



DRAFT DECISION

Ergon Energy Distribution Determination 2020 to 2025

Attachment 13 Control mechanisms

October 2019

© Commonwealth of Australia 2019

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the:

Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 3131, Canberra ACT 2601

or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165

Email: EnergyQueensland2020@ aer.gov.au

AER reference: 62728

Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Ergon Energy for the 2020–2025 regulatory control period. It should be read with all other parts of the draft determination.

The draft determination includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 16 – Negotiated services framework and criteria

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

Contents

Note	13-2
Contents	13-3
Shortened forms	13-4
13 Control mechanisms	13-5
13.1 Draft decision	13-5
13.2 Ergon Energy's proposal	13-6
13.3 Assessment approach	13-7
13.4 Draft decision for standard control services	13-7
13.4.1 Reasons for draft decision for standard control services	13-7
13.4.2 Deliberately under-recovered revenue	13-10
13.4.3 Reporting on designated pricing proposal charges.....	13-10
13.4.4 Reporting on jurisdictional scheme amounts	13-11
13.4.5 Rounding of inputs in annual pricing proposal process.....	13-11
13.4.6 Control mechanism for standard control services	13-11
13.5 Draft decision for alternative control services	13-15
13.5.1 Form of control for alternative control services	13-15
13.5.2 New services introduced during the regulatory control period..	13-18
13.5.3 Reasons for draft decision for alternative control services.....	13-18
A DUoS unders and overs account	13-19
B Designated pricing proposal charges unders and overs account	13-21
C Jurisdictional scheme amounts unders and overs account	13-23
D Rounding of inputs in annual pricing proposals	13-25

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CPI	consumer price index
distributor	distribution network service provider
DMIS	demand management incentive scheme
DPPC	designated pricing proposal charges
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
F&A	framework and approach
NEM	national electricity market
NER or the rules	national electricity rules
NSP	network service provider
PTRM	post-tax revenue model
RIN	regulatory information notice
STPIS	service target performance incentive scheme
TAR	total allowable revenue
WACC	weighted average cost of capital

13 Control mechanisms

A control mechanism imposes limits over the prices of both direct control services and alternative control services and/or the revenues that a distribution network service provider can recover from customers for these services. For standard control services, the National Electricity Rules (NER) require the control mechanism be of the prospective CPI-X form (or some incentive-based variant).¹

We will regulate Ergon Energy's standard control services under a revenue cap control mechanism and alternative control services under a price cap control mechanism for the 2020–25 regulatory control period. This is consistent with the position in our Framework and Approach for Ergon Energy published in July 2018.² It is also consistent with the current approach.

This attachment discusses:

- the application of the revenue cap and price cap
- compliance with the price controls³
- the mechanism through which Ergon Energy will recover distribution use of system (DUoS) charges including adjustments for revenue under or over recovery⁴
- reporting of recovery of designated pricing proposal charges and jurisdictional scheme amounts.⁵

13.1 Draft decision

Our draft determination for Ergon Energy is as follows:

- The control mechanism for standard control services is a revenue cap.
- The control mechanism for alternative control services is a price cap.
- Section 13.4.6 contains the revenue cap formulae.
 - The revenue cap for any given regulatory year is the total allowed revenue, or TAR, calculated using the formula in Figure 13.1.
 - The side constraints applying to price movements for each of Ergon Energy's classes must be consistent with the formula in Figure 13.2.
- Section 13.5.1 contains the price cap formulae.
 - The cap on Ergon Energy's prices for services for legacy metering, public lighting and ancillary services (fee based) are defined in Figure 13.3.

¹ NER, cl. 6.2.6(a).

² AER, *Final framework and approach for Ergon Energy 2020–25 regulatory control period*, July 2018.

³ NER, cl. 6.12.1(13).

⁴ NER, cl. 6.12.1(11).

⁵ NER, cl. 6.12.1(19) and 6.12.1(20).

- The price cap applying to Ergon Energy's quoted services is included in Figure 13.4.
- Ergon Energy's pricing proposal must demonstrate compliance with the revenue cap—in accordance with Figure 13.1—by including adjustments for DUoS revenue under or over recovery in accordance with appendix A of this attachment.⁶
- Ergon Energy must submit as part of its annual pricing proposal, a record of the amount of revenue recovered from designated pricing proposal charges and associated payments in accordance with appendix B of this attachment.
- Ergon Energy must submit as part of its annual pricing proposal, a record of any jurisdictional scheme amounts it recovers and associated payments in accordance with appendix C of this attachment.
- Appendix D of this attachment details rules about how rounding is to be handled in the annual pricing approval process.

13.2 Ergon Energy's proposal

Ergon Energy has accepted the decisions in our final Framework and Approach to:⁷

- Apply a revenue cap to standard control services.
- Apply price caps to alternative control services.

Ergon Energy proposed that the basis of control mechanisms for alternative control services are:⁸

- For both public lighting and legacy type 6 metering services, apply a limited building block approach to develop prices in the first year and then a price path for the remaining years of the regulatory control period. For network ancillary services provided on a fee basis (including fee-based connection and metering related services), apply a formula-based approach (cost-build up) in the first year and then a price path for the remaining years of the regulatory control period.
- For network ancillary services provided on a quotation basis (including quoted connection and metering related services), apply a formula-based approach (cost build-up) for the labour rates in the first year and then a price path for the labour rates in the remaining years of the regulatory control period.

Ergon Energy accepted the formulae that gave effect to the revenue caps for standard control services as set out in our Framework and Approach. Ergon Energy also accepted the price cap formulas for alternative control services, however proposed the addition of a 'capital allowance' component to the fee-based service and quoted service formulae.

⁶ NER, cl. 6.18.2(b)(7).

⁷ Energy Queensland, *Control Mechanisms 2020-25*, January 2019, p. 3.

⁸ Energy Queensland, *Control Mechanisms 2020-25*, January 2019, pp. 3-4.

13.3 Assessment approach

Our assessment of the control mechanism was set out in our final Framework and Approach. The final Framework and Approach sets the control mechanism for standard control services as a revenue cap, which is binding on our determination.⁹ The basis of the revenue cap must be of the prospective CPI-X form (or some incentive based variant).¹⁰

Our final Framework and Approach deliberately set out a generic formula to give effect to the control mechanism for standard control services.¹¹ The generic formula requires the control mechanism parameters be specified with more precision in order to be implemented. This draft determination clarifies our position regarding the control mechanism formula and its respective parameters.

Our final Framework and Approach set the control mechanism for alternative control services as a price cap.¹² This is detailed below in section 13.5.

13.4 Draft decision for standard control services

The following discusses the reasons for our draft decision for each parameter of the revenue cap control mechanism, including the reporting on designated pricing proposal charges and jurisdictional scheme amounts.

13.4.1 Reasons for draft decision for standard control services

Total allowable revenue

In this draft determination, the revenue cap for any given regulatory year is the TAR for distribution services. Section 13.4.6 contains the formula that gives effect to the revenue cap.

Intra-period adjustment to the weighted average cost of capital

Changes to the TAR resulting from the trailing average cost of debt update will be implemented through annual revisions to the X factors. Further discussion on this adjustment can be found in attachment 3—rate of return—which discusses the WACC annual adjustment and attachment 1—annual revenue requirement—which details issues relating to X factors.

⁹ AER, *Framework and approach for Energex and Ergon Energy control period commencing 1 July 2020*, July 2018, p. 44; NER, cl. 6.12.3(c).

¹⁰ NER, cl. 6.2.6(a).

¹¹ AER, *Framework and approach for Energex and Ergon Energy control period commencing 1 July 2020*, July 2018, pp. 52-54.

¹² AER, *Framework and approach for Energex and Ergon Energy control period commencing 1 July 2020*, July 2018, p. 54; NER, cl. 6.12.3(c).

Incentive scheme adjustments (I factor)

The I factor parameter is for annual TAR adjustments relating to a service provider's performance against the incentive schemes. This factor now captures the efficiency benefit sharing scheme, the capital expenditure sharing scheme, and the service target performance incentive scheme.¹³

The service target performance incentive scheme component of the I factor is to be applied as a percentage adjustment to annual revenue, as determined by the AER.¹⁴ Ergon Energy will submit a compliance report for year t-2 before the start of year t. We will then determine the percentage adjustment for year t-2 to be applied in the year t annual pricing proposal.

The details of the demand management innovation allowance mechanism, and of the new demand management incentive scheme, were proposed by the AER in November 2017.¹⁵

The current demand management innovation allowance applies to Ergon Energy in the current regulatory control period. The operation of this mechanism requires that we determine and apply any carryover amount from underspending the allowance as a deduction from the distributor's revenue requirement in the subsequent regulatory control period.¹⁶

As a consequence, it is necessary to include a factor adjusting for the carryover amount for this mechanism in the next regulatory control period.

For the new demand management incentive scheme, as part of the annual pricing process, Ergon Energy will submit a compliance report for year t-2 eight months before the start of year t. We will then determine the total financial incentive recoverable for year t-2 four months before the start of year t. This amount will then be included in Ergon Energy's annual pricing proposal and be recoverable by DUOS charges in year t.¹⁷

For this reason, we will include an adjustment in the I factor accounting for this incentive. These adjustments are consistent with Ergon Energy's proposal.

¹³ AER, *Electricity distribution service providers: Service target performance incentive scheme*, November 2018, pp. 34-35.

¹⁴ AER, *Electricity distribution network service providers: Service target performance incentive scheme: Appendix C*, 1 November 2009, p. 32.

¹⁵ AER, *Demand management incentive scheme*, November 2017; AER, *Explanatory Statement, Demand management incentive scheme*, November 2017; AER, *Demand management innovation allowance mechanism*, November 2017; AER, *Explanatory statement, Demand management innovation allowance mechanism*, November 2017; AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

¹⁶ AER, *Demand Management Innovation Allowance Mechanism; Electricity distribution network service providers*, December 2017, p. 7.

¹⁷ AER, *Demand Management Incentive Scheme; Electricity distribution network service providers*, December 2017, p. 7.

Annual adjustments (B factor)

The B factor parameter is for annual TAR adjustments required within the 2020–25 regulatory control period. Consistent with our final Framework and Approach the B factor will include 'true-up' adjustments for DUoS revenue under or over recovery.¹⁸

In the Framework and Approach we noted that the B factor was likely to include adjustments for the unders and overs account. Our draft determination is that the B factor will include a true-up for the net present value of under or over recovered revenue. This true-up will be calculated based upon the DUoS unders and overs account kept in accordance with the method in appendix A.

Under a revenue cap, Ergon Energy's revenues in year t will be adjusted annually to clear (or true-up) any under or over recovery of actual revenue collected through DUoS charges in year t–2 and any estimated under or over recovery of revenues in year t–1. In regulatory year t, we will therefore base the level of this adjustment on the opening balance of the DUoS unders and overs account.

As the under or over recovery in regulatory year t will have six months of nominal WACC applied to it during the regulatory year, while the opening balance of the DUoS unders and overs account will have one year of nominal WACC applied during the regulatory year, we consider that the true-up requires an adjustment by six months of WACC to be on a common basis. As the purpose is to offset the opening balance, we further consider that the sign of the true-up should be the reverse of the sign of the opening balance. For clarity, if Ergon Energy has recovered below its allowable revenue prior to year t, this balance will be negative and this true-up should be positive to allow Ergon Energy to recover that revenue in year t to bring the balance of the unders and overs account to zero.

The B factor used in the unders/overs account for the calculation of TAR excludes the true-up for DUoS revenue under/over recovery for the regulatory year, and is therefore expected to be zero where there are no defined annual adjustments.

Cost pass through adjustments (C factor)

The C factor is for annual TAR adjustments relating to AER approved cost pass through amounts, and can also include AER approved end-of-period adjustments. These could include once off adjustments to revenue required during the 2020–25 regulatory control period, which are not able to be accounted for in the other factors of the revenue cap formula.

We consider this factor acts in a complementary manner with the B factor which makes annual adjustments to TAR. Should the B factor fail to capture all of the revenue adjustments required in the 2020–25 regulatory control period through its annual

¹⁸ AER, *Framework and approach for Energex and Ergon Energy control period commencing 1 July 2020*, July 2018, p. 53.

function, true-up adjustments in the final year of the 2020–25 regulatory control period may be required. The C factor provides an avenue for this to be done.

The wording of the phrase end-of-period adjustments is intentionally broad to allow the distributor to propose any such adjustments it considers would be required. However, it is not a catch-all factor and so would only apply if specific end-of-period adjustments were identified by Ergon Energy and approved by the AER.

Greater clarity around the types of costs that can be included as a cost pass through are set out in attachment 14—pass through events.

Calculation of the consumer price index escalation

We will apply the annual movement between the Australian Bureau of Statistics' (ABS) published December quarter data for calculating the consumer price index (CPI) escalation.

Use of the December quarter data will mean Ergon Energy will apply an actual CPI escalation (rather than an estimated or 'placeholder' CPI escalation) when it submits its pricing proposals. The use of an actual CPI escalation will allow the process for setting prices to be more transparent which is consistent with the intent of the pricing rule provisions.¹⁹

The application of this calculation is set out in Figure 13.1 (revenue cap formula).

13.4.2 Deliberately under-recovered revenue

We accept there are times when Ergon Energy may decide to recover below its allowed level of revenue. This is in contrast to unintentional under recovery due to a natural variation between forecast quantities of a service offered and actual quantities achieved. In the event of intentional under-recovery, this revenue will not be counted as an under recovery for the purpose of the under and overs account and by extension will therefore not subsequently increase the total allowable revenue in future years.

13.4.3 Reporting on designated pricing proposal charges

We must decide how Ergon Energy will report on the recovery of designated pricing proposal charges²⁰ for each year of the 2020–25 regulatory control period and how to account for any under or over recovery of revenue associated with those charges.²¹

¹⁹ NER, cl. 6.18.5 (g)(3).

²⁰ Designated pricing proposal charges are charges related to: designated pricing proposal services (prescribed exit fees, prescribed common transmission services and prescribed transmission use of system services); avoided customer transmission use of system charges; charges provided by another distributor (but only to the extent they comprise of designated pricing proposal services or standard control services); and charges or payments related specified in NER, cl. 11.39.

²¹ NER, cl. 6.12.1 (19).

We apply an under and over recovery mechanism to facilitate this reporting and account for the true-up of under and over recovery of revenue. This approach is the same as the DUoS revenue under and over recovery mechanism and is consistent with the requirements of the NER.²² The operation of this method is detailed in appendix B.

13.4.4 Reporting on jurisdictional scheme amounts

We must decide how Ergon Energy will report on the recovery of jurisdictional scheme amounts for each year of the 2020–25 regulatory control period and how to account for any under or over recovery of revenue associated with those charges.²³

Our draft decision jurisdictional scheme amounts under and over recovery mechanism approach is consistent with the requirements of the NER.²⁴ It is also consistent with the approach applied to electricity distributors in other jurisdictions. The operation of this method is detailed in appendix C.

13.4.5 Rounding of inputs in annual pricing proposal process

When reporting on compliance as part of the annual pricing proposal process each year of the 2020–25 regulatory control period, we require that certain calculation inputs be used on an unrounded basis while others may be used on a rounded basis.

The process for rounding and the specific inputs to be rounded are detailed in appendix D.

13.4.6 Control mechanism for standard control services

Our decision on the formulae that give effect to the control mechanism must be as set out in the F&A unless we consider that a material change in circumstances occurs which justifies departing from that approach.²⁵ Figure 13.1 sets out the revenue cap formula for distribution services.

The formula in the F&A included an Adjusted Annual Revenue (AAR) factor, which represented the adjusted annual smoothed revenue requirement. This factor allowed for the adjustment to revenue requirements for the STPIS. In our F&A, we stated that we would apply the version of the STPIS that was current at that time. The revenue cap formula was based on that version of the STPIS. We noted in the F&A paper that we were, at that time, undertaking a review of the STPIS. After the final F&A was published, we finalised the STPIS review and released our new STPIS guideline.

²² NER, cl. 6.12.1(19), 6.18.7.

²³ NER, cl. 6.12.1 (20).

²⁴ NER, cl. 6.18.7A.

²⁵ NER, cl. 6.12.3(c1).

Now that we have completed our review and published the revised STPIS, our draft decision is to apply the revised STPIS. STPIS outcomes will now be specified as a fixed monetary amount, rather than a percentage adjustment.²⁶ This causes the need to adjust how we account for STPIS in the revenue cap control formula. We consider that there has been a material change in circumstances which requires us to depart from the F&A and apply the revised STPIS to this revenue determination process.²⁷ As a result of the new application of the STPIS under the I factor, the revenue cap formula has been simplified and no longer requires this AAR factor.

Figure 13.1 Revenue cap formula²⁸

$$\begin{aligned}
 1. \quad & TAR_t \geq \sum_{i=1}^n \sum_{j=1}^m p_t^{ij} q_t^{ij} && i = 1, \dots, n \text{ and } j = 1, \dots, m \text{ and } t = 1, 2, \dots, 5 \\
 2. \quad & TAR_t = AR_t + I_t + B_t + C_t && t = 1, 2, \dots, 5 \\
 3. \quad & AR_t = AR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t) && t = 2, \dots, 5
 \end{aligned}$$

where:

TAR_t is the total allowable revenue in year t.

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

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

t is the regulatory year.

AR_t is the annual smoothed revenue requirement in the Post Tax Revenue Model (PTRM) for year t.

I_t is the sum of the service target performance incentive scheme, efficiency benefit sharing scheme, capital expenditure sharing scheme, demand management incentive scheme, and innovation allowance adjustments as they relate to year t-2, applied in year t.

²⁶ AER, *Amendment to the Service Target Performance Incentive Scheme - Explanatory Statement*, November 2018, p. 3.

²⁷ NER, cl. 6.12.3(b).

²⁸ All parameters are in nominal terms unless otherwise specified.

B_t is the sum of annual adjustment factors for year t and includes the true-up for any under or over recovery of actual revenue collected through DUoS charges calculated using the following method:

$$DUoS \text{ Under and Overs True} - Up_t = -(Opening \text{ Balance}_t)(1 + WACC_t)^{0.5}$$

where:

$DUoS \text{ Under and Overs True} - Up_t$ is the true-up for the balance of the DUoS unders and overs account in year t.

$Opening \text{ Balance}_t$ is the opening balance of the DUoS unders and overs account in year t as calculated by the method in appendix A.

$WACC_t$ is the approved weighted average cost of capital used in regulatory year t in the DUoS unders and overs account in appendix A. This WACC figure will be a nominal WACC figure that reflects actual inflation rather than forecast inflation.

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

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities²⁹ from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

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

divided by

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

minus one.

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

X_t is the X factor for each year of the 2020-25 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year.

²⁹ If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

Side constraints

Figure 13.2 sets out the side constraints formula. For each regulatory year after the first year of a regulatory control period, side constraints apply to the weighted average revenue raised from each tariff class. In accordance with the NER, the permissible percentage increase is the greater of CPI–X plus 2 per cent or CPI plus 2 per cent.³⁰ Recovery of certain revenues, such as those to accommodate pass throughs and incentive schemes, are disregarded in deciding whether the permissible percentage has been exceeded.³¹

Figure 13.2 Side constraints formula³²

$$\frac{\left(\sum_{i=1}^n \sum_{j=1}^m d_t^{ij} q_t^{ij}\right)}{\left(\sum_{i=1}^n \sum_{j=1}^m d_{t-1}^{ij} q_t^{ij}\right)} \leq (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) + B_t'$$

where each tariff class has "n" tariffs, with each up to "m" components, and where:

d_t^{ij} is the proposed price for component 'j' of tariff 'i' for year t.

d_{t-1}^{ij} is the price charged for component 'j' of tariff 'i' in year t–1.

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

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities³³ from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

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

divided by

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

minus one.

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

³⁰ NER, cl. 6.18.6(c).

³¹ NER, cl. 6.18.6(d).

³² All parameters are in nominal terms unless otherwise specified.

³³ If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

X_t is the X factor for each year of the 2020–25 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year. If $X > 0$, then X will be set equal to zero for the purposes of the side constraint formula.

B_t is the annual percentage change from the sum of annual adjustment factors for year t and includes true-up for any under or over recovery of actual revenue collected through DUoS charges calculated using the method in Figure 13.1.

With the exception of the CPI and X factor, the percentage for each of the other factors above can be calculated by dividing the incremental revenues (as used in the total annual revenue formula) for each factor by the expected revenues for regulatory year t–1 (based on the prices in year t–1 multiplied by the forecast quantities for year t).

13.5 Draft decision for alternative control services

In our final Framework and Approach, we set out our decision to apply price caps to alternative control services.³⁴ Ergon Energy's proposed formulae for alternative control services for the 2020–25 regulatory control period reflect the Framework and Approach paper.

Ergon Energy accepted the AER's form of control mechanism,³⁵ however in its cost build-up for fee-based services and its cost formula for quoted services it indicated it would include a 'capital allowance' component.³⁶ AER staff queried this component due to its inconsistent application and lack of submitted justification for inclusion. Ergon Energy subsequently advised the AER that the inclusion of this component was an error, and confirmed that they have accepted the AER's control mechanism formula as stated in the final Framework and Approach.³⁷

Our final formulae in the Framework and Approach are binding, unless there is a material change in circumstances which would justify varying these formulas.³⁸ We do not consider that such a change has arisen for alternative control services.

13.5.1 Form of control for alternative control services

Consistent with our final Framework and Approach, the price cap formula that will apply to Ergon Energy's alternative control services (except for quoted services) is below.³⁹

³⁴ AER, *Framework and approach for Energex and Ergon Energy control period commencing 1 July 2020*, July 2018, pp. 56-57.

³⁵ Energy Queensland, *Control Mechanisms 2020-25*, January 2019, pp. 5-6.

³⁶ Ergon Energy, *Alternative Control Services 2020-25*, January 2019, pp. 22-23.

³⁷ Ergon Energy, *Response to AER Information Request #014*, March 2019.

³⁸ NER, cl. 6.12.3(c1).

Figure 13.3 Price cap formula to apply to Ergon Energy's legacy metering, public lighting and ancillary services (fee based)

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

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

Where:

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

p_t^i is the price of service i in year t. For the first year of the regulatory control period, the cap on the price of service i will be as per the schedule of approved charges set out in Attachment 15.

\bar{p}_{t-1}^i is the cap on the price of service i in year t-1.

t is the regulatory year.

ΔCPI_t is the annual percentage change in the ABS consumer price index (CPI) All Groups, Weighted Average of Eight Capital Cities⁴⁰ from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

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

divided by

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

minus one.

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

X_t^i is the X factor for service i in year t. The value of this factor is as specified in Attachment 15 – Alternative Control Services. The X factor for public lighting is 0 per cent.

³⁹ AER, *Framework and approach Energex and Ergon Energy Regulatory control period commencing 1 July 2020*, July 2018, p. 56-57.

⁴⁰ If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

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

Quoted services

Figure 13.4 Price cap formula to apply to Ergon Energy's quoted services

$$\text{Price} = \text{Labour} + \text{Contractor Services} + \text{Materials}$$

Where:

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

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities⁴¹ from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

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

divided by

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

minus one.

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

X_t^i is the X factor for service i in year t. The value of this factor is as specified in Attachment 15 – Alternative Control Services.

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

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

⁴¹ If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

13.5.2 New services introduced during the regulatory control period

Where new services are introduced during the regulatory control period, and where such services were not identified at the time of our determination but for which the service clearly falls within one of the established service groupings, a quoted price approach is to be adopted based on a similar service within that same service grouping.⁴² Ergon Energy can then propose to classify this service differently at the time of the next regulatory determination. This is consistent with our Framework and Approach, and regulatory determinations across all NEM jurisdictions.

For example, the price for a new type of security lighting would be set based on the same approach as a similar security lighting service. This approach would give Ergon Energy additional flexibility to introduce new services while offering consumers the protections associated with price regulation.

Ergon Energy must advise us of any new alternative control services created within the regulatory control period as part of its annual pricing proposal. Its proposal should provide a detailed description of the service along with how the new service will be charged.

13.5.3 Reasons for draft decision for alternative control services

Following feedback we have received throughout the NSW 2019–24 regulatory determinations, particularly from Accredited Service Providers, with regards to a lack of transparency around invoices received, we consider it appropriate to introduce requirements around transparency of billing. This will aid in achieving consistency between regulatory arrangements for similar services across all jurisdictions.⁴³

When charging for quoted services:

1. Ergon Energy must provide itemised invoices to the customer or the service recipient.
2. The charges must be consistent with good industry practice in terms of the resource requirements.

⁴² AER, *Framework and approach Energex and Ergon Energy Regulatory control period commencing 1 July 2020*, July 2018, p. 55.

⁴³ NER, cl. 6.2.5(d)(4).

A DUoS unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2020–25 regulatory control period, Ergon Energy must maintain a DUoS unders and overs account in its annual pricing proposal.⁴⁴

Ergon Energy must provide the amounts for the following entries in its DUoS unders and overs account for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):⁴⁵

1. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the respective nominal weighted average cost of capital (WACC) for each intervening year between regulatory year t–2 and year t.⁴⁶ The WACC applied for each year will be that approved by the AER for the relevant year.
3. The amount of revenue recovered from DUoS charges in respect of that year, less the total annual revenue for the year in question.
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC.
5. The total sum of items 1–4 to derive the closing balance for each year.

Ergon Energy must provide details of calculations in the format set out in Table 13.1. Amounts provided for the most recently completed regulatory year (t–2) must be audited.⁴⁷ Amounts provided for the current regulatory year (t–1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of DUoS charges, Ergon Energy is expected to achieve a closing balance as close to zero as practicable in its DUoS unders and overs account in each forecast year in its annual pricing proposals during the 2020–25 regulatory control period.

⁴⁴ NER, cl. 6.18.2(b)(7).

⁴⁵ In exceptional circumstances, the DUoS unders and overs account can accommodate additional years—such as year t–3. If available, amounts provided for additional years must be audited where they depart from the annual RIN.

⁴⁶ The WACC for each year will be that approved by the AER for the respective year and as calculated as set out in Figure 13.1.

⁴⁷ A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

Table 13.1 Example calculation of DUoS unders and overs account (\$'000, nominal)

	Year t-2 (actual)	Year t-1 (estimate)	Year t (forecast)
(A) Revenue from DUoS charges	45 779	40 269	39 510
(B) Less TAR for regulatory year =	43 039	41 427	44 429
+ Annual smoothed revenues (AR _t)	40 189	41 393	44 393
+ Incentive scheme amounts (I _t) ^a	1 026	34	36
+ Annual adjustments (B _t) ^b	0	0	0
+ Cost pass through amount (C _t)	1 824	0	0
(C) Revenue deliberately under-recovered in year	1 000	0	0
(A minus B plus C) Under/over recovery of revenue for regulatory year	3 740	-1 158	-4 919^c
DUoS unders and overs account			
Nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	1 737	5 656 ^d	4 778
Interest on opening balance	87	311	287
Under/over recovery of revenue for regulatory year	3 740	-1 158	-4 919
Interest on under/over recovery for regulatory year	92	-31	-145
Closing balance	5 656	4 778	0^e

Notes:

- (a) Incentive schemes can include STPIS, EBSS, CESS, DMIS, the Allowance Mechanism, and any other schemes as set out in our determination.
- (b) B_t parameter calculations in the DUoS unders and overs account exclude the true-up for DUoS revenue under/over recovery for regulatory year and are therefore expected to be 0.
- (c) Approved DUoS revenue under/over recovery for regulatory year t.
- (d) Opening balance is the previous year's closing balance.
- (e) Ergon Energy is expected to achieve a closing balance as close to zero as practicable in its DUoS unders and overs account in each forecast year in its annual pricing proposals in the 2020–25 regulatory control period.

B Designated pricing proposal charges⁴⁸ unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2020–25 regulatory control period, Ergon Energy must maintain a designated pricing proposal charges unders and overs account in its annual pricing proposal.⁴⁹

Ergon Energy must provide the amounts for the following entries in its designated pricing proposal charges unders and overs account for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):⁵⁰

1. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the respective nominal weighted average cost of capital (WACC) for each intervening year between regulatory year t–2 and year t.⁵¹ The WACC applied for each year will be that approved by the AER for the relevant year.
3. The amount of revenue recovered from designated pricing proposal charges in respect of that year, less the total annual revenue for the year in question.
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC.
5. The total sum of items 1–4 to derive the closing balance for each year.

Ergon Energy must provide details of calculations in the format set out in Table 13.2. Amounts provided for the most recently completed regulatory year (t–2) must be audited.⁵² Amounts provided for the current regulatory year (t–1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of designated pricing proposal charges, Ergon Energy is expected to achieve a closing balance as close to zero as practicable in its designated pricing proposal charges unders and overs account in

⁴⁸ Designated pricing proposal charges are charges related to: designated pricing proposal services (prescribed exit fees, prescribed common transmission services and prescribed transmission use of system services); avoided customer transmission use of system charges; charges provided by another distributor (but only to the extent they comprise of designated pricing proposal services or standard control services); and charges or payments related specified in NER clause 11.39.

⁴⁹ NER, cll. 6.18.2(b)(6), 6.12.1(19), 6.18.7.

⁵⁰ In exceptional circumstances, the designated pricing proposal charges unders and overs account can accommodate additional years—such as year t–3. If available, amounts provided for additional years must be audited where they depart from the annual RIN.

⁵¹ The WACC for each year will be that approved by the AER for the respective year and as calculated as set out in Figure 13.1.

⁵² A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

each forecast year in its annual pricing proposals during the 2020–25 regulatory control period.

Table 13.2 Example calculation of designated pricing proposal charges unders and overs account (\$'000, nominal)

	Year t–2 (actual)	Year t–1 (estimate)	Year t (forecast)
(A) Revenue from designated pricing proposal charges (DPPC)	40 077	34 944	36 609
(B) Less DPPC related payments for regulatory year =	34 365	38 734	39 200
+ DPPC to be paid to TNSP	33 672	37 933	38 000
+ Avoided TUoS/DPPC payments	572	734	800
+ Inter-distributor payments	121	67	400
(A minus B) Under/over recovery of revenue for regulatory year	5 712	–3 790	–2 540^a
<i>DPPC unders and overs account</i>			
Nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	167	6 028 ^b	2 467
Interest on opening balance	8	332	148
Under/over recovery of revenue for regulatory year	5 712	–3 790	–2 540 ^a
Interest on under/over recovery for regulatory year	141	–103	–75
Closing balance	6 028	2 467	0^c

Notes: (a) Approved DPPC revenue under/over recovery for regulatory year t.
(b) Opening balance is the previous year's closing balance.
(c) Ergon Energy is expected to achieve a closing balance as close to zero as practicable in its DPPC unders and overs account in each forecast year in its annual pricing proposals in the 2020–25 regulatory control period.

C Jurisdictional scheme amounts⁵³ unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2020–25 regulatory control period, Ergon Energy must maintain a jurisdictional scheme amounts unders and overs account in its annual pricing proposal.⁵⁴

Ergon Energy must provide the amounts for the following entries in its jurisdictional scheme amounts unders and overs account for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):⁵⁵

1. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the respective nominal weighted average cost of capital (WACC) for each intervening year between regulatory year t–2 and year t.⁵⁶ The WACC applied for each year will be that approved by the AER for the relevant year.
3. The amount of revenue recovered from jurisdictional scheme amounts charges in respect of that year, less the total annual revenue for the year in question;
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC.
5. The total sum of items 1–4 to derive the closing balance for each year.

Ergon Energy must provide details of calculations in the format set out in Table 13.3. Amounts provided for the most recently completed regulatory year (t–2) must be audited.⁵⁷ Amounts provided for the current regulatory year (t–1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

Where Ergon Energy receives a government subsidy for jurisdictional schemes in lieu of recovering these amounts directly from jurisdictional scheme charges (or part thereof), it will be required to record the subsidy amount received as revenue. This will not impact the operation of the unders/overs account, and where Ergon Energy

⁵³ Jurisdictional scheme amounts are amounts a distributor is required under a jurisdictional scheme obligation as defined by the NER to: pay a person; pay into a fund established under an Act of a participating jurisdiction; credit against charges payable by a person; or reimburse a person, less any amounts recovered by the distributor from any person in respect of those amounts other than under the NER.

⁵⁴ NER, cll. 6.12.1(20), 6.18.2(b)(6A), 6.18.7A(b) and (c).

⁵⁵ In exceptional circumstances, the jurisdictional scheme amounts unders and overs account can accommodate additional years—such as year t–3. If available, amounts provided for additional years must be audited.

⁵⁶ The WACC for each year will be that approved by the AER for the respective year and as calculated as set out in Figure 13.1.

⁵⁷ A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

receives a full government subsidy for jurisdictional schemes it will not recover any amounts from customers in relation to those jurisdictional schemes.⁵⁸

In proposing variations to the amount and structure of jurisdictional scheme charges, Ergon Energy is expected to achieve a closing balance as close to zero as practicable in its jurisdictional scheme amounts unders and overs account in each forecast year in its annual pricing proposal during the 2020–25 regulatory control period.

Table 13.3 Example calculation of jurisdictional scheme amounts unders and overs account (\$'000, nominal)

	Year t–2 (actual)	Year t–1 (estimate)	Year t (forecast)
(A) Revenue from jurisdictional schemes	19 777	23 121	26 965
(B) Less jurisdictional scheme payments for regulatory year =	20 272	20 959	28 641
+ Jurisdictional scheme 1 payments	14 159	13 954	13 961
+ Jurisdictional scheme 2 payments	6 113	7 005	14 680
(A minus B) Under/over recovery of revenue for regulatory year	–495	2 162	–1 676^a
<i>Jurisdictional scheme amount unders and overs account</i>			
Nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	–52	–562 ^b	1 628
Interest on opening balance	–3	–31	98
Under/over recovery of revenue for regulatory year	–495	2 162	–1 676 ^a
Interest on under/over recovery for regulatory year	–12	59	–50
Closing balance	–562	1 628	0^c

Notes: (a) Approved jurisdictional scheme amounts revenue under/over recovery for regulatory year t.
 (b) Opening balance is the previous year's closing balance.
 (c) Ergon Energy is expected to achieve a closing balance as close to zero as practicable in its jurisdictional scheme amount unders and overs account in each forecast year in its annual pricing proposals in the 2020–25 regulatory control period.

⁵⁸ Ergon Energy currently receives a government subsidy for the Solar Bonus Scheme Feed-in tariff. This Queensland Government subsidy is active until 30 June 2020, with the Solar Bonus Scheme running until 2028.

D Rounding of inputs in annual pricing proposals

The following sets out our draft determination around the requirement of how Ergon Energy must use calculation inputs, whether on a rounded or unrounded basis, in the annual pricing approval process.

'Unrounded', for this purpose, will be taken to mean at least fifteen digit floating point precision (the level of accuracy at which numbers will be stored in Microsoft Excel workbooks of .XLS, .XLSX, .XLSM or .XLSB). This definition accepts that numbers with fewer than fifteen floating digits may not require fifteen digits to express (such as 2.25 being equivalent to 2.25000000000000) but will meet the definition of fifteen digit floating point precision.

Rounding in calculations must be done on a 'nearest' basis. So rounding to two decimal places means rounding to the nearest two decimal places, not rounding up automatically or down automatically. This accepts the convention that if a number falls precisely between two points, it can be rounded up (e.g. 2.245 can be rounded to 2.25 rather than 2.24).

Where a calculation produces an output which is to be used as an input in another calculation, rounding should not occur. Rounding should be applied to final outputs only, unless otherwise specified.

Unrounded inputs should be taken from approved Excel models where appropriate. X factors should be unrounded inputs taken from the approved model. Where necessary, inputs should be calculated as an alternative to using a rounded value. For example, inflation should be used as calculated based around the CPI tables as provided by the Australian Bureau of Statistics, or the AER's nominated best available substitute should this index cease to be calculated. The result of this calculation should be taken as is, not rounded before use. Table 13.4 sets out the required level of precision for an inflation calculation.

Table 13.4 Demonstration of inflation calculation

	Required Precision
The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2 (example)	112.1
The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1 (example)	114.6
ΔCPI_t	2.23015165031222%

When applying a price cap, the value of \bar{P}_i^i should be rounded to the nearest two decimal places each year.

Table 13.5 Demonstration of price cap calculation (with rounding)

	Required Precision
\bar{p}_{t-1}^i	\$23.28
X factor (example: should be taken from model)	-7.125%
ΔCPI_t	2.23015165031222%
\bar{p}_t^i (unrounded)	\$25.4938708296164
\bar{p}_t^i (rounded)	\$25.49

Prices p_t^i can be rounded to as few or as many decimal places as required, subject to being less than or equal the two decimal place value of \bar{p}_t^i . In the above table, this would mean a price of \$25.49 would be acceptable, as would a price of \$25.4899. However, a price of \$25.493 would not be compliant.

For avoidance of ambiguity, where a price is expressible as a rate for a period of time, rounding of the price cap will apply to the largest relevant time period. So an hourly, service will be capped on an hourly basis. However, a service which can be priced either on a daily rate or an annual rate will have rounding apply to the cap on the annual rate. The daily rate should then represent the annual rate divided by 365, or 366 should the regulatory year to which the price applies include 29 February 2024. This daily rate may be expressed on a rounded basis (with discretion from Ergon Energy on the appropriate level of decimal places to apply) but must be based on a rounding to the nearest decimal place.

The factors of the revenue cap formula, adjusted annual smoothed revenue requirement, sum of incentive scheme adjustments, sum of annual adjustment factors and sum of approved cost pass through amounts should be rounded to no fewer than two decimal places. Prices, quantities, X factors and CPI must be used unrounded in the revenue cap formula.

Unrounded inputs include all those not specified above as being rounded.