Part of Energy Queensland

25 June 2025

Mr Arek Gulbenkoglu
General Manager, Network Expenditure
Australian Energy Regulator
aerinquiry@aer.gov.au

Dear Mr Gulbenkoglu,

Capital Expenditure Incentive Guideline Review

Queensland's two distribution network service providers (DNSPs), Ergon Energy Corporation Limited (Ergon Energy Network) and Energex Limited (Energex), welcome the opportunity to provide feedback to the Australian Energy Regulator's (AER) Capital Expenditure Incentive Guideline (Guideline) Review consultation.

We support the AER in its attempts to consider factors outside of DNSPs' control including the volume of connections and unforeseen bespoke connections. However, we believe the AER's proposed volumetric adjustment methodology is overly simplistic and it would be incorrect to assume that this could be easily applied to reveal sufficiently accurate expenditure information that the AER could use to determine a DNSP's connections' expenditure (connex) efficiency. This is because:

- DNSPs across jurisdictions have different connection policies and methodologies to forecast their connections expenditure. Therefore, the proposed changes would have varying degrees of applicability/workability.

- connex mostly relates to Commercial and Industrial customers - where both scope and volumes are issues that DNSPs cannot control. Thus, the proposed volumetric adjustment would be most effective for simple connex or mostly residential type customers but this represents a small proportion of overall connex, and this in practice, would still be complex to apply.

- the proposed volumetric adjustment does not consider the amount of capital contributions received which can vary significantly between customers and regulatory years.

Considering the above issues, we therefore recommend that the AER consider two options for the Capital Expenditure Sharing Scheme (CESS) connex:

- **Exclusion of all connex forecasts from the CESS for all DNSPs**

  The exclusion of all connex would:

  - maintain the simplicity, transparency and effectiveness that the current CESS affords,
  - avoid the need for:
    - DNSPs to overhaul their connex forecast methodologies and IT systems to comply with the proposed CESS changes, and
    - the AER to expend its limited resources to assess connex efficiency, and
  - mean that DNSPs would no longer receive windfall gains when connex was lower than forecast and conversely would not be penalised for factors affecting connections that are outside of their control.

  It should also be noted that in its review of DNSPs' regulatory proposals, the AER assesses the prudency and efficiency of forecast capital expenditure (capex) and operating expenditure (opex), including connex. That is, at the time of its assessment/regulatory proposal determinations, the AER satisfies itself that DNSPs' forecasts are as efficient as can be.

  Furthermore, where a DNSP's labour and materials costs are the same for all capex (e.g., augmentation, replacement and connections) there would remain constant pressure on DNSPs to drive their efficiency, in order to qualify for CESS rewards (and avoid penalties), for other categories of capex still included in the CESS. This is the case for Ergon Energy Network and Energex.

- **Providing DNSPs the option to include or exclude connex from the CESS**

  This alternative option provides DNSPs the choice on whether to have their connex forecasts included in the CESS as it recognises that some DNSPs see value and may be able to easily comply with the AER's proposed CESS changes. However, for this option we believe the AER should consider the following issues:

  - whilst the Guideline's new section 2.6.1 states that it is the AER's default position to apply the volumetric adjustments to a DNSP's standard connex, it is unclear to Ergon Energy Network and Energex why it also states:[1]

    "We will determine whether or not to apply the volumetric adjustment for standard connections capex in response to a DNSP's proposal."

    We seek clarity as to the reason for the AER's discretion in applying this adjustment.

[1] AER Capital Expenditure Incentive Guidelines - marked up, p7.

- similarly, with regards to the proposed Guideline's new section 2.8.1, dealing with reduced penalties for individual large bespoke connections, we query why:
  - the AER has given itself the discretion whether to reduce the penalty because of the use of the word "may" in the Guideline, and
  - the Guideline remains silent on bespoke connections in cases where a DNSP has qualified for a CESS reward, which would mean the CESS was asymmetrical in its application.
- with regards to the Guideline's section 4.3.2 Stage 2, we are concerned about the proposed addition:[2]

  > "The detailed assessment is not limited to a specific category where an NSP has overspent. We may assess prudency and efficiency of all categories if an ex post review is triggered."

  This is because we expect other specific categories would have already passed the AER's review and assessment of their prudency and efficiency and this proposed change provides the AER another opportunity to do this.

In its review of the CESS the AER may also wish to consider:

- ex-ante exclusions for high-risk safety projects (e.g. driven by poor asset conditions or SafetyNet risks) and projects undertaken to strengthen the resilience of DNSPs' networks.
- in its ex post prudency and efficiency assessment, factors outside of DNSPs' control, including material prices in the international markets, the impact of severe weather, fuel prices, and changes in government legislation/policies.
- reducing the CESS penalties and rewards to lessen the impact the CESS has on DNSPs and their customers.

This letter does not contain confidential information and may be published. Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact me or Lindsay Chin on [redacted]

Yours sincerely

[redacted]

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[2] Ibid., p17.