

ELECTRICITY ACT 1994
Section 253AA

As Minister for Energy and Water Supply, pursuant to section 253AA of the *Electricity Act 1994*, I hereby direct the Queensland Competition Authority to undertake a review of the draft revenue proposals by the electricity distributors Energex and Ergon Energy for their 2015/16 to 2019/20 regulatory period, for the purpose of providing me with advice for Cabinet on the reasonableness of the draft proposals and their implications for customer prices.

The following are the Terms of Reference pertaining to this direction.

1. Introduction

The Queensland electricity Distribution Network Service Providers (DNSPs), Energex and Ergon Energy, are required to submit their revenue proposals for 2015/16-2019/20 to the Australian Energy Regulator (AER) by 31 October 2014.

The Government has decided to seek an independent review of the DNSPs' draft revenue proposals. The Government has decided this review will be undertaken by the Queensland Competition Authority (QCA).

2. Objectives

In accordance with the Government's decision, the QCA will review the Energex and Ergon Energy revenue proposals, to independently assess the reasonableness of the proposals and their implications for customer prices.

3. Review Scope

The QCA will undertake a review of the DNSPs' draft 2015/16-2019/20 revenue proposals ahead of their submission to the AER on 31 October 2014, and provide objective advice to the Government on the reasonableness of the proposals. For clarity, the review is not intended to replicate either the processes for development of the DNSPs' revenue proposals, or the AER's review of the proposals.

Broadly, the review is intended to assess the reasonableness of the DNSPs' approaches and proposals. Within this context, the QCA should exercise its discretion in identifying and providing advice on any material departures from what might be considered reasonable expenditure projections, or from appropriate rate of return or taxation settings. Elements of the DNSPs' proposals on which specific advice would be expected include:

1. Rate of Return (Weighted Average Cost of Capital), having regard to commercial financing practice, relevant market data, the rate of return guidelines published by the AER and other evidence;
2. Tax, in particular the value of imputation credits i.e. gamma; and
3. Proposed capital and operational expenditure (capex and opex), having regard to the capex and opex objectives and input costs, overheads and cost escalators.

In addition to the advice requested above, the QCA should provide advice on other elements of the revenue proposal that it considers could usefully be reviewed in more detail, with more time.

The review should have regard to changes in the operating environment as compared with the previous revenue period, such as:

- lower costs of finance and increased certainty in financial markets;
- changing demand forecasts and slowing growth in peak demand;
- reform impacts, including the savings associated with key reforms at both jurisdictional and national levels (for example, amendments to reliability standards);
- outcomes of appeals subsequent to previous determinations; and
- recent changes to the National Electricity Rules (NER) and new AER Guidelines for economic regulation.

Consideration should be given to the assumptions underlying the revenue proposals and the review should have regard to the AER's published Framework and Approach.

4. Reporting and Outcomes

The QCA will provide a final report on the outcome of its review to the Minister for Energy and Water Supply by Friday, 10 October 2014.

The QCA is required to provide regular status reports at intervals agreed with the Department of Energy and Water Supply (DEWS). The QCA should also be prepared to brief officials on request.

5. Context and background

The Queensland Government promotes a cost-effective, safe, secure and resilient supply for Queensland electricity customers. The DNSPs' revenue proposals will have a significant impact on the price of electricity in Queensland between 2015 and 2020.

The DNSPs' Shareholding Ministers have reserve powers under the *Government Owned Corporations Act 1993* (GOC Act) and the *Electricity Act 1994* to direct a course of action that is in the public interest. However, the GOC Act also provides that a GOC's management must be given authority and autonomy to make commercial decisions and the businesses must act commercially.

Significant changes have been made to the national regulatory framework with the aim of reducing the impact of increasing network costs on customer bills. In particular, the Economic Regulation Rule Change of 2012 increased the powers of the AER to interrogate DNSP forecasts and constrain allowances. Furthermore, the AER's first annual benchmarking report will be delivered on 30 September 2014, and will provide for further scrutiny of the businesses' levels of expenditure.

The AER's newly formed Consumer Challenge Panel (CCP) has outlined a number of areas of dispute with the New South Wales DNSPs' proposals, and will be urging the AER to seriously challenge the networks to provide clear evidence of all of their claims regarding customers' preferences and willingness to pay for those preferences.

The CCP will also review the Queensland DNSPs' proposals. The key aspects of the proposals that the CCP has indicated that it will be considering include:

- New regulatory rules and strengthened regulatory powers;
- Significantly lower cost of capital;
- The significant downturn in electricity consumption and demand;
- Amended network planning standards; and
- State Government Network Reform Programs.

6. Timeframes for review

The review should commence as soon as possible following the QCA’s receipt of this direction.

The QCA is to provide a final report on its review by Friday, 10 October 2014.

7. Process

The QCA will lead the review but it is expected that, given the timeframe for the review, it may need to:

- engage specific services or expertise (e.g. engineering expertise) as it deems necessary and prudent to supplement its capacity
- rely on other sources of advice to assess aspects of the DNSPs’ proposals and their alignment with credible forecasts, for example, Australian Energy Market Operator demand forecasts

DEWS will secure copies of the DNSPs’ latest draft revenue proposals for provision to the QCA as soon as possible in the week commencing 18 August 2014.

The DNSPs will provide any updated versions of their revenue proposals to the QCA as they become available. The DNSPs will also provide supplementary advice to the QCA as requested during the review period, including all information and assistance that is reasonably requested by the QCA.

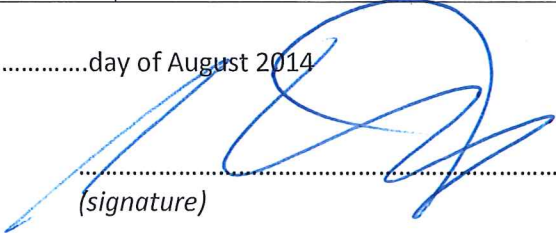
The DNSPs will fund the reasonable external costs of the review. The QCA should provide advice on review costs as soon as possible.

8. Key Milestones:

Activity	Due by
QCA Terms of Reference published	19 August 2014
DEWS provides current draft revenue proposals to QCA	week commencing 18 August 2014
Status reports and briefings	As agreed with DEWS
QCA Final Report to Minister for Energy and Water Supply	10 October 2014
Businesses submit revenue proposals	31 October 2014

DATED this 19thday of August 2014

SIGNED by
Mark McArdle
Minister for Energy and Water Supply


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