p> <p>Activities that might otherwise be distribution service activities, but should be Unregulated Services are:</p> <ul style="list-style-type: none"> • The Isolated Systems Networks – because they are not part of the interconnected grid, and the National Electricity Rules do not apply; • The North West Minerals Province network – because it is not part of the interconnected grid, and the National Electricity Rules do not apply. In the event that this network ever becomes interconnected, it would remain as an Unregulated Service because it is the subject of a separate pre-existing ACCC authorisation; • The undersea cable is the subject of a commercial arrangement that pre-dated the initial National Electricity Code, and has been treated as an Unregulated Service by the QCA. <p>Maintenance and technical activities are performed on an unregulated subcontract basis for Powerlink, e.g. transformer maintenance. This is not a distribution service.</p> <p>Isolated Systems Generation activities are not distribution services activities and are not part of the interconnected grid.</p> <p>Electrical assets within customers' electrical installations are not part of a distribution system, and are therefore not distribution services.</p> <p>Remote Area Power Stations and Solar PV Systems sales are not distribution services because it is a commercial sale arrangement and does not relate to the distribution of electricity using a distribution system.</p> <p>Retailing electricity is not a distribution service.</p> <p>Telecommunications services are not distribution services.</p> <p>SPARQ Solutions Pty Ltd is a joint venture company wholly owned by Ergon Energy Corporation Limited and ENERGEX Limited. SPARQ provides IT services to support both Ergon Energy's and ENERGEX's businesses. Some of these activities are not related to the provision of distribution services. To the extent that SPARQ's activities are related to the provision of distribution services, this will be transparently identified in the Cost Allocation Method and/or when examining transactions with parties that are not at arms length.</p>