



# Framework and approach

**ActewAGL**

**Regulatory control period  
commencing 1 July 2019**

July 2017

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## Shortened forms

Shortened Form	Extended Form
Allowance Mechanism	demand management innovation allowance mechanism
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
COAG	Council of Australian Governments
CPI	consumer price index
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
expenditure assessment guideline	expenditure forecast assessment guideline for electricity distribution
GSL	guaranteed service level
F&A	Framework and approach
kWh	kilowatt hours
NEM	National Electricity Market
NEO	National Electricity Objective
NER or the rules	National Electricity Rules
next regulatory control period	1 July 2019 to 30 June 2024
opex	operating expenditure
RAB	regulatory asset base
ROLR	retailer of last resort

**Shortened Form****Extended Form**

STPIS

service target performance incentive scheme

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## Overview

The Australian Energy Regulator (AER) is the economic regulator for transmission and distribution electricity and gas network businesses across Australia (excluding Western Australia). Our powers and functions for the electricity sector are set out in the National Electricity Law (NEL) and National Electricity Rules (NER).

ActewAGL operates the sole monopoly electricity distribution network in the Australian Capital Territory (ACT). The network comprises the poles, wires and transformers used for transporting electricity across urban and rural population centres to homes and business. ActewAGL designs, constructs, operates and maintains the distribution network for ACT electricity consumers.

We make regulatory decisions on the revenue that ActewAGL can recover from its customers. We determine its revenue by an assessment of its efficient costs and forecasts. Our assessment is based on a regulatory proposal submitted by the network business in advance of a regulatory control period, in this case beginning 1 July 2019. The regulatory proposal sets out ActewAGL's view on its expected costs, services, incentive schemes and required revenues. Our regulatory determinations set out our decisions on these issues.

The regulatory framework we administer is based on an incentive regime. We set a network business' allowed revenue for a period (typically five years) based on the best available information, rigorous assessment and consideration of consumers' views. A network business is then provided with incentives to outperform the revenue we determine. The network business retains any savings for a period of time before those savings are passed to customers through lower network bills.

The Framework and Approach (F&A) is the first step in a two year process to determine efficient prices for electricity distribution services in the ACT. The F&A determines, amongst other things, which services we will regulate and the broad nature of the regulatory arrangements. This includes an assessment of services (service classification) and whether we need to directly control the prices and/or revenues set for those services. The F&A also facilitates early consultation with consumers and other stakeholders and assists electricity distribution businesses prepare regulatory proposals.

Five years ago we published an F&A for ActewAGL for the current regulatory control period. For the 2019–24 regulatory control period we consider it prudent to review the current F&A paper. Changes to the NER in November 2012 introduced new incentive schemes and allowed us to adopt improved approaches to assessing expenditure forecast by the network service providers.<sup>1</sup> The Power of Choice reforms also introduced changes to metering contestability.<sup>2</sup> Further, we are currently developing a new demand management incentive

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<sup>1</sup> Which we outline in our published guidelines. These guidelines are available at [www.aer.gov.au/Better-regulation-reform-program](http://www.aer.gov.au/Better-regulation-reform-program)

<sup>2</sup> See: <http://www.aemc.gov.au/Major-Pages/Power-of-choice>.

scheme (DMIS) and innovation allowance mechanism (Allowance Mechanism)<sup>3</sup> and have recently published a national ring-fencing guideline.<sup>4</sup>

Before reaching our proposed approach, we published a preliminary F&A for ActewAGL on 10 March 2017, seeking submissions from interested parties. Submissions closed on 21 April 2017, with three responses received, including a submission from our Consumer Challenge Panel (sub-panel 10), ActewAGL and SA Power Networks.<sup>5</sup>

Table 1 summarises the ActewAGL distribution determination process.

**Table 1: ActewAGL distribution determination process**

Step	Date
AER published preliminary position F&A for ActewAGL	10 March 2017
AER to publish final F&A for ActewAGL	July 2017
ActewAGL submits regulatory proposal to AER	January 2018
AER to publish Issues paper and hold public forum	March/April 2018*
Submission on regulatory proposal close	May 2018
AER to publish draft decision	September 2018
AER to hold a predetermination conference	October 2018
ActewAGL to submit revised regulatory proposal to AER	December 2018
Submissions on revised regulatory proposal and draft decision close	January 2019*
AER to publish ActewAGL determination for regulatory control period	April 2019

\*The date provided is based on the AER receiving a compliant proposal. The date may alter if we receive a non-compliant proposal.

Source: NER, chapters 6.

This overview sets out our positions on:

- classification of distribution services (which services we will regulate)
- control mechanisms (how we will determine prices for regulated services)

<sup>3</sup> See: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism>.

<sup>4</sup> AER, *Ring-fencing guideline electricity distribution*, November 2016. See: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-ring-fencing-guideline-2016>.

<sup>5</sup> All submissions are available on the AER's website at <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-determination-2019-24/aer-position>.

- incentives schemes for service quality, capital expenditure, operating expenditure and demand management
- expenditure forecasting tools to test ActewAGL’s regulatory proposal
- how we will calculate depreciation of ActewAGL’s regulatory asset base
- how we will price transmission assets (dual function assets).

We summarise below our approach to each of the above matters. Further details of our approach to each matter are set out in the following chapters.

## Classification of distribution services

We regulate distribution services provided by ActewAGL. Service classification determines the nature of economic regulation, if any, applicable to distribution services. We will regulate services provided on a monopoly basis under a price or revenue cap, which directly controls the charges that a distributor may levy a customer. Less prescriptive regulation is applied where prospect of competition exists. In some situations we may remove regulation altogether—unregulated distribution services must be provided through either a separate affiliate to the distributor or the distributor must demonstrate functional separation.<sup>6</sup> Broadly, this means that while existing regulated distribution services will continue to be provided by the distributor, all unregulated distribution services or new services that come into existence within a regulatory control period must be provided separate to the regulated network business, unless it applies for, and receives, a waiver under the ring-fencing guideline.

Table 2 provides an overview of the different classes of distribution services for the purposes of economic regulation under the NER.

**Table 2: Classifications of distribution services**

Classification		Description	Regulatory treatment
<b>Direct control service</b>	Standard control service	Services that are central to electricity supply and therefore relied on by most (if not all) customers such as building and maintaining the shared distribution network.  Most distribution services are classified as standard control.	We regulate these services by determining prices or an overall cap on the amount of revenue that may be earned for all standard control services.  The costs associated with these services are shared by all customers via their regular electricity bill.
	Alternative control	Customer specific or customer requested services. These services may also have	We set service specific prices to provide a reasonably opportunity to

<sup>6</sup> Functional separation may include physical separation of offices, staff separation, accounting separation and separate branding/avoiding cross-promotion. See AER, *Ring-fencing guideline electricity distribution*, November 2016; AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016, available at <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-ring-fencing-guideline-2016>.

service	potential for provision on a competitive basis rather than only by the local distributor.	enable the distributor to recover the efficient cost of each service from customers using that service.
<b>Negotiated service</b>	Services we consider require a less prescriptive regulatory approach because all relevant parties have sufficient countervailing market power to negotiate the provision of those services.	Distributors and customers are able to negotiate the service and price according to a framework established by the NER. We are available to arbitrate if necessary.
<b>Unclassified distribution services</b>	Distribution services that are contestable will not be classified.	We have no role in regulating these services.
<b>Non-distribution services</b>	Services that are not distribution services. <sup>7</sup>	We have no role in regulating these services.

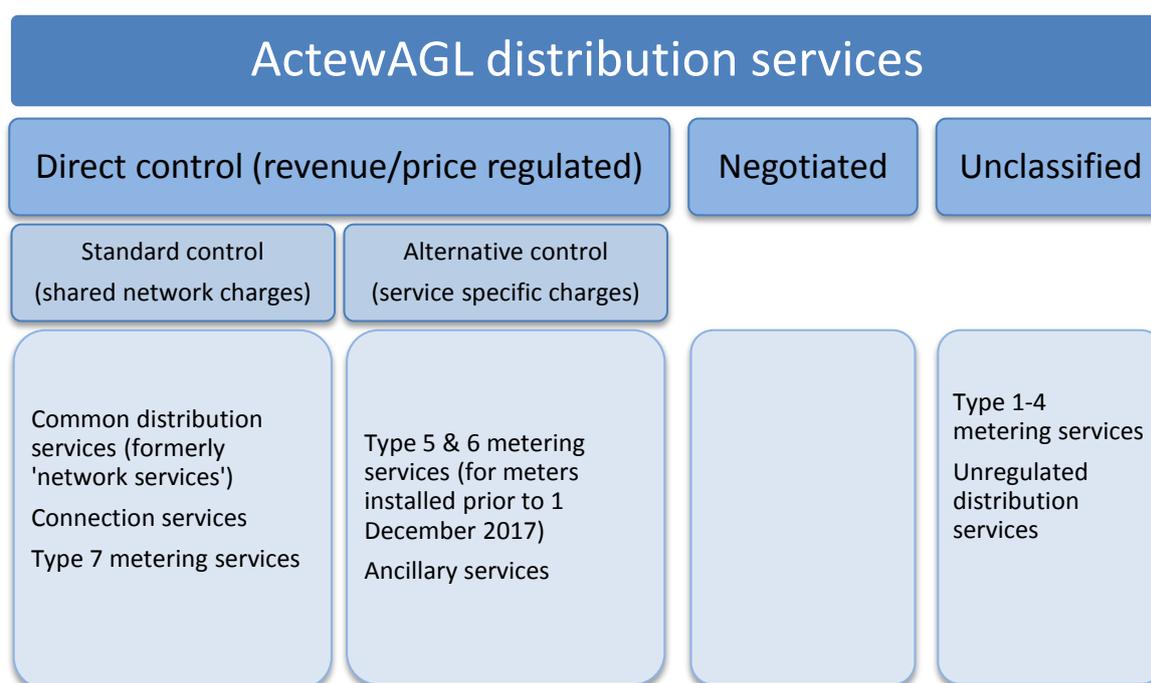
Source: AER

Our proposed position is to change the classification of some of ActewAGL's distribution services for the 2019–24 regulatory control period. Otherwise we have clarified service descriptions to better align with the services being provided, create consistency and predictability across jurisdictions as far as practicable in how new distribution services might be classified.

Our proposed service classification for ActewAGL's distribution services is set out in figure 1 below.

<sup>7</sup> The NER defines a distribution service as a service provided by means of, or in connection with, a distribution system. NER, Chapter 10, glossary.

**Figure 1 AER proposed classification of ActewAGL distribution services**



Source: AER

Our final F&A decision on service classification is not binding for our determination on ActewAGL's regulatory proposal. However, under the NER we may only change our classification approach if unforeseen circumstances arise, justifying a departure from our final F&A position.<sup>8</sup>

## Control mechanisms

Following on from service classifications, our determinations impose controls on direct control service prices and/or their revenues.<sup>9</sup> We may only accept or approve control mechanisms in a distributor's regulatory proposal if they are consistent with our final F&A.<sup>10</sup> In deciding control mechanism forms, we must select one or more from those listed in the NER.<sup>11</sup> These include price schedules, caps on the prices of individual services, weighted average price caps, revenue caps, average revenue caps and hybrid control mechanisms.

Our decision on the control mechanisms for ActewAGL is:

- standard control services – revenue cap
- alternative control services – caps on the prices of individual services.

<sup>8</sup> NER, cl. 6.12.3(b).

<sup>9</sup> NER, cl. 6.2.5(a).

<sup>10</sup> NER, cl. 6.12.3(c).

<sup>11</sup> NER, cl. 6.2.5(b).

We note the transition to a revenue cap control mechanism will ensure consistent regulatory arrangements to standard control services across all electricity distributors subject to economic regulation under the NER. We also consider a revenue cap will result in benefits to consumers through a higher likelihood of revenue recovery at efficient costs and will provide better incentives for demand side management.

The continuation of caps on the prices of individual services for alternative control services will ensure consistency across regulatory control periods and across jurisdictions. We also consider that caps on the prices of individual services are more suitable than other control mechanisms for delivering cost reflective prices.

For standard control services the NER mandates the basis of the control mechanism must be the prospective CPI-X form or some incentive-based variant.<sup>12</sup>

Our final F&A decision on the form of control is binding on us and ActewAGL for the 2019–24 regulatory determination.<sup>13</sup> We may only vary our proposed control mechanism formulas in response to unforeseen circumstances.<sup>14</sup>

## Incentive schemes

Incentive schemes encourage network businesses to manage their networks in a safe, reliable manner that serves the long term interests of consumers. They provide network businesses with incentives to only incur efficient costs and to meet or exceed service quality targets. Our proposed position is to apply the following available incentive schemes to ActewAGL:

- Service Target Performance Incentive Scheme (STPIS)
- Efficiency Benefit Sharing Scheme (EBSS)
- Capital Expenditure Sharing Scheme (CESS)
- Demand Management Incentive Scheme (DMIS) and Innovation Allowance Mechanism (Allowance Mechanism).

Our final F&A approach on the application of incentive schemes is not binding on us or ActewAGL.

## Application of our Expenditure Forecast Assessment Guideline

Our Expenditure Forecast Assessment Guideline<sup>15</sup> is based on a reporting framework allowing us to compare the relative efficiencies of distributors. Our proposed position is to

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<sup>12</sup> NER, cl. 6.2.6(a). The basis of the form of control is the method by which target revenues or prices are calculated e.g. a building block approach.

<sup>13</sup> NER, cl. 6.8.1(b)(1)(i).

<sup>14</sup> NER, cl. 6.12.3(c1).

<sup>15</sup> AER, *Expenditure Forecast Assessment Guideline for Distribution*, November 2013.

apply the guideline, including its information requirements, to ActewAGL in the 2019–24 regulatory control period.

Our expenditure assessment guideline outlines a suite of assessment/analytical tools and techniques to assist our review of ActewAGL’s regulatory proposal. We intend to apply the assessment/analytical tools set out in the guideline and any other appropriate tools for assessing expenditure forecasts.

Our final F&A approach on the application of the guideline is not binding.

## Depreciation

When we roll forward ActewAGL’s regulatory asset base (RAB) for the upcoming regulatory control period we must adjust for depreciation. Our proposed approach is to use depreciation based on forecast capex (or forecast depreciation) to establish the opening RAB as at 1 July 2024. In combination with our proposed application of the CESS this approach will maintain incentives for ActewAGL to pursue capital expenditure efficiencies. These improved efficiencies will benefit consumers through lower regulated prices.

Our final F&A decision on the depreciation approach is not binding.

## Dual function assets

Dual function assets are high-voltage transmission assets forming part of a distribution network. We decide whether to price dual function assets according to transmission or distribution pricing rules. Under transmission pricing rules the asset costs are recovered from all ACT customers, like the cost of other transmission assets. Distribution pricing rules recover costs from only the customers of a specific distribution network.

According to information submitted by ActewAGL, the distribution business does operate dual function assets. Our decision is to apply transmission pricing rules to ActewAGL’s dual function assets because doing otherwise would materially impact ActewAGL’s distribution customers and affect consumption, production and investment.<sup>16</sup>

Our final F&A decision on dual function assets is binding.<sup>17</sup>

## Consumer engagement by network service providers

We released the Consumer Engagement Guideline for Network Service Providers<sup>18</sup> in 2013 to assist network businesses develop, implement and ultimately entrench stakeholder engagement as part of its business processes.

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<sup>16</sup> AER, *Stage 1 Framework and approach paper ActewAGL*, March 2013. See: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-determination-2014-19/aer-position>

<sup>17</sup> NER, cl. 6.8.1(b)(1)(ii).

<sup>18</sup> AER, *Consumer engagement guideline for network service providers*, November 2013; AER, *Explanatory statement – Consumer engagement guideline for network service providers*, November 2013, see: <https://www.aer.gov.au/networks->

Our Consumer Challenge Panel (CCP sub-panel 10), in its submission to our preliminary F&A, stressed that there is an expectation that ActewAGL use 'best endeavours' to apply the Consumer Engagement Guideline as a minimum standard in developing its regulatory proposal for 2019–24.<sup>19</sup> We agree with CCP sub-panel 10's submission on this issue.

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<sup>19</sup> pipelines/guidelines-schemes-models-reviews/consumer-engagement-guideline-for-network-service-providers.  
Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, p. 20.

# 1 Classification of distribution services

This chapter sets out our proposed approach on the classification of distribution services provided ActewAGL in the 2019–24 regulatory control period. Service classification determines the nature of economic regulation, if any, applicable to distribution services. Applying the classification process prescribed in the NER, we may classify services so that we:

- directly control prices of some distribution services<sup>20</sup>
- allow parties to negotiate services and prices and only arbitrate disputes if necessary, or
- do not regulate some distribution services at all.

Our classification decisions therefore determine which services we will regulate and how distributors will recover the cost of providing those regulated services. We introduced our ring-fencing guideline for electricity distributors and our classification decisions will also settle ring-fencing obligations that will apply ActewAGL for the 2019–24 regulatory control period.<sup>21</sup> For these reasons, we have closely reviewed the table of distribution services at appendix B.<sup>22</sup>

We are also aware that the Australian Energy Market Commission (AEMC) is currently assessing rule change proposals from the Council of Australian Governments Energy Council and Australian Energy Council on contestability of energy services.<sup>23</sup> While the AEMC's consideration of these rule change requests is ongoing, we have developed our proposed classification positions within the current regulatory framework. We aim to provide improved clarity, consistency across jurisdictions as far as practicable, predictability in how new distribution services might be classified and service descriptions that better align with the services being provided. Our approach is supported by CCP sub-panel 10.<sup>24</sup> ActewAGL also accepted our service classification at a high level, but has sought clarification to some ancillary descriptions, which we discuss below.<sup>25</sup>

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<sup>20</sup> Control mechanisms available for each service depend on their classification. Control mechanisms available for direct control services are listed by clause 6.2.5(b) of the NER. These include caps on revenue, average revenue, prices and weighted average prices. A fixed price schedule or a combination of the listed forms of control are also available.

Negotiated services are regulated under part D of chapter 6 of the NER.

<sup>21</sup> AER, *Ring-fencing guideline electricity distribution*, November 2016; AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016.

<sup>22</sup> As requested by ActewAGL in its letter to the AER: *Request for the AER to make, or make an amended or replacement framework and approach*, 28 October 2016, p. 3–4.

<sup>23</sup> AEMC, *Consultation paper, National Electricity Amendment (Contestability of energy services) Rule 2016 (COAG), National Electricity Amendment (Contestability of energy services - demand response and network support) Rule 2016 (Australian Energy Council)*, 15 December 2016.

<sup>24</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, p. 6.

<sup>25</sup> ActewAGL, *Response to AER preliminary framework and approach*, April 2017, p. 8.

## 1.1 AER's proposed position

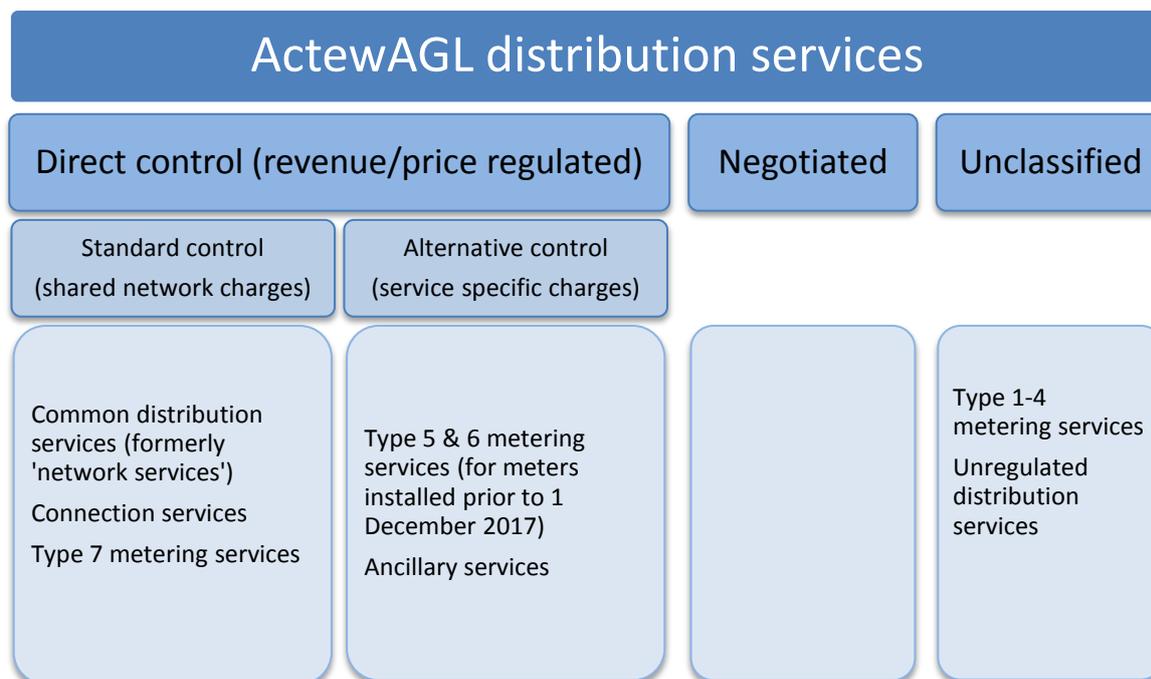
Overall, our proposed position is to change the classification of some ACT distribution services for the 2019–24 regulatory control period.

Our proposed position is to group distribution services provided by ActewAGL as:

- common distribution services (formerly 'network services')
- metering services
- connection services
- ancillary services
- unregulated distribution services.

Figure 1.1 summarises our proposed classification of ACT distribution services. Our assessment approach and reasons follow.

**Figure 1.1 AER proposed classification of ACT distribution services**



Source: AER

## 1.2 AER's assessment approach

In conducting our assessment of distribution service classification, we commence on the basis that we:

- classify the service, rather than the asset – we can only decide on service classification if we understand what the service being provided is. That is, distribution service

classification involves the classification of services distributors supply to customers rather than the classification of:

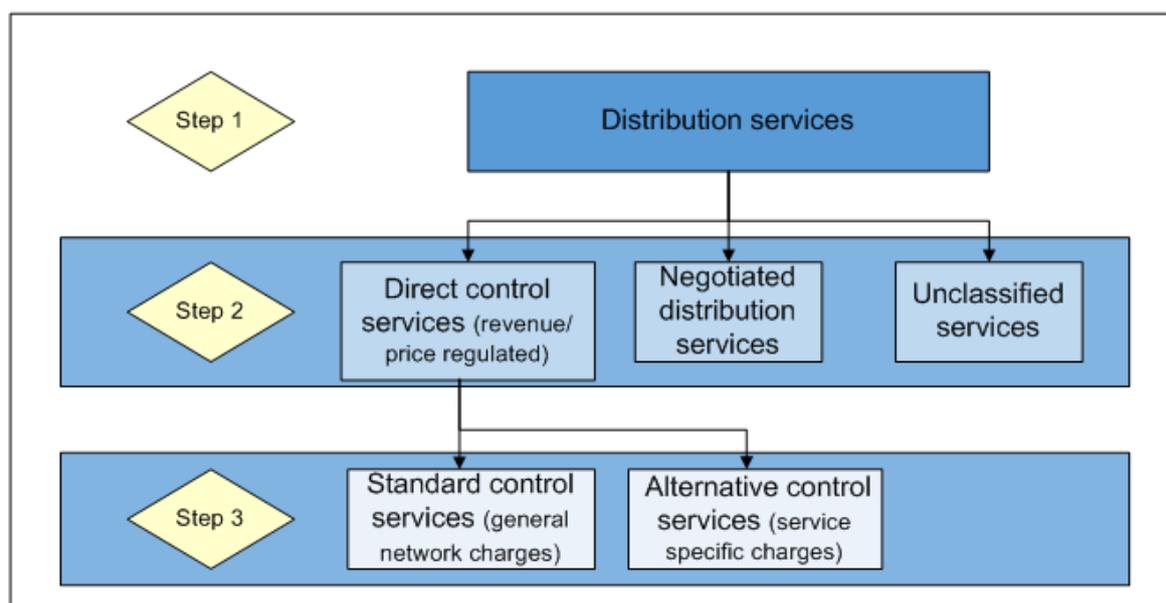
- the assets used to provide such services;
  - the inputs/delivery methods distributors use to provide such services to
  - customers
  - services that consumers or other parties provide to distributors.
- classify distribution services in groups<sup>26</sup> – our general approach to service classification is to classify services in groupings rather than individually. This obviates the need to classify services one-by-one and instead defines a service cluster, that where a service is similar in nature it would require the same regulatory treatment. As a result, a new service with characteristics that are the same or essentially the same as other services within a group might simply be added to the existing grouping and hence be treated in the same way for ring-fencing purposes. This provides distributors with flexibility to alter the exact specification (but not the nature) of a service during a regulatory control period. Where we make a single classification for a group of services, it applies to each service in the group.
  - In some circumstances, we may choose to classify a single service because of its particular nature. In addition, a distribution service that does not belong to any existing service classification may be 'not classified' and therefore be treated as an unregulated distribution service for that regulatory control period. New distribution services (that are created within a regulatory control period) are also to be treated as unregulated distribution services for the remainder of that regulatory control period.

Once we group services, the NER sets out a three-step classification process we must follow. We must consider a number of specified factors at each step. Figure 1.2 outlines the classification process under the NER.

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<sup>26</sup> NER, cl. 6.2.1(b).

**Figure 1.2 Distribution service classification process**



Source: NER, chapter 6, part B.

As illustrated by figure 1.2:

- We must first satisfy ourselves that a service is a 'distribution service' (step 1). The NER define a distribution service as a service provided by means of, or in connection with, a distribution system.<sup>27</sup> A 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'.<sup>28</sup>
- We then consider whether economic regulation of the service is necessary (step 2). When we do not consider economic regulation is warranted we will not classify the service. If economic regulation is necessary, we consider whether to classify the service as either a direct control or negotiated distribution service.
- When we consider that a service should be classified as direct control, we further classify it as either a standard control or alternative control service (step 3).

When deciding whether to classify services as either direct control or negotiated services, or to not classify them, the NER requires us to have regard to the 'form of regulation factors' set out in the NEL.<sup>29</sup> We have reproduced these at appendix A. They include the presence or extent of barriers to entry by alternative providers and whether distributors possess market power in provision of the services. The NER also requires us to consider the previous form

<sup>27</sup> NER, chapter 10, glossary.

<sup>28</sup> NER, chapter 10, glossary.

<sup>29</sup> NER, cl. 6.2.1(c); NEL, s. 2F.

of regulation applied to services and the desirability of consistency in the form of regulation for similar services both within and beyond the jurisdiction.<sup>30</sup>

For services we intend to classify as direct control services, the NER requires us to have regard to a further range of factors.<sup>31</sup> These include the potential to develop competition in provision of a service and how our classification may influence that potential; whether the costs of providing the service are directly attributable to a specific person; and the possible effect of the classification on administrative costs.

The NER also specifies that for a service regulated previously, unless a different classification is clearly more appropriate, we must:<sup>32</sup>

- not depart from a previous classification (if the services have been previously classified), and
- if there has been no previous classification—the classification should be consistent with the previously applicable regulatory approach.<sup>33</sup>

Our classification decisions determine how distributors will recover the cost of providing services.<sup>34</sup> Distributors recover standard control service costs by averaging them across all customers using the shared network. This shared network charge forms the core distribution component of an electricity bill. In contrast, distributors will charge a specific user who requests an alternative control service. Alternative control classification is akin to a 'user-pays' system. We set service specific prices to enable the distributor to recover the full efficient cost of each service from the customers using that service. At a high level, a service will be classified as ACS if it is either:

- potentially contestable, or
- it is a monopoly service used by a small number of identifiable customers on a discretionary or infrequent basis and the costs can be directly attributed to those customers.

For services we classify as negotiated, distributors and customers will negotiate service provision and price under a framework established by the NER. Our role is to arbitrate disputes where distributors and prospective customers cannot agree. Two instruments support the negotiation process:

- Negotiating distribution service criteria—sets out the criteria distributors are to apply in negotiating the price, and terms and conditions, under which they supply distribution services. We will also apply the negotiating distribution service criteria in resolving disputes.

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<sup>30</sup> NER, cl. 6.2.1(c).

<sup>31</sup> NER, cl. 6.2.2(c).

<sup>32</sup> NER, cl. 6.2.2(d).

<sup>33</sup> NER, cll. 6.2.1(d) and 6.2.2(d).

<sup>34</sup> We regulate distributors by determining either the prices they may charge (price cap) or by determining the revenues they may recover from customers (revenue cap).

- Negotiating framework—sets out the procedures a distributor and any person wishing to use a negotiated distribution service must follow in negotiating for provision of the service.

In the case of some distribution services, we may determine there is sufficient competition that there is no need for us to classify the service as either a direct control or negotiated distribution service. That is, the market is sufficiently competitive, allowing customers to shop around for the best price. We refer to these distribution services as 'unregulated distribution services'. Broadly, pursuant to our Ring-Fencing Guideline, this means that while existing regulated distribution services will continue to be provided by the distributor, all unregulated distribution services or new services that come into existence within a regulatory control period must be provided outside of the regulated network business, unless it applies for, and receives, a waiver under the ring-fencing guideline.<sup>35</sup>

### 1.3 Reasons for AER's proposed position

This section sets out our proposed service classification and reasons for ActewAGL's 2019–24 regulatory control period for:

- common distribution services (formerly 'network services')
- metering services
- connection services
- ancillary services
- unregulated distribution services.

Appendix B contains a detailed table of our preliminary classification of ACT distribution services.

#### 1.3.1 Common distribution services

This service group was formerly called 'network services'. However, to avoid confusion with the defined terms in chapter 10 of the NER, we propose to rename this service group 'common distribution services'.

Common distribution services are concerned with providing a safe and reliable electricity supply to customers.<sup>36</sup> Common distribution services are intrinsically tied to the network infrastructure and the staff and systems that support the shared use of the distribution network by customers. Customers use or rely on access to common distribution services on a regular basis. Providing common distribution services involves a variety of different activities, such as the construction and maintenance of poles and wires used to transport energy across the shared network. The precise nature of activities provided to plan, design,

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<sup>35</sup> AER, *Ring-fencing guideline electricity distribution*, November 2016; AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016.

<sup>36</sup> NER, Chapter 10 glossary.

construct and maintain the shared network may change over time. Regardless of what activities make up common distribution services, this service group reflects the provision of access to the shared network to customers.

CCP sub-panel 10 agreed with our preliminary definition and classification of common distribution services, but suggested that the group could be named 'core distribution services' as it refers to the 'core business' of a network distribution service provider.<sup>37</sup> Our proposed approach is to retain 'common distribution services' as it has greater meaning to customers by referring to the common services they receive from the distributors.

We had proposed a description of common distribution services in our preliminary F&A for ActewAGL. Following consideration of submissions, we have adopted the description of common distribution services as proposed by Ausgrid as it more appropriately captures the scope of those services. That description is contained in appendix B. We propose to apply this definition to all distributors, including ActewAGL.

Ausgrid explained that its common distribution services description contains three key parts.<sup>38</sup> In short, Ausgrid submitted these are:

1. An overarching description of the services which is based on the definition of 'distribution use of system service' in chapter 10 of the NER. This provides a legally sound footing on which to base the description which is consistent with regulatory obligations as a distributor.
2. A list of the key inputs that are directly or indirectly involved in providing common distribution services. The description only includes the core set of activities which fall into the service group. The exceptions are those activities that fall within common distribution services, but which may not readily appear to do so. For example, activities involved in the relocation of assets forming part of the distribution network but which are not relocations requested by a third party, works to fix damage to the network (including emergency recoverable works) and network demand management for distributor purposes. The phrase 'for distributor purposes' is intended to avoid the capture of unregulated battery storage or micro-grid businesses which provide services that are not distribution services.
3. An express exclusion of any other services that are separately classified but which may still meet the description of common distribution services. The purpose of the exclusion is to ensure that distribution services that are unclassified and therefore unregulated are not inadvertently captured by common distribution services. This is important to facilitate compliance with the ring-fencing guideline.

Ausgrid submitted that the substance of its amended description varies little from our preliminary F&A description, but provided better accuracy and less ambiguity.<sup>39</sup>

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<sup>37</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, p. 7.

<sup>38</sup> Ausgrid, *Submission on AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, pp. 4–5.

Our proposed position is to classify common distribution services as direct control services. ActewAGL holds an electricity distribution licence.<sup>40</sup> This licence is the only distribution licence currently issued for the ACT. Similarly, under the *Utilities Act 2000* (ACT), a person must not provide a utility service except in accordance with a licence.<sup>41</sup> The same legislation obliges ActewAGL to operate, maintain (including repair and replace as necessary) and protect its supply network. This is to ensure safe, reliable and economic supply of electricity to users.<sup>42</sup> Therefore, only ActewAGL can provide common distribution services relating to the safe and reliable supply of electricity through its distribution network. Additionally, consumers cannot source common distribution services in their distribution area from external providers. These arrangements create a regulatory barrier, preventing third parties from providing common distribution services.<sup>43</sup>

Therefore, we consider that there is no opportunity for third parties to enter the market for the provision of common distribution services. We must further classify direct control services as either standard or alternative control services.<sup>44</sup> Our proposed position is to retain the current standard control classification for common distribution services. There is no potential to develop competition in the market for common distribution services because of the barriers outlined above.<sup>45</sup> There would be no material effect on administrative costs for us, ActewAGL, users or potential users by continuing this classification.<sup>46</sup> We currently classify common distribution services (or 'network services') in the ACT and all other NEM jurisdictions as standard control services.<sup>47</sup> Further, distributors provide common distribution services through a shared network and therefore cannot directly attribute the costs of these services to individual customers.<sup>48</sup>

## Emergency recoverable works

We define emergency recoverable works as the distributor's emergency work to repair damage following a person's act or omission, for which that person is liable (for example, repairs to a power pole following a motor vehicle accident).

Given that these services are provided in connection with a distribution system, we consider this a distribution service. However, we currently do not classify this service, treating it as an unregulated distribution service. This is because the cost of these works may be recovered through other avenues (e.g. under common law). That is, the distributor can seek payment of their costs to fix the network from the parties responsible for causing the damage, through

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<sup>39</sup> Ausgrid, *Submission on AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, pp. 4–5.

<sup>40</sup> The licence is issued by the Independent Competition and Regulatory Commission (ICRC) (ACT).

<sup>41</sup> Section 21 of the *Utilities Act 2000* (ACT). Section 6(a) of the same Act defines a 'utility service' to include 'the distribution of electricity through an electricity network.'

<sup>42</sup> For example, ss. 2 and 79 of the *Utilities Act 2000* (ACT).

<sup>43</sup> NER, cl. 6.2.1(c)(1); NEL, ss. 2F(a), (d) and (f).

<sup>44</sup> NER, cl. 6.2.2(a).

<sup>45</sup> NER, cl. 6.2.2(c)(1).

<sup>46</sup> NER, cll. 6.2.2(c)(2), (3).

<sup>47</sup> NER, cl. 6.2.2(c)(4).

<sup>48</sup> NER, cl. 6.2.2(c)(5).

the courts if necessary. However, following the introduction of our ring-fencing guideline, classifying this service as an unregulated distribution service would require it to be ring-fenced.

Therefore, our proposed position is for emergency recoverable works to be subsumed into the common distribution services group and classified as a direct control and standard control service. CCP sub-panel 10 supported this approach.<sup>49</sup> Distributors are required to perform works to maintain or repair the shared network to ensure a safe and reliable electricity supply.

Although we propose classifying this service as a standard control service, a distributor is still expected to seek recovery of the cost of these emergency repairs from the third party where possible. If a distributor is successful in recovering the cost of the emergency repairs from a third party, this payment or revenue, would be netted off against the efficient operating expenditure (opex) incurred by a distributor in performing emergency recoverable works.<sup>50</sup> This prevents distributors from recovering the cost of emergency repairs twice—as a standard control charge across the broader customer base and from the responsible third party. Going forward, we propose to adopt this approach across all NEM jurisdictions.

### 1.3.2 Metering services

All electricity customers have a meter that measures the amount of electricity they use.<sup>51</sup> On 26 November 2015, the AEMC made a final rule that will open up competition in metering services and give consumers more opportunities to access a wider range of metering services.<sup>52</sup>

The competitive framework is designed to promote innovation and lead to investment in advanced meters that deliver services valued by consumers at a price they are willing to pay. Improved access to the services enabled by advanced meters will provide consumers with opportunities to better understand and take control of their electricity consumption and the costs associated with their usage decisions.<sup>53</sup>

The final rule alters who has overall responsibility for the provision of metering services by providing for the role and responsibilities of the Responsible Person to be performed by a new type of Registered Participant – a Metering Coordinator. Any person can become a Metering Coordinator subject to satisfying certain registration requirements.<sup>54</sup>

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<sup>49</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, pp. 7–8.

<sup>50</sup> In our preliminary F&A (at p. 21), we incorrectly stated that the cost of emergency repairs recovered from a third party would be netted off the regulatory asset base and treated like a capital contribution. We have changed our position because our preliminary approach may not have achieved the objective of avoiding over-recovery of costs.

<sup>51</sup> All connections to the network must have a metering installation (NER, cl. 7.3.1A(a)).

<sup>52</sup> AEMC, *Competition in metering services information sheet*, 26 November 2015.

<sup>53</sup> AEMC, *Competition in metering services information sheet*, 26 November 2015.

<sup>54</sup> AEMC, *Competition in metering services information sheet*, 26 November 2015.

Retailers are required to appoint the Metering Coordinator for their retail customers. The final rule also includes a number of other features to support the competitive framework for the provision of metering services, including consumer protections<sup>55</sup> and an ability for consumers to opt out of having an advanced meter installed if they have an existing, working meter.<sup>56</sup>

The new arrangements will commence on 1 December 2017 and have required changes to the NER and the National Electricity Retail Rules (NERR).<sup>57</sup> Consequently, our proposed classification of some metering services will also change for the 2019–24 regulatory control period.

### **Type 1 to 4 metering services**

Type 1 to 4 meters provide a range of additional functions compared to other meters. In particular, these meter types have a remote communication ability. Type 1 to 4 meters are competitively available<sup>58</sup> and we do not currently regulate them in the ACT or in most other jurisdictions—they are not classified and therefore are unregulated distribution services and our proposed position is for them to remain so.

### **Type 5 and 6 metering services**

ActewAGL is currently the monopoly provider of type 5 (interval) and 6 (accumulation) meters. However, from 1 December 2017 (and therefore before the commencement of the next regulatory control period on 1 July 2019), metering services across the National Energy Market (NEM) will become contestable. Therefore, from 1 December 2017, households and other small customers who traditionally use these meter types may wish to change their metering provider and the type of meter they have.

While ActewAGL cannot install new type 5 and 6 meters from 1 December 2017, it will continue to operate and maintain existing type 5 and 6 meters until they are replaced. Therefore, ActewAGL will still recover the capital cost of type 5 and 6 metering equipment installed prior to 1 December 2017 as an alternative control service. Type 5 and 6 metering services were unbundled from standard control services in our final determination for 2015–19 regulatory control period<sup>59</sup> to promote customer choice and remove any classification barriers limiting contestable provision of these meters.<sup>60</sup> This approach aligned with AEMC's Power of Choice recommendations to unbundle metering costs from shared network charges.<sup>61</sup>

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<sup>55</sup> AEMC, *Competition in metering services information sheet*, 26 November 2015.

<sup>56</sup> AEMC, *Final rule to increase consumers' access to new services information sheet*, 26 November 2015.

<sup>57</sup> AEMC, *Competition in metering services information sheet*, 26 November 2015.

<sup>58</sup> NER, cll. 7.2.3(a)(2) and 7.3.1.A(a).

<sup>59</sup> AER, *Final decision ActewAGL 2015–19 regulatory control period, Attachment 13 Classification of services*, April 2015.

<sup>60</sup> AER, *Final decision ActewAGL 2015–19 regulatory control period, Attachment 13 Classification of services*, April 2015.

<sup>61</sup> AEMC, *Consultation paper — National electricity amendment (expanding competition in metering and related services)*, April 2014.

## Type 7 metering services

Type 7 metering services are unmetered connections with a predictable energy consumption pattern (for example, public lighting connections). Such connections do not include a meter that measures electricity use. Charges associated with type 7 metering services relate to the process of estimating electricity use. For example, the distributor estimates public light usage using the total time the lights were on, the number of lights in operation and the light bulb wattage. ActewAGL is the monopoly provider of type 7 metering services in the ACT.<sup>62</sup>

We therefore consider that there is no potential to develop competition in the provision of type 7 metering services.<sup>63</sup> Currently, type 7 metering services in the ACT are classified as alternative control services. In our current F&A we did not consider it worthwhile to alter the classification for a distribution service provided free of charge.<sup>64</sup> However, we consider a direct control and further, standard control service classification is clearly more appropriate for this monopoly service.<sup>65</sup> We are not departing from the current direct control service classification<sup>66</sup> and a standard control classification would satisfy the NER's desire for consistency in regulatory approach to type 7 metering services across NEM jurisdictions.<sup>67</sup> Our proposed change in classification would have no impact on the administrative costs on us, ActewAGL, users or potential users.<sup>68</sup> CCP sub-panel 10 supported our proposed classification of type 7 metering services,<sup>69</sup> while ActewAGL did not discuss our approach in its submission on our preliminary F&A.

## Ancillary services – Metering

ActewAGL will be required to provide ancillary metering services to support the metering contestability framework along with ongoing metering services to support existing type 5 and 6 meters.

Some examples include:

- Type 5 and 6 meter final read – to conduct a final read on removed type 5 metering equipment as required by the Australian Energy Market Operator Service Level Procedure.<sup>70</sup>

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<sup>62</sup> NER, cl. 7.2.3(a)(2).

<sup>63</sup> NER, 6.2.2(c)(1).

<sup>64</sup> AER, *Stage 1 final F&A for ActewAGL*, March 2013, p. 36.

<sup>65</sup> NER, cl. 6.2.1(d).

<sup>66</sup> NER, cl. 6.2.1(d)(1).

<sup>67</sup> NER, cl. 6.2.2(c)(4).

<sup>68</sup> NER, cl. 6.2.2(c)(2).

<sup>69</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, p. 9.

<sup>70</sup> This Service Level Procedures applies to Metering Providers who are accredited and registered by AEMO to provide metering services within the National Electricity Market (NEM). The Service Level Procedure details the technical requirements and performances associated with the provision, installation and maintenance of a metering installation. This Service Level Procedures is established under clause 7.14.1A of the NER for the various categories of registration and metering installation types as detailed under clause S7.4 of the NER.

- Distributor arranged outage for purposes of replacing meter – at the request of a retailer or metering coordinator, provide notification to affected customers and facilitate the disconnection/reconnection of customer metering installations where a retailer planned interruption cannot be conducted.<sup>71</sup>
- Type 5 and 6 meter recovery and disposal – at the request of the customer or their agent to remove or remove and dispose of a type 5 or 6 meter where a permanent disconnection has been requested.

A detailed list of ancillary metering services is contained in appendix B.

Our proposed classification and reasons for ancillary services (which captures ancillary metering services) are set out in section 1.3.4 below with our broader discussion on all ancillary services.

### **Metering coordinator, metering provider, metering data provider**

Under the competitive framework for metering, the roles of metering coordinator, metering provider and metering data provider may be performed by any registered person.<sup>72</sup>

While we consider a metering coordinator, metering provider or metering data provider are distribution services, our proposed approach is to not classify these services.<sup>73</sup> That is, we propose to treat them as unregulated distribution services. Importantly, we consider that pre-existing type 5 and 6 metering services, as detailed in appendix B, already encompasses these roles and is reflected in the alternative control service charges.

To explain further, each distributor, as the current 'responsible person' under the NER, will be appointed as the metering coordinator as at 1 December 2017.<sup>74</sup> The distributors will remain in this role until such time as their type 5 or 6 meter is replaced or they receive notice from a retailer that it is replacing them as metering coordinator. While a distributor acts as the initial metering coordinator performing its current services like type 5 and 6 metering reading, maintenance and testing, we will classify it as an alternative control service. SA Power Networks supported this approach.<sup>75</sup>

### **1.3.3 Connection services**

Put simply, a connection service refers to the services a distributor performs in order to:

<sup>71</sup> AEMC, *Rule determination, National Electricity Amendment (Expanding competition in metering and related services) Rule 2015; National Energy Retail Amendment (Expanding competition in metering and related services) Rule 2015*, 26 November 2015, p. 206.

<sup>72</sup> AEMC, *Rule determination, National Electricity Amendment (Expanding competition in metering and related services) Rule 2015; National Energy Retail Amendment (Expanding competition in metering and related services) Rule 2015*, 26 November 2015, pp. 127–131.

<sup>73</sup> NER, chapter 10, glossary; *Ergon Energy Corporation Ltd v Australian Energy Regulator* [2012] FCA 393

<sup>74</sup> NER, cl. 11.86.7.

<sup>75</sup> SA Power Networks, *Submission on AER preliminary framework and approach for NSW, ACT, TAS*, 21 April 2017, pp. 1–2.

- connect a person’s home, business or other premises to the electricity distribution network (premises connection)
- get more electricity from the distribution network than is possible at the moment (augmentation);
- extend the network to reach a person’s premises (extension).

We currently classify ActewAGL's connection services as described above as direct control and further, as standard control services. Our proposed approach is to continue this classification. CCP sub-panel 10 supported our approach.<sup>76</sup>

ActewAGL holds the only electricity distribution licence to provide connection services in the ACT. This licensing arrangement results in a regulatory barrier preventing third parties from providing connection services.<sup>77</sup> Additionally, we consider the scale and scope of resources available to ActewAGL also prevent the competitive provision of connection services by a third party. We therefore consider that ActewAGL possesses significant market power in the provision of connection services.<sup>78</sup>

Although we classify separate components of connection services<sup>79</sup> in some other NEM jurisdictions, we do not consider it the most appropriate approach for the ACT. This is because ActewAGL may recover costs through shared network charges to the extent that costs have not been recovered as capital contributions under Chapter 5A of the NER.<sup>80</sup>

The purpose of Chapter 5A and the Guideline<sup>81</sup> is to provide a framework and charging principles for new connections or connection alterations.<sup>82</sup> We are mindful of classifying ActewAGL’s connection services in a way that supports the operation of Chapter 5A and the Guideline. ActewAGL will be required to identify any unique circumstances in its Connection Policy that will form part of its regulatory proposals.<sup>83</sup>

Under Chapter 5A and the Guideline, connection services classified as standard control services will be charged according to our decision on the form of control (for example, a price cap or revenue cap). Chapter 5A and the Guideline also provide that for standard control services a distributor may seek a capital contribution from the customer toward the cost of the connection service. ActewAGL may only seek a capital contribution from a

<sup>76</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, p. 9.

<sup>77</sup> NEL, s. 2F(a).

<sup>78</sup> NEL, s. 2F(d).

<sup>79</sup> NER, chapter 5A.

<sup>80</sup> ActewAGL, *Response to the AER's preliminary framework and approach paper*, 24 August 2012, p. 11.

<sup>81</sup> As permitted by NER, cll. 6.2.1(c)(4) and 6.2.2(c)(6); AER, *Connection charge guidelines for electricity retail customers, under Chapter 5A of the National Electricity Rules*, June 2012.

<sup>82</sup> AER, *Connection charge guidelines for electricity retail customers, under Chapter 5A of the National Electricity Rules*, June 2012, p. 29.

<sup>83</sup> ActewAGL is yet to submit its Connection Policy (indeed, it may be some way from being drafted). Consequently, the classifications may be inconsistent with the Connection Policy. We will consider any such adjustments in our final F&A and if necessary, draft determination to avoid any inconsistencies).

customer when the incremental cost of the standard control connection service exceeds the estimated incremental revenue expected to be derived from the standard control connection service. Put simply, if the customer's connection cost exceeds the revenues that will be paid by that customer over time, then the customer will be asked to make a contribution to the connection costs.

ActewAGL provides a basic connection to anyone requesting to connect to the network to use electricity. Connections over and above the cost of a basic connection may trigger a capital contribution. ActewAGL may only seek a capital contribution from a customer when the incremental cost of the standard control connection service exceeds the estimated incremental revenue expected to be derived from the standard control connection service. Put simply, ActewAGL provides a basic connection to anyone requesting to connect to the network to use electricity. Connections over and above the cost of a basic connection may trigger a capital contribution. This additional charge (capital contribution) may be negotiated between the distributor and the customer.<sup>84</sup> The negotiated capital contribution does not alter the classification of the service from standard control to a negotiated distribution service.

This approach avoids the broader customer base bearing the cost of customer specific service requests or where the connection exceeds the cost of a basic connection.

With the effect of Chapter 5A and the Guideline in mind, we intend to retain the current classification of connection services as standard control services.<sup>85</sup> We consider that there is no basis to move away from this classification as:

- There is little, if any, prospect for competition in the market for connection services. That is, we are not aware of any ACT Government initiatives to introduce contestability for connection services in the 2019–24 regulatory control period. Therefore, our classification will not influence the potential for competition.
- There would be no material effect on administrative costs to us, ActewAGL, users or potential users. This is because classifying connection services as standard control services is consistent with the current regulatory approach.
- The nature of basic connection services is that in most instances, the customer requesting the service will benefit from the provision of that service. As such, the costs are directly attributable to identifiable customers. However, the operation of Chapter 5A and the Guideline provide a safety net for the broader customer base. That is, the requirement of the requesting customer to make a capital contribution to a service protects the broader customer base from incurring additional costs for services of no benefit to them.

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<sup>84</sup> AER, *Connection charge guidelines for electricity retail customers, under Chapter 5A of the National Electricity Rules*, June 2012 and NER, chapter 5A.

<sup>85</sup> NER, cl. 6.2.2(c)(3).

- We classify standard connection services in Queensland and South Australia as standard control services.<sup>86</sup> In Victoria and Tasmania, we classify standard connection services as alternative control services.<sup>87</sup>

We must act on the basis that there should be no departure from a previous classification unless another classification is clearly more appropriate.<sup>88</sup> We consider the current standard control classification supports the operation of Chapter 5A and the Guideline and provides a framework for consumers to understand where additional contributions may be required. For these reasons, we intend to classify connection services including premises connections, extensions and network augmentation, as standard control services.

CCP sub-panel 10 raised concerns that ActewAGL has limited incentive in supplying connection services particularly augmentation services in a timely way as connection services are excluded from the STPIS.<sup>89</sup> We note that ActewAGL is required under the Utilities (Electricity Service and Installation Rules Code) Determination 2013 (Utilities Code)<sup>90</sup> to develop electricity service and installation rules. The Utilities Code requires ActewAGL to comply with its rules<sup>91</sup> which must allow for the safe, reliable and efficient connection of electrical installations to the distribution network.

While CCP sub-panel 10 submitted that we should consider the wider application of the definition of service targets going forward,<sup>92</sup> we note that customers are not without a safety net for the provision of connection services by virtue of the Utilities Code.

### 1.3.4 Ancillary services

Ancillary services share the common characteristics of being services provided to individual customers on an 'as needs' basis (e.g. meter testing and reading at a customer's request, moving mains, temporary supply). Ancillary services involve work on, or in relation to, parts of ActewAGL's distribution network. Therefore, similar to common distribution services, only ActewAGL may perform these services in its distribution area.

The above factors create a regulatory barrier preventing any party other than ActewAGL providing ancillary services in its distribution area.<sup>93</sup> Because of this monopoly position,

<sup>86</sup> AER, *Final decision, Queensland distribution determination 2015–20*, October 2015, p. 13-19; AER, *Final decision, South Australia distribution determination 2015–20*, October 2015, p. 13-15

<sup>87</sup> AER, *Final decision, Victorian DNSPs distribution determination 2016–20*, May 2016, p. 13-20; AER, Draft decision, *TasNetworks distribution determination 2017–19*, p. 13-13.

<sup>88</sup> NER, cl. 6.2.2(d).

<sup>89</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 10.

<sup>90</sup> See: <http://www.legislation.act.gov.au/di/2013-220/current/pdf/2013-220.pdf>. The Utilities Code is made under the *Utilities Act 2000* (ACT).

<sup>91</sup> ActewAGL, *Service and installation rules for connection to the electricity distribution network*, May 2015.

<sup>92</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 18.

<sup>93</sup> NEL, s. 2F(a).

customers have limited negotiating power in determining the price and other terms and conditions on which ActewAGL provide these services. These factors contribute to our view that ActewAGL possesses significant market power in providing ancillary services.<sup>94</sup>

For these reasons, we consider that we should classify ancillary services as direct control services.

Further, we intend to classify ancillary services as alternative control services because ActewAGL provides these services to specific customers.<sup>95</sup> As such, the cost of each ancillary service is directly attributable to an individual customer.<sup>96</sup> This results in costs that are more transparent for customers.

We adopt this view even though some ancillary services do not exhibit signs of competition or potential for competition. We also note that there would be no material effect on the administrative costs to us, ActewAGL, users or potential users.<sup>97</sup> This is because classifying ancillary services as alternative control services is consistent with the current approach. CCP sub-panel 10 supported our approach to classifying ancillary services.<sup>98</sup>

To the extent that the provision of ancillary services become or may become contestable through future changes to the regulatory or contestability frameworks, our proposed alternative control classification would allow ActewAGL to compete as a discrete price for the service is set for each ancillary service.

### 1.3.5 Unregulated distribution services

Unregulated distribution services is the term we use to describe distribution services which we have not classified as either direct control or negotiated services.<sup>99</sup> These services are provided on an unregulated basis and are potentially provided by other service providers in a competitive market. This group of services is particularly important as the number and types of services offered by distributors is growing and changing.

In November 2016, we released the Ring-Fencing Guideline for Electricity Distribution.<sup>100</sup> Our ring-fencing guideline interacts with a number of regulatory instruments, including our service classification decisions. Specifically, our service classification decisions set ring-fencing obligations for each distributor for its next regulatory control period.<sup>101</sup> Under our ring-fencing guideline, any unregulated distribution service would be protected by functional

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<sup>94</sup> NEL, s. 2F.

<sup>95</sup> NER, cl. 6.2.2(c)(5).

<sup>96</sup> NER, cl. 6.2.2(c)(5) - this includes a small number of identifiable customers.  
NER, cl. 6.2.2(c)(2).

<sup>98</sup> Consumer Challenge Panel (Sub-Panel 10), *Submission on AER's preliminary framework and approach for ActewAGL*, 21 April 2017, p. 10.

<sup>99</sup> AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016, p. 13.

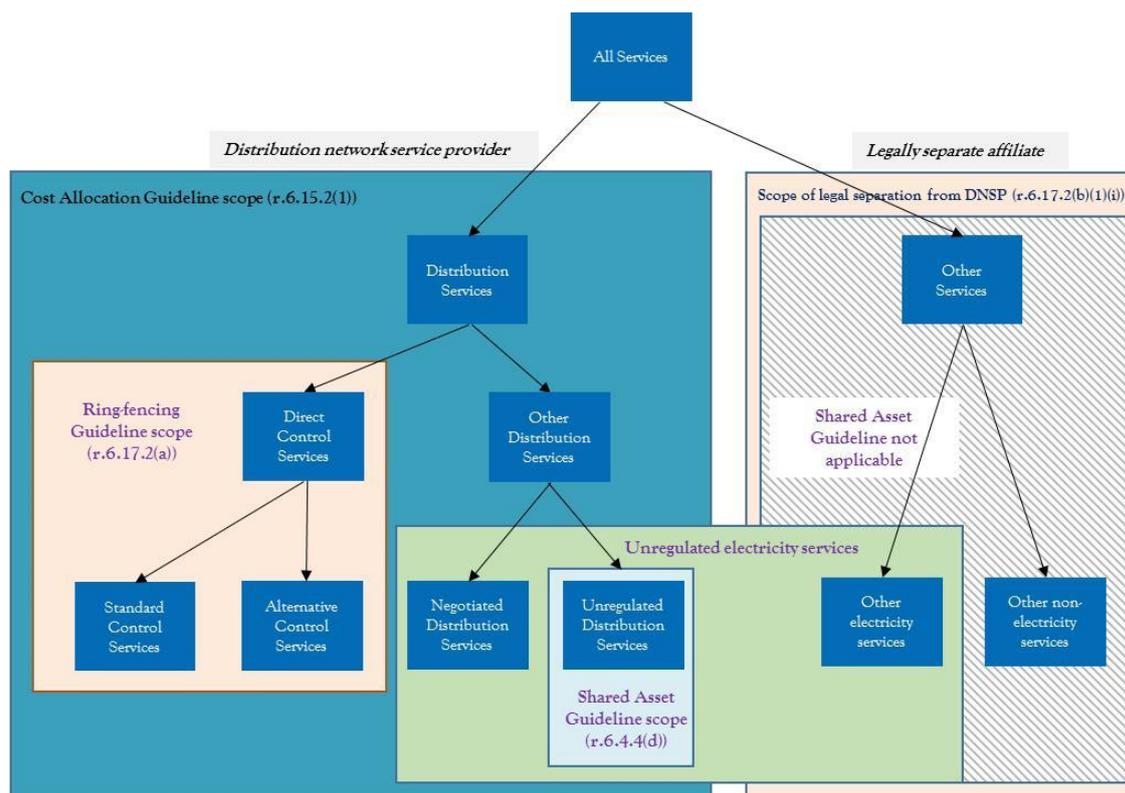
<sup>100</sup> AER, *Ring-fencing guideline electricity distribution*, November 2016; AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016.

<sup>101</sup> AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016, pp. 13–16.

and accounting separation. This removes the potential risk of a distributor benefitting from its privileged access to network information to gain a competitive advantage.

Figure 1.3 illustrates the interrelationship between service classification and ring-fencing obligations. Essentially, a distributor may only provide distribution services. Affiliated entities may provide other electricity services. For the purposes of this final F&A we are not addressing interactions with other regulatory frameworks in detail as these are set out in the explanatory statement to the ring-fencing guideline.<sup>102</sup>

**Figure 1.3 Distribution services linkage to ring-fencing**



Source: AER

In approaching classification of unregulated distribution services, distributors (and the AER) are considering if the service would be better offered by an affiliate and therefore not classified (i.e. fall into the 'other electricity services' group on the services diagram above).

Alternatively, some of these distribution services could be classified as alternative control services. As part of our distribution determination, we would set a cost-reflective price for the service based on information provided by the distributor. Customer uptake of the distributor provided service would depend on whether the price of the service is competitive with that of other market participants. It should be noted that if a service is classified as an alternative control service, it would not be subject to ring-fencing obligations, such as the requirements

<sup>102</sup> AER, *Electricity distribution ring-fencing guideline explanatory statement*, November 2016, pp. 13–16.

to use a different brand, to use separate offices and to not share staff. Consequently, there are market effects of classifying a potentially contestable service as an alternative control service rather than an unregulated service.

We expect that there may be a number of distribution services that distributors identify subsequent to this F&A process or within the 2019–24 regulatory control period that would be unregulated. These unregulated distribution services must comply with the ring-fencing guideline until such time as we reconsider service classification for 2024–29 regulatory control period.

## 2 Control mechanisms

Our distribution determination must impose controls over the prices (and/or revenues) of direct control services.<sup>103</sup> This section sets out our decision, together with our reasons, on the form of control mechanisms to apply to ActewAGL's direct control services for the 2019–24 regulatory control period. This section also sets out our proposed formulae to give effect to these control mechanisms.

As discussed in chapter 1, we classify direct control services as standard control services or alternative control services. Different control mechanisms may apply to each of these classifications, or to different services within the same classification. Appendix B provides our proposed classification of ActewAGL's distribution services.

The form of control mechanisms in a distributor's regulatory proposal must be as set out in the relevant F&A paper.<sup>104</sup> Additionally, the formulae that give effect to the control mechanisms in a distributor's regulatory proposal must be the same as the formulae set out in the relevant F&A paper. The formulae cannot be altered unless we consider that unforeseen circumstances justify departing from the formulae set out in that paper.<sup>105</sup>

### 2.1 AER's decision

Our decision is to apply the following control mechanisms in the 2019–24 regulatory control period:

- Revenue cap — for services we classify as standard control services.
- Caps on the prices of individual services — for services we classify as alternative control services.

For standard control services, ActewAGL supported our preliminary position to replace its current average revenue cap control mechanism with a revenue cap to ensure it retains a fair opportunity to recover its allowed revenues.<sup>106</sup>

### 2.2 AER's assessment approach

Our consideration of the control mechanisms for direct control services consists of three parts:

- the form of the control mechanisms<sup>107</sup>
- the formulae to give effect to the control mechanisms

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<sup>103</sup> NER, cl.6.2.5(a).

<sup>104</sup> NER, cl.6.12.3(c).

<sup>105</sup> NER, cl.6.12.3(c1).

<sup>106</sup> ActewAGL, Response to AER's preliminary framework and approach, April 2017, p. 11..

<sup>107</sup> NER, cl. 6.2.5(b).

- the basis of the control mechanisms.<sup>108</sup>

The NER sets out the control mechanisms that may apply to both standard and alternative control services.<sup>109</sup>

- a schedule of fixed prices

A schedule of fixed prices specifies a price for every service provided by a distributor. The specified prices are escalated annually by inflation, the X factor and applicable adjustment factors. A distributor complies with the constraint by submitting prices matching the schedule in the first year and then escalated prices in subsequent years.

- caps on the prices of individual services (price caps)<sup>110</sup>

Caps on the prices of individual services are the same as a schedule of fixed prices except that a distributor may set prices below the specified prices.

- caps on the revenue to be derived from a particular combination of services (revenue cap)

A revenue cap sets total annual revenue (TAR) for each year of the regulatory control period. A distributor complies with the constraint by forecasting sales for the next regulatory year and setting prices so the expected revenue is equal to or less than the TAR. At the end of each regulatory year, the distributor reports its actual revenues to us. We account for differences between the actual revenue recovered and the TAR in future years. This operation occurs through an overs and unders account, whereby any revenue over recovery (under recovery) is deducted from (added to) the TAR in future years.

- tariff basket price control (weighted average price cap or WAPC)

A WAPC is a cap on the average increase in prices from one year to the next. This allows prices for different services to adjust each year by different amounts. For example, some prices may rise while others may fall, subject to the overall WAPC constraint. A weighted average is used to reflect that services may be sold in different quantities. Therefore, a small increase in the price of a frequently provided service must be offset by a large decrease in the price of an infrequently provided service. A distributor complies with the constraint by setting prices so the change in the weighted average price is equal to or less than the CPI-X cap. Importantly, the WAPC places no ceiling on the revenue recovered by a distributor in any given year. That is, if revenue recovered under the WAPC is greater than (less than) the expected revenue, the distributor keeps (loses) that additional (shortfall) revenue.

- revenue yield control (average revenue cap)

An average revenue cap is a cap on the average revenue per unit of electricity sold that a distributor can recover. The cap is calculated by dividing the TAR by a particular unit (or

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<sup>108</sup> NER, cl. 6.2.6(a).

<sup>109</sup> NER, cl. 6.2.5(b).

<sup>110</sup> A price cap and a schedule of fixed prices are largely the same mechanism, with the only difference being that a price cap allows the distributors to charge below the capped price on some or all of the services.

units) of output, usually kilowatt hours (kWh). The distributor complies with the constraint by setting prices so the average revenue is equal to or less than the TAR per unit of output.

- a combination of any of the above (hybrid).

A hybrid control mechanism is any combination of the above mechanisms. Typically, hybrid approaches involve a proportion of revenue that is fixed and a proportion that varies according to pre-determined parameters, such as peak demand.

In considering our decision on the control mechanisms for ActewAGL's standard control services, we have only considered the continuation of the current average revenue cap, or adoption of a revenue cap or price caps. We have not considered the other forms of control mechanisms for standard control services based on our previous considerations that they are not superior to either an average revenue cap or a revenue cap in addressing the factors set out in clause 6.2.5(c) of the NER. We have also considered a price cap control mechanism, which was proposed by AGL.<sup>111</sup>

We have not considered a schedule of fixed prices. We consider direct price control mechanisms do not provide the level of flexibility within the regulatory control period to manage distribution use of service charges shared across the broad customer base.

We have not considered a WAPC as our previous considerations on this type of control mechanism noted the incentives for distributors to systematically recover revenue above efficient cost recovery resulting in higher bills for consumers.<sup>112</sup> We consider a control mechanism that results in higher bills for consumers than necessary is not consistent with the national electricity objective.<sup>113</sup>

We have also not considered a hybrid approach as our previous deliberations considered the higher administrative costs outweigh the potential benefits of this form of control.<sup>114</sup>

Our decision on the control mechanisms for ActewAGL's alternative control services, is based on whether there is reason to depart from the current price caps in terms of the factors set out in clause 6.2.5(c) of the NER.

## 2.2.1 Standard control services

In determining a control mechanism to apply to standard control services, we must have regard to the factors in clause 6.2.5(c) of the NER:

- need for efficient tariff structures

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<sup>111</sup> AGL, *Consultation to amend or replace F&A for NSW, ACT and TAS*, 2 December 2016.

<sup>112</sup> For example, see: AER, *Final framework and approach for the Victorian electricity distributors: Regulatory control period commencing 1 January 2016*, 24 October 2014, p. 82 and AER, *Stage 1 Framework and approach, Ausgrid, Endeavour Energy and Essential Energy, 1 July 2014–30 June 2019*, March 2013, p. 78.

<sup>113</sup> NEL, s. 7.

<sup>114</sup> For example, see: AER, *Final framework and approach for Victorian electricity distributors: Regulatory control period commencing 1 January 2016*, 24 October 2014, p. 86.

- possible effects of the control mechanism on administrative costs of us, the distributor, users or potential users
- regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination
- desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction)
- any other relevant factor.

We also propose to have regard to three other factors which we consider are relevant to assessing the most suitable control mechanism:

- revenue recovery
- price flexibility and stability
- incentives for demand side management.

The basis of the control mechanism for standard control services must be of the prospective CPI-X form or some incentive-based variant.<sup>115</sup>

Section 2.3 sets out our consideration of each of the above factors in deciding on the form of control mechanism for standard control services.

## 2.2.2 Alternative control services

In determining a control mechanism to apply to alternative control services, we must have regard to the factors in clause 6.2.5(d) of the NER:

- the potential for competition to develop in the relevant market and how the control mechanism might influence that potential
- the possible effects of the control mechanism on administrative costs for us, the distributor and users or potential users
- the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination
- the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction)
- any other relevant factor.

We propose that another relevant factor is the provision of cost reflective prices. Efficient prices (cost reflectivity) allow consumers to compare the cost of providing the service to their needs and wants. It also better promotes the national electricity objective by ensuring that customers only pay for services they use. Cost reflective prices also enable distributors to make efficient investment and demand side management decisions.

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<sup>115</sup> NER, cl. 6.2.6(a).

We must state what the basis of the control mechanism is in our distribution determination.<sup>116</sup> This may utilise elements of Part C of chapter 6 of the NER with or without modification. For example, the control mechanism may use a building block approach or incorporate a pass through mechanism.<sup>117</sup>

Section 2.4 sets out our consideration of each of the above factors in deciding on the form of control mechanism for alternative control services.

## 2.3 AER's reasons — control mechanism and formulae for standard control services

Our decision is to transition the control on ActewAGL's standard control services revenues from an average revenue cap to a revenue cap for the 2019–24 regulatory control period.<sup>118</sup> We have made our decision to apply a revenue cap control mechanism having regard to the factors set out under clause 6.2.5(c) of the NER.

A transition to a revenue cap control mechanism will ensure consistent regulatory arrangements to standard control services across all electricity distributors subject to economic regulation under the NER.

A revenue cap will also result in benefits to consumers through a higher likelihood of revenue recovery at efficient costs and will provide better incentives for demand side management. Furthermore, our recent approach to the operation of the revenue cap has reduced the magnitude of overall price variability during a regulatory control period, which has been a concern in the past. We provide our consideration of these issues below.

### 2.3.1 Efficient tariff structures

In deciding on a control mechanism, the NER requires us to have regard to the need for efficient tariff structures.<sup>119</sup> We consider tariff structures are efficient if they reflect the underlying cost of supplying distribution services.

It is likely that efficient tariff structures can be developed and implemented under all types of control mechanisms. Our recent assessment of distributors' tariff structures has demonstrated that efficient tariff structures have been developed and will be implemented under both average revenue cap and revenue cap control mechanisms.

Our previous considerations on the interaction between a control mechanism and its ability to deliver efficient tariff structures during a regulatory control period relied solely on the incentive properties of the different types of control mechanisms.<sup>120</sup> However, recent

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<sup>116</sup> NER, cl. 6.2.6(b).

<sup>117</sup> NER, cl. 6.2.6(c).

<sup>118</sup> Consideration of this change was raised by ActewAGL in its letter to the AER: *Request for the AER to make, or make an amended or replacement framework and approach*, 28 October 2016, p. 3.

<sup>119</sup> NER, cl. 6.2.5(c)(1).

<sup>120</sup> For example, see: AER, *Final framework and approach for the Victorian electricity distributors: Regulatory control period*

changes to the NER now require us to undertake a supplementary assessment of the efficiency of a distributor's tariff structures which are set out in a tariff structure statement. Therefore, consideration of the interaction between control mechanisms and efficient tariff structures should also be informed by our assessment of a distributor's tariff structure statement.

The requirement for a distributor to prepare a tariff structure statement is new. It arises from a significant process of reform to the NER governing distribution network pricing. The purpose of the reforms is to empower customers to make informed choices by:

- Providing better price signals—tariffs that reflect what it costs to use electricity at different times so that customers can make informed decisions to better manage their bills.
- Transitioning to greater cost reflectivity—requiring distributors to explicitly consider the impacts of tariff changes on customers, and engaging with customers, customer representatives and retailers in developing network tariff proposals over time.
- Managing future expectations—providing guidance for retailers, customers and suppliers of services such as local generation, batteries and demand management by setting out the distributor's tariff approaches for a set period of time.

A distributor's tariff structure statement sets out the tariff structures it can apply over a regulatory control period.<sup>121</sup> The tariff structure statement should show how a distributor applied the distribution pricing principles<sup>122</sup> to develop its tariff structures and the indicative price levels of tariffs for the coming five year regulatory control period. The network pricing objective of the distribution pricing principles is the focus for a distributor when developing its network tariffs. The objective is that:<sup>123</sup>

the tariffs that a distributor charges for provision of direct control services to a retail customer should reflect the distributor's efficient costs of providing those services to the retail customer.

We must approve a tariff structure statement unless we are reasonably satisfied it will not comply with the distribution pricing principles or other relevant requirements of the NER.<sup>124</sup>

In February 2017, we made final decisions on the initial tariff structure statements for ActewAGL and the distributors in Queensland, New South Wales and South Australia. On 28 April 2017, we made our final decision on TasNetworks' initial tariff structure statement.

Through the initial tariff structure statements many distributors will be introducing more cost reflective tariff structures such as demand based tariffs. In our assessment we found no

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*commencing 1 January 2016, 24 October 2014, pp. 79–81 and AER, Stage 1 Framework and approach, Ausgrid, Endeavour Energy and Essential Energy, 1 July 2014–30 June 2019, March 2013, pp. 76–77.*

<sup>121</sup> NER, cl. 6.18.1A(a)(3).

<sup>122</sup> This is a reference to the Rules' *pricing principles for direct control services*, alternatively described in this paper as the "distribution pricing principles"; NER, cl. 6.18.5(e)–(j).

<sup>123</sup> NER, cl. 6.18.5(a).

<sup>124</sup> NER, cl. 6.12.3(k).

evidence to suggest that ActewAGL's average revenue cap or other distributors' revenue caps inhibited the ability to develop or implement efficient tariff structures. Therefore, we consider that efficient tariff structures can occur under both average revenue caps and revenue cap control mechanisms. On this basis, we also consider efficient tariff structures are likely to occur under all forms of control mechanisms, including price caps.

While our consideration of efficient tariff structures does not necessarily indicate a revenue cap should be favoured over an average revenue cap or price caps, our decision needs to be weighed against the other factors under clause 6.2.5(c) of the NER.

We note that tariff reform brought about by the tariff structure statements is still in its infancy. We may revisit the interaction between a control mechanism and efficient tariff structures for future F&A's.

### **2.3.2 Administrative costs**

In deciding on a control mechanism, the NER requires us to have regard to the possible effects of the control mechanism on administrative costs.<sup>125</sup> We consider, where possible, a control mechanism should minimise the complexity and administrative burden for us, the distributor and users.

Generally, we consider there is little difference in administrative costs between control mechanisms under the building block framework in the long run. However, we consider the application of a revenue cap control mechanism to ActewAGL's standard control services revenues would lead to some reduced complexity and administrative burden for us.

ActewAGL is currently the only electricity distributor subject to economic regulation under the NER whose standard control services are not subject to a revenue cap control mechanism. We consider the application of a universal control mechanism (except for minor jurisdictional peculiarities) would lead to reduced complexity and administrative burden for us through standardisation of modelling approaches, incentive schemes and consultation requirements.

We also consider other stakeholders such as retailers would incur reduced administrative costs due to the consistent control mechanism approaches across jurisdictions and regulatory control periods.

At least ActewAGL and we will incur additional administrative costs in transitioning from an average revenue cap to a price cap. For example, new tariff models would need to be developed for annual pricing proposals to demonstrate compliance with the new control mechanism.

We acknowledge ActewAGL is likely to incur some additional administrative costs in transitioning to a new control mechanism. Notwithstanding this, we consider a transition to a revenue cap for the 2019–24 regulatory control period appropriate weighed against the other factors under clause 6.2.5(c) of the NER discussed below.

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<sup>125</sup> NER, cl. 6.2.5(c)(2).

### 2.3.3 Existing regulatory arrangements

In deciding on a control mechanism, the NER requires us to have regard to the regulatory arrangements applicable to the relevant service immediately before the commencement of the distribution determination.<sup>126</sup>

We consider that consistency in regulatory arrangements across regulatory periods for similar services provided by a distributor is generally desirable but is not primary to our consideration in this instance. The consistency across regulatory periods also needs to be weighed against the other factors under clause 6.2.5(c) of the NER.

Our consideration is supported by ActewAGL, which submitted that the continuation of its current average revenue cap needs to be considered in a more general context of the changing business environment for operating an electricity distribution network.<sup>127</sup> On this basis, ActewAGL seeks an amendment or replacement of its average revenue cap.

Having regard to the other factors under clause 6.2.5(c) of the NER, our decision is to transition the control mechanism for ActewAGL's standard control services to a revenue cap.

### 2.3.4 Desirability of consistency between regulatory arrangements

In deciding on a control mechanism, the NER requires us to have regard to the desirability of consistency between regulatory arrangements for similar services both within and beyond the relevant jurisdiction.<sup>128</sup>

As noted above, ActewAGL is currently the only electricity distributor subject to economic regulation under the NER whose standard control services are not subject to a revenue cap control mechanism. We note price caps are not applied to standard control services in any jurisdiction. Therefore, our decision is to transition ActewAGL to a revenue cap for the 2019–24 regulatory control period for consistency of regulatory arrangements for similar services across jurisdictions.

Also noted above, the application of a universal control mechanism would lead to reduced complexity and administrative burden for us and other stakeholders through standardisation of modelling approaches, incentive schemes and consultation requirements. These standardised aspects of the regulatory framework may also assist customers and other interest groups' understanding and involvement in distribution determination processes. We consider it desirable to have all jurisdictions on the same control mechanisms for standard control services. There are no reasons peculiar to the ACT that suggest a different control mechanism to that applied in other jurisdictions for these services.

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<sup>126</sup> NER, cl. 6.2.5(c)(3).

<sup>127</sup> ActewAGL, Request for the AER to make, or make an amended or replacement, framework and approach paper, 28 October 2016, p. 3.

<sup>128</sup> NER, cl. 6.2.5(c)(4).

### 2.3.5 Revenue recovery

We consider that a control mechanism should give a distributor an opportunity to recover efficient costs. Also, a control mechanism should limit revenue recovery above such costs. Revenue recovery above efficient costs results in higher prices for end users. Further, allocative efficiency is reduced when a distributor recovers additional revenue from price sensitive services through prices above marginal cost.<sup>129</sup>

ActewAGL posited that in a changing environment for operating electricity distribution networks, it seeks amendment or replacement of its average revenue cap to ensure it can recover its approved revenue requirement over the 2019–24 regulatory control period.<sup>130</sup> AGL submitted that we review the control on TasNetworks' revenues in light of uncertainty around future network demand and utilisation.<sup>131</sup> AGL posited a price cap control would better align prudent expenditure and cost minimisation with maintaining network utilisation.

Generally, we consider that a revenue cap provides a high likelihood of efficient cost recovery. Under a revenue cap, revenue recovery is fixed and unrelated to energy sales. Similarly, costs for distributors are largely fixed and unrelated to energy sales. Therefore, our view is that a revenue cap is likely to lead to efficient cost recovery.

We also consider that a revenue cap incentivises distributors to reduce their expenditures because their revenues are assured during the regulatory control period. These lower costs can be shared with customers in future regulatory control periods. Therefore, we consider a revenue cap adequately addresses AGL's concerns that the control mechanism should align prudent expenditure and cost minimisation with maintaining network utilisation.

In contrast, a control mechanism where revenue depends on energy sales (such as average revenue caps or price caps) provides distributors with incentives to understate sales forecasts and adjust tariffs to gain revenues above efficient cost recovery.<sup>132</sup> The systematic recovery of revenue above efficient cost recovery results in higher bills for consumers.<sup>133</sup> We consider a control mechanism that results in higher bills for consumers than necessary is not consistent with the national electricity objective.<sup>134</sup>

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<sup>129</sup> Allocative efficiency is achieved when the value consumers place on a good or service (reflected in the price they are willing to pay) equals the cost of the resources used up in production. The condition required is that price equals marginal cost. When this condition is satisfied, total economic welfare is maximised.

<sup>130</sup> ActewAGL, *Request for the AER to make, or make an amended or replacement, framework and approach paper*, 28 October 2016, p. 3.

<sup>131</sup> AGL, *Consultation to amend or replace F&A for NSW, ACT and TAS*, 2 December 2016, p. 2.

<sup>132</sup> For example, see: AER, *Preliminary positions: Framework and approach paper ActewAGL—Regulatory control period commencing 1 July 2014*, pp. 64–67; AER,

<sup>133</sup> For example, see: AER, *Final framework and approach for the Victorian electricity distributors: Regulatory control period commencing 1 January 2016*, 24 October 2014, p. 82 and AER, *Stage 1 Framework and approach, Ausgrid, Endeavour Energy and Essential Energy, 1 July 2014–30 June 2019*, March 2013, p. 78.

<sup>134</sup> NEL, s. 7.

In terms of efficient revenue recovery, we consider a revenue cap control mechanism better reflects the national electricity objective than those that rely on energy sales.<sup>135</sup>

### 2.3.6 Pricing flexibility and stability

Price flexibility enables a distributor to restructure its tariffs to meet changes in the environment of operating an electricity distribution network during a regulatory control period. Price stability is important because it affects retailers' ability to manage risks incurred from changes to network tariffs, which they then package into retail plans for customers. It also affects customers' ability to manage their bills.

We consider price flexibility is primarily influenced by the distribution pricing principles and the side constraint. Therefore, price flexibility is similar for all control mechanisms as they are subject to the same distribution pricing principles and the same side constraint.

In terms of price stability, some control mechanisms are more likely to deliver stable prices than others. However, price instability can occur under all control mechanisms because the NER requires various annual price adjustments regardless of the control mechanism.<sup>136</sup>

Within a regulatory control period, an average revenue cap will deliver more overall price stability than a revenue cap. The increased variability under a revenue cap occurs because future revenues and tariffs are adjusted to account for the difference between the actual revenue recovered and the TAR. These differences are due to the variations between forecast and actual sales volumes. As noted by AGL in its submission to TasNetworks' preliminary F&A, under a revenue cap falling demand creates price increases.<sup>137</sup> The reverse happens with increasing demand. The true up of this under or over recovery of revenue is calculated in the unders and overs account.

Typically there is a two year lag from when the under or over recovery of revenue occurs (year  $t-2$ ) and the year in which audited accounts can be relied upon to make an accurate revenue true up adjustment (year  $t$ ). This lagged effect may cause price instability when an under (over) recovery of revenue in one year is followed by an over (under) recovery in the following year. In this scenario, price movements go in one direction for first year and then go in the opposite direction the following year.

We have somewhat addressed this issue in our recent determinations by applying a rolling unders and overs account which includes an additional true up for the estimated under and over recovery of revenues for the year in between (year  $t-1$ ).<sup>138</sup> The inclusion of this estimated year helps smooth year-on-year revenue and tariff adjustments because the effects of the estimated year  $t-1$  under or over recovery will have been largely accounted for

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<sup>135</sup> NEL, s. 7.

<sup>136</sup> These include cost pass throughs, jurisdictional scheme obligations, tribunal decisions and transmission prices passed on to the distributors from transmission network service providers.

<sup>137</sup> AGL, *Consultation to amend or replace F&A for NSW, ACT and TAS*, 2 December 2016, p. 2.

<sup>138</sup> For example, see: AER, *Final Decision, CitiPower distribution determination 2016 to 2020: Attachment 14–Control mechanisms*, May 2016, Appendix A, pp. 18–19.

when year t–1 becomes year t–2. That is, when year t–1 becomes year t–2 the adjustment to the TAR will only need to account for the difference between the estimated and actual under or over recovery and not the overall total under or over recovery.

In terms of stability across regulatory control periods, we consider an average revenue cap can result in greater price volatility compared to a revenue cap.<sup>139</sup> This issue is particularly pronounced if a trend of falling demand and consumption has set in throughout the regulatory control period. This scenario would prompt a large upward adjustment in the X-factors (and hence prices) for the next regulatory control period under an average revenue cap. In contrast, the volume forecasts are updated annually under a revenue cap. This would mean that prices would rise gradually over the regulatory period (rather than jump up at the end of the period) if a trend of falling demand was evident.

On balance, when weighing price flexibility and stability along with the other factors we have considered, our decision is to transition ActewAGL's control mechanism for standard control services to a revenue cap. While we acknowledge a revenue cap has a higher likelihood of overall price instability during a regulatory control period, we consider our application of the rolling overs and unders account reduces the magnitude of this effect.

### 2.3.7 Incentives for demand side management

Demand side management refers to the implementation of non-network solutions to avoid the need to build network infrastructure to meet increases in annual or peak demand.<sup>140</sup> Where prices are cost reflective, consumers and providers of demand side management face efficient incentives because they can take into account the cost of providing the service in decision making.

As stated above, AGL submitted that a price cap control mechanism be considered in light of uncertainty around network demand and utilisation.<sup>141</sup> However, we consider a revenue cap provides better signals for distributors to undertake demand side management.

Under a revenue cap a distributor's revenue is fixed over the regulatory control period. A distributor can therefore improve its financial position by reducing costs. This creates an incentive for a distributor to undertake demand side management projects that reduce total costs, even if that means the distributor does not build new assets or replace existing ones.<sup>142</sup> We consider this provides a stronger incentive for a distributor to undertake demand side management within a regulatory control period compared to a control mechanism that has expected revenues varying with overall sales, such as in a price cap.

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<sup>139</sup> AER, *Preliminary positions: Framework and approach paper ActewAGL—Regulatory control period commencing 1 July 2014*, pp. 67–69.

<sup>140</sup> Generally peak demand is referred to as the maximum load on a section of the network over a very short time period.

<sup>141</sup> AGL, *Consultation to amend or replace F&A for NSW, ACT and TAS*, 2 December 2016, p. 2.

<sup>142</sup> That is, demand side management projects that result in a reduction in future network expenditure greater than the cost of implementing the demand side management projects.

Under ActewAGL's average revenue cap control mechanism, its revenues are linked more closely to actual volumes of electricity distributed. As a result, its profits increase with sales if the marginal revenue is greater than the marginal cost of providing services. Demand side management may not be attractive for distributors if such projects result in less revenue as a result of the decline in demand or consumption that they induce.

### 2.3.8 Formulae for control mechanism

We are required to set out our proposed approach to the formulae that give effect to the control mechanisms for standard control services in the F&A paper.<sup>143</sup> In making a distribution determination, the formulae must be as set out in our final F&A, unless we consider that unforeseen circumstances justify departing from the formulae as set out in the F&A paper.<sup>144</sup> Below is proposed formula to apply to ActewAGL's standard control services revenues. We consider that the formula gives effect to the revenue cap.

**Figure 2.1 Proposed revenue cap formula to apply to ActewAGL's standard control services**

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

where:

$TAR_t$  is the total allowable revenue in year t.

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

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

$t$  is the regulatory year

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

$AAR_t$  is the adjusted annual smoothed revenue requirement for year t.

<sup>143</sup> NER, cl. 6.8.1(b)(2)(ii).

<sup>144</sup> NER, cl. 6.12.3(c1).

$I_t$  is the sum of incentive scheme adjustments in year t. To be decided in the distribution determination.

$B_t$  is the sum of annual adjustment factors in year t. Likely to incorporate but not limited to adjustments for the overs and unders account. To be decided in the distribution determination.

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

$S_t$  is the s-factor for regulatory year t.<sup>145</sup> As it currently stands, the s-factor will incorporate any adjustments required due to the application of the AER's STPIS.<sup>146</sup> However, we are currently undertaking a review of the STPIS. How the s-factor will apply within the revenue cap formula for next regulatory control period may depart from the current arrangement. Depending on the outcome of our review, provision to adjust revenues for performance against the STPIS may be made through either the  $S$  or  $I$  factors as set out in this final F&A paper. If the review is completed in time, ActewAGL may need to apply the revised STPIS for the 2019–24 regulatory control period. We will consider the application of the revised STPIS during the revenue determination process.

$\Delta CPI_t$  is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities<sup>147</sup> 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.

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<sup>145</sup> The meaning for year “t” under the price control formula is different to that in Appendix C of STPIS. Year “t+1” in Appendix C of STPIS is equivalent to year “t” in the price control formula of this decision.

<sup>146</sup> AER, *Electricity distribution network service providers - service target performance incentive scheme*, 1 November 2009.

<sup>147</sup> 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 in year t, incorporating annual adjustments to the PTRM for the trailing cost of debt where necessary. To be decided in the distribution determination.

## 2.4 AER's reasons — control mechanism for alternative control services

We intend to apply caps on the prices of individual services (price caps) in the 2019–24 regulatory control period to all of ActewAGL's alternative control services.<sup>148</sup> We propose classifying the following services as alternative control services:

- type 5 and 6 metering services (legacy meters)
- ancillary services.

We note ActewAGL's alternative control services are currently subject to price cap regulation. The continuation of these price caps over the 2019–24 regulatory control period best addresses the factors set out under clause 6.2.5(d) of the NER.

Unlike standard control services, the NER is not prescriptive on the basis of the control mechanism for alternative control services.<sup>149</sup> For example, the price caps could be based on a building block approach, or a modified building block cost build up. We have set out our proposed formulae that will give effect to the price cap control mechanisms in Figure 2.2 and Figure 2.3 below. However, it is at the distributor's discretion as to the approach it undertakes to develop its initial prices.

Prices for certain ancillary services (quoted services) will be determined on a quoted basis. Prices for quoted services are based on quantities of labour and materials with the quantities dependent on a particular task. For example, where a customer seeks a non-standard connection which may involve an extension to the network the distributor may only be able to quote on the service once it knows the scope of the work. Because of this uncertainty, our proposed price cap formula for quoted services differs to that proposed to apply to metering and fee based services. Our quoted services price cap is consistent with the approach we have adopted in the past.

Our consideration of the relevant factors is set out below.

### 2.4.1 Influence on the potential to develop competition

We consider a departure from the current price cap controls for ActewAGL's alternative control services would not have a significant impact on the potential development of competition. We consider the primary influence on competition development will be the classification of services as alternative control services. Chapter 1 discusses service classification.

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<sup>148</sup> The Consumer Challenge Panel supported maintaining price caps for alternative control services. Consumer Challenge Panel - Sub Panel CCP4, Submission, 10 March 2015.

<sup>149</sup> NER, cl. 6.2.6(c).

## 2.4.2 Administrative costs

Where possible, a control mechanism should minimise the complexity and administrative burden for us, the distributor and users. The continuation of price caps will impose no additional administrative costs for us, ActewAGL or users. Additional administrative costs will be incurred at least to ActewAGL and us if an alternative control mechanism was applied to these services.

## 2.4.3 Existing regulatory arrangements

We consider consistency across regulatory control periods is generally desirable. Our proposed position maintains this regulatory consistency as it continues the application of price cap control mechanisms for ActewAGL's alternative control services.

## 2.4.4 Desirability of consistency between regulatory arrangements

We consider consistency across jurisdictions is also generally desirable. Our proposed position maintains this consistency across jurisdictions.

We note that apart from the Victorian distributor's metering services which are subject to a revenue cap, price cap control mechanisms are currently applied to the alternative control services for all other electricity distributors subject to economic regulation under the NER.

## 2.4.5 Cost reflective prices

We consider that price caps are more suitable than other control mechanisms for delivering cost reflective prices. To apply price caps to the prices, we estimate the cost of providing each service and set the price at that cost. This will enhance cost reflectivity on both competitive and non-competitive services.

## 2.4.6 Formulae for alternative control services

We are required to set out our approach to the formulae that gives effect to the control mechanisms for alternative control services.<sup>150</sup> In making a distribution determination, the formulae must be as set out in our final F&A, unless we consider that unforeseen circumstances justify departing from the formulae as set out in the F&A paper.<sup>151</sup>

Below are our proposed price cap formulae which will apply to ActewAGL's alternative control services.

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<sup>150</sup> NER, cl. 6.8.1(b)(2)(ii).

<sup>151</sup> NER, cl. 6.12.3(c1).

**Figure 2.2 Price cap formula to apply to ActewAGL's legacy metering 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. The initial value is to be decided in the distribution determination.

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

$t$  is the regulatory year

$\Delta CPI_t$  is the annual percentage change in the ABS consumer price index (CPI) All Groups, Weighted Average of Eight Capital Cities<sup>152</sup> 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 X factors are to be decided in the distribution determination and will be based on the approach the distributor undertakes to develop its initial prices.

$A_t^i$  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.

<sup>152</sup> 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.

## Figure 2.3 Price cap formula to be applied to ActewAGL'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:

$\Delta CPI_t$  is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities<sup>153</sup> 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 X factor is to be decided in the distribution determination and will be based on the approach the distributor undertakes to develop its initial prices.

*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.

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<sup>153</sup> 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.

## 3 Incentive schemes

This chapter sets out our proposed application of a range of incentive schemes to ActewAGL for the 2019–24 regulatory control period. At a high level, we intend to apply the:

- service target performance incentive scheme
- efficiency benefit sharing scheme
- capital expenditure sharing scheme
- demand management incentive scheme and innovation allowance mechanism.

### 3.1 Service target performance incentive scheme

This section sets out our proposed approach and reasons for applying the service target performance incentive scheme (STPIS) to ActewAGL in the next regulatory control period.

Our distribution STPIS<sup>154</sup> provides a financial incentive to distributors to maintain and improve service performance. The scheme aims to ensure that cost efficiencies incentivised under our expenditure schemes do not arise through the deterioration of service quality for customers. Penalties and rewards under the STPIS are calibrated with how willing customers are to pay for improved service. This aligns the distributor's incentives towards efficient price and non-price outcomes with the long-term interests of consumers, consistent with the National Electricity Objective (NEO).

The STPIS operates as part of the building block determination and contains two mechanisms:

- The service standards factor (s-factor) adjustment to the annual revenue allowance for standard control services rewards (or penalises) distributors for improved (or diminished) service compared to predetermined targets. Targets relate to service parameters pertaining to reliability and quality of supply, and customer service.
- A guaranteed service level (GSL) component composed of direct payments to customers<sup>155</sup> experiencing service below a predetermined level. This component only applies if there is not another GSL scheme already in place.<sup>156</sup>

While the mechanics of how the STPIS will operate are outlined in our scheme, we must set out key aspects specific to ActewAGL in the next regulatory control period at the determination stage, including:

- the maximum revenue at risk under the STPIS

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<sup>154</sup> AER, *Electricity distribution network service providers - service target performance incentive scheme*, 1 November 2009.

<sup>155</sup> Except where a jurisdictional electricity GSL requirement applies.

<sup>156</sup> Service level is assessed (unless we determine otherwise) with respect to parameters pertaining to the frequency and duration of interruptions; and time taken for streetlight repair, new connections and publication of notices for planned interruptions.

- how the distributor's network will be segmented or the purpose of setting performance targets
- the applicable parameters for the s-factor adjustment of annual revenue performance targets for the applicable parameters in each network segment
- the criteria for certain events to be excluded from the calculation of annual performance and performance targets
- incentive rates that determine the penalties and rewards under the scheme.

ActewAGL may propose to vary the application of the STPIS in its regulatory proposal.<sup>157</sup> We can accept or reject the proposed variation in our determination. Each year we will calculate ActewAGL's s-factor based on its service performance in the previous year against targets, subject to the revenue at risk limit. Our national STPIS includes a banking mechanism, allowing distributors to propose delaying a portion of the revenue increment or decrement for one year to limit price volatility for customers.<sup>158</sup> A distributor proposing a delay must provide in writing its reasons and justification for as to why a delay will result in reduced price variations to customers.

Our national STPIS currently applies to ActewAGL which is subject to financial penalty or reward of  $\pm 2.5$  per cent through an s-factor adjustment to revenue in the current regulatory control period.

GSLs are provided for through the Independent Competition and Regulatory Commission (ICRC) GSL scheme, so the GSL component of our scheme does not apply.

### 3.1.1 AER's proposed position

Our proposed position is to continue to apply the national STPIS to ActewAGL in the 2019–24 regulatory control period. We propose to:

- set revenue at risk at  $\pm 5$  per cent
- segment the network according to the urban and short rural feeder categories
- apply the system average interruption duration index or SAIDI, system average interruption frequency index or SAIFI and customer service (telephone answering) parameters
- set performance targets based on ActewAGL's average performance over the past five regulatory years
- apply the method in the STPIS for excluding specific events from the calculation of annual performance and performance targets

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<sup>157</sup> AER, *Electricity distribution network service providers – service target performance incentive scheme*, 1 November 2009, cl. 2.2.

<sup>158</sup> AER, *Electricity distribution network service providers – service target performance incentive scheme*, 1 November 2009, cl. 2.5(d) and (e).

- apply the method and value of customer reliability (VCR) values as indicated in AEMO's 2014 Value of Customer Reliability Review final report.

We will not to apply the GSL component if ActewAGL remains subject to a jurisdictional GSL scheme.

We are currently undertaking a review of the STPIS. If the review is completed in time, ActewAGL may need to apply the revised STPIS for the 2019–24 regulatory control period. We will consider the application of the revised STPIS during the revenue determination process.

The Consumer Challenge Panel (CCP10) supported the application of STPIS as proposed in the preliminary F&A. CCP10 also submitted that we should consider for the STPIS a wider application of the definition of service targets and performance in upcoming determinations.<sup>159</sup> As part of our review we will consult on broader definition on service reliability and performance.

### 3.1.2 AER's assessment approach

In deciding how to apply the scheme we have considered the requirements of the NER. The NER sets out certain requirements in relation to developing and implementing a STPIS.<sup>160</sup> These include:

#### Jurisdictional obligations

- consulting with the authorities responsible for the administration of relevant jurisdictional electricity legislation
- ensuring that service standards and service targets (including GSL) set by the scheme do not put at risk the distributor's ability to comply with relevant service standards and service targets (including GSL) specified in jurisdictional electricity legislation any regulatory obligations or requirements to which the distributor is subject.

#### Benefits to consumers

- We must take into account the benefits to consumers of applying the STPIS. This includes: the need to ensure that benefits to consumers likely to result from the scheme are sufficient to warrant any penalty or reward under the scheme
- the willingness of the customer or end user to pay for improved performance in the delivery of services
- balanced incentives
- the past performance of the distribution network

<sup>159</sup> Consumer Challenge Panel Sub Panel CCP10, *Submission to Preliminary framework and approach for ActewAGL*, 21 April 2017, pp.14–15.

<sup>160</sup> NER, cl. 6.6.2(b).

- any other incentives available to the distributor under the NER or the relevant distribution determination
- the need to ensure that the incentives are sufficient to offset any financial incentives the distributor may have to reduce costs at the expense of service levels
- the possible effects of the schemes on incentives for the implementation of non-network alternatives.

We considered the benefits to consumers of applying the STPIS when we developed the scheme. These considerations are set out in our final decision for the distribution STPIS.<sup>161</sup>

### 3.1.3 Reasons for AER's proposed position

Our reasons for applying the STPIS to ActewAGL in the 2019–24 regulatory control period are set out below.

#### Jurisdictional obligations

In the ACT, the Independent Competition and Regulatory Commission (ICRC) administers and monitors compliance with the distribution licence conditions it sets. Our proposed approach to applying the STPIS in ACT is to not create duplication or compromise ActewAGL's ability to comply with the jurisdictional requirements. Our proposed approach is therefore to not apply the GSL component of our national STPIS while the GSL arrangements in the ACT remain in place. We will amend this position if the ACT Government advises that these arrangements will cease to apply.

#### Benefits to consumers

We are mindful of the potential impact of the STPIS on consumers. Under the NER, we must consider customers' willingness to pay for improved service performance so benefits to consumers are sufficient to warrant any penalty or reward under the STPIS.<sup>162</sup>

Under the STPIS, a distributor's financial penalty or reward in each year of the regulatory control period is the change in its annual revenue allowance after the s-factor adjustment. Economic analysis of the value consumers place on improved service performance is an important input to the administration of the scheme. Value of customer reliability (VCR) studies estimate how willing customers are to pay for improved service reliability as a monetary amount per unit of unserved energy during a supply interruption.

The VCR estimates currently in our national STPIS are taken from studies conducted for the Essential Services Commission Victoria and Essential Services Commission of South Australia.<sup>163</sup>

<sup>161</sup> AER, *Final decision: Electricity distribution network service providers Service target performance incentive scheme*, 1 November 2009.

<sup>162</sup> NER, cl. 6.6.2(b)(3)(vi).

<sup>163</sup> Charles River Associates, *Assessment of the Value of Consumer Reliability (VCR) - Report prepared for VENCORP*.

In September 2014 AEMO completed its analysis of the VCR across the NEM.<sup>164</sup> We stated in our final decision for ActewAGL's 2015–19 regulatory period<sup>165</sup> and our preliminary F&A for ActewAGL's 2019–24 regulatory period,<sup>166</sup> that we will apply AEMO's VCR through the distribution determination in calculating ActewAGL's incentive rates. This is because we consider the 2014 AEMO NSW and ACT VCR better reflects the willingness of customers to pay for the reliable supply of electricity in the ACT. We consider that this approach is still appropriate.

Our proposed approach is to apply the scheme standard level of revenue at risk for ActewAGL at  $\pm 5$  per cent as we consider that this standard level would better meet the objectives of the STPIS.

## Balanced incentives

We administer our incentive schemes within a regulatory control period to align distributor incentives with the NEO. In implementing the STPIS we need to be aware of both the operational integrity of the scheme and how it interacts with our other incentive schemes. This is discussed below.

## Defining performance targets

How we measure actual service performance and set performance targets can significantly impact how well the STPIS meets its stated objectives.

The NER require us to consider past performance of the distributor's network in developing and implementing the STPIS.<sup>167</sup> Our preferred approach is to base performance targets on ActewAGL's average performance over the past five regulatory years.<sup>168</sup> Using an average calculated over multiple years instead of applying performance targets based solely on the most recent regulatory year limits a distributor's incentive to underperform in a specific year to make future targets less onerous.

Under this approach, distributors will only receive a financial reward for achieving reliability improvements. More importantly, a distributor can only retain the reward if it can maintain the reliability improvements. This is because once an improvement is made; the benchmark performance targets will be adjusted to reflect the improved level of performance. If it allows reliability to decline in the future, the distributor will be penalised. Our STPIS limits variability in penalties and rewards caused by circumstances outside the distributor's control. We exclude interruptions to supply deemed to be outside the major event day boundary from both the calculation of performance targets and measured service performance.

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Melbourne 2002; KPMG, *Consumer Preferences for Electricity Service Standards*, 2003.

<sup>164</sup> AEMO, *Value of customer reliability review - Final report*, September 2014.

<sup>165</sup> AER, *ActewAGL final decision 2015–19, Attachment 11 – Service target performance incentive scheme*, pp. 11–21.

<sup>166</sup> AER, *Preliminary framework and approach for ActewAGL 2019–24*, March 2017, p. 54.

<sup>167</sup> NER, cl. 6.6.2(b)(3)(iii).

<sup>168</sup> Subject to any modifications required under cl. 3.2.1(a) and (b) of the national STPIS.

ActewAGL submitted that, given circumstances and effects of dramatically reduced opex in the current regulatory period, it could not support proceeding on the basis that the existing STPIS will apply without significant changes to STPIS parameters (revenue at risk and performance targets) being implemented in the determination.<sup>169</sup> We will revisit this issue during the revenue determination process.

## Interactions with our other incentive schemes

In applying the STPIS we must consider any other incentives available to the distributor under the NER or relevant distribution determination.<sup>170</sup> In the ACT the STPIS will interact with our expenditure and demand management incentive schemes.

The efficiency benefit sharing scheme (EBSS) provides a distributor with an incentive to reduce operating costs. The STPIS counterbalances this incentive by discouraging cost reductions that lead to a decline in performance. The s-factor adjustment of annual revenue depends on the distributor's actual service performance compared to predetermined targets.

In setting STPIS performance targets, we will consider both completed and planned reliability improvements expected to materially affect network reliability performance.<sup>171</sup>

The capital expenditure sharing scheme (CESS) rewards a distributor if actual capex is lower than the approved forecast amount for the regulatory year. Since our performance targets will reflect planned reliability improvements, any incentive a distributor may have to reduce capex by not achieving the planned performance outcome will be curtailed by the STPIS penalty.

The NER requires us to consider the possible effects of the STPIS on a distributor's incentives to implement non-network alternatives to augmentation.

In the past we have received submissions requesting outages caused by failed non-network solutions be excluded from the STPIS. This is on the basis that the exclusion of these outages will increase the use of non-network solutions. We consider that such arrangement will transfer the financial risk of non-network solution operators to customers.

We consider that non-network solution operators and the distributor are the parties best placed to manage the risk of outages rather than the customers. Further, as customers are the party who finally fund the non-network solutions adopted by the distributors through network charges, they should not become the party to bear the risk of outages of such projects.

The STPIS treats the reliability implications of network and non-network solutions symmetrically, neither encouraging nor discouraging non-network alternatives to augmentation. Hence, we consider the current incentive framework of the STPIS is adequate

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<sup>169</sup> ActewAGL: *Submission in response to the AER's preliminary Framework and Approach*, 24 April 2017, pp. 14–15.

<sup>170</sup> NER, cl. 6.6.2(b)(3)(iv).

<sup>171</sup> Included in the distributor's approved forecast capex for the next period.

to encourage distributors to select appropriate network or non-network solutions to manage their networks.

## 3.2 Efficiency benefit sharing scheme

The EBSS is intended to provide a continuous incentive for distributors to pursue efficiency improvements in opex, and to fairly share these between distributors and consumers. Consumers benefit from improved efficiencies through lower network prices in future regulatory control periods.

ActewAGL asked us to clarify our intentions on the application of our revealed cost approach versus other methodologies before arriving at a position on the application of the EBSS during the 2019–24 period.<sup>172</sup> We address our position on the application of the EBSS in relationship to our proposed opex forecasting approach below. We address our application of our Expenditure forecast assessment guideline in chapter 4.

### 3.2.1 AER's proposed position

We intend to apply the EBSS to the ActewAGL in the 2019–24 regulatory control period if we are satisfied the scheme will fairly share efficiency gains and losses between consumers and ActewAGL.<sup>173</sup> We will decide if and how we will apply it in our determination. Our determination will take into account the information available to us at that time as to ActewAGL's revealed costs and the basis on which we approve its forecast opex.

### 3.2.2 AER's assessment approach

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between a network service provider and network users.<sup>174</sup> We must also have regard to the following factors in developing and implementing the EBSS:<sup>175</sup>

- the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme
- the need to provide service providers with a continuous incentive to reduce opex
- the desirability of both rewarding service providers for efficiency gains and penalising service providers for efficiency losses
- any incentives that service providers may have to capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

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<sup>172</sup> ActewAGL in its letter to the AER: *Request for the AER to make, or make an amended or replacement framework and approach*, 28 October 2016, p. 4.

<sup>173</sup> NER, cl. 6.5.8(a).

<sup>174</sup> NER, cl. 6.5.8(a).

<sup>175</sup> NER, cl. 6.5.8(c).

### 3.2.3 Reasons for AER's proposed position

The EBSS does not apply to ActewAGL in the 2015–19 regulatory control period.<sup>176</sup>

At the time we made our determination for the 2015–19 regulatory control period, economic benchmarking and other corroborating evidence indicated that ActewAGL's opex was higher than opex incurred by a benchmark efficient service provider. In our decision,<sup>177</sup> we noted that ActewAGL had just over three years before it submitted its next regulatory proposal. Consequently, it was uncertain whether, and to what extent, we were likely to rely on ActewAGL's revealed costs in the 2015–19 regulatory control period to forecast opex in the 2019–24 regulatory control period. It followed that if we were not going to use a revealed cost approach for forecasting opex in the 2019–24 regulatory control period, there was not a strong reason to apply the EBSS in the 2015–19 regulatory control period.

In its submission, ActewAGL agreed with our preliminary F&A that an EBSS should apply in the 2019–24 regulatory control period where opex is forecast based on a revealed cost approach.<sup>178</sup> Similarly, the CCP sub-panel 10 supported the application of the EBSS while acknowledging its relationship to the revealed cost forecasting approach.<sup>179</sup>

The EBSS is intrinsically linked to a distributor's revealed costs. In assessing a distributor's opex proposal, we seek to identify an efficient opex amount in the base year (the 'revealed costs' of the distributor), which we use to develop an alternative estimate of total opex for the 2019-24 regulatory control period. We compare this to a distributor's opex proposal when assessing it against the opex criteria. If we approve opex that reflects a distributor's revealed costs and apply the EBSS, and the distributor then makes an incremental efficiency gain, it will receive a reward through the EBSS. The lower revealed costs will inform our assessment of the distributor's proposed opex forecast for the subsequent period such that consumers are likely to benefit from those lower costs on an ongoing basis. This is how efficiency improvements are shared between consumers and the business.

Where approved forecast opex reflects revealed costs, the application of the EBSS serves two important functions:

1. it removes the incentive for a distributor to inflate opex in the expected base year in order to gain a higher opex forecast for the next regulatory control period
2. it provides a continuous incentive for a distributor to pursue efficiency improvements across the regulatory control period.

The EBSS does this by allowing a distributor to retain efficiency gains (or losses) for a total of six years (typically), regardless of the year in which it was made.

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<sup>176</sup> AER, *Electricity distribution network service providers, efficiency benefit sharing scheme*, 26 June 2008.

<sup>177</sup> AER, *ActewAGL distribution determination 2015–19, final decision*, April 2015, Attachment 9, pp. 9-7.

<sup>178</sup> ActewAGL, *Submission on preliminary framework and approach*, April 2017, p. 5.

<sup>179</sup> Consumer Challenge Panel (Sub-panel 10), *Submission on preliminary framework and approach*, 21 April 2017, p. 14.

We will determine if we will apply the EBSS when we have ActewAGL's proposal and assess that against its revealed costs. This will inform us as to whether the application of the EBSS will sufficiently benefit electricity consumers in terms of any likely reward or penalty, and if it will provide a continuous incentive to ActewAGL to pursue efficiency improvements.

### 3.3 Capital expenditure sharing scheme

The CESS aims to incentivise distributors to undertake efficient capex throughout the regulatory control period by rewarding efficiency gains and penalising efficiency losses. Consumers benefit from improved efficiency through lower network prices in the future. This section sets out our proposed approach and reasons for our intention to apply version 1 (dated 29 November 2013) of the CESS to ActewAGL.

The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between a distributor and network users.

The CESS works as follows:

- We calculate the cumulative underspend or overspend amount for the current regulatory control period in net present value terms.
- We apply the sharing ratio of 30 per cent to the cumulative underspend or overspend to work out what the distributor's share of any underspend or overspend amount should be.
- We calculate the CESS payments taking into account the financing benefit or cost to the distributor of any underspend or overspend amount.<sup>180</sup> We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB.
- The CESS payments will be added to or subtracted from the distributor's regulated revenue as a separate building block in the next regulatory control period.

Under the CESS a distributor retains 30 per cent of the financing benefit or cost of any underspend or overspend amount, while consumers retain 70 per cent of the financing benefit or cost of any underspend or overspend amount.

#### 3.3.1 AER's proposed position

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<sup>180</sup> We calculate benefits as the benefits to the distributor of financing the underspend since the amount of the underspend can be put to some other income generating use during the period. Losses are similarly calculated as the financing cost to the distributor of the overspend.

We intend to apply the CESS, as set out in our capex incentives guideline,<sup>181</sup> to ActewAGL in the 2019–24 regulatory control period. Our approach is supported in principle by ActewAGL and CCP sub-panel 10.<sup>182</sup>

### 3.3.2 AER's assessment approach

In deciding whether to apply a CESS to a distributor, and the nature and details of any CESS to apply to a distributor, we must:<sup>183</sup>

- make that decision in a manner that contributes to the capex incentive objective set out in the NER<sup>184</sup>
- consider the CESS principles,<sup>185</sup> capex objectives,<sup>186</sup> other incentive schemes, and where relevant the opex objectives, as they apply to the particular distributor, and the circumstances of the distributor.

Broadly, the capex incentive objective is to ensure that only capex that meets the capex criteria enters the RAB used to set prices. Therefore, consumers only fund capex that is efficient and prudent.

### 3.3.3 Reasons for AER's proposed position

We propose to apply the CESS to ActewAGL in the next regulatory control period as we consider this will contribute to the capex incentive objective.

ActewAGL is currently subject to a CESS. As part of our Better Regulation program we consulted on and published version 1 of the capex incentives guideline which sets out the CESS.<sup>187</sup> The guideline specifies that in most circumstances we will apply a CESS, in conjunction with forecast depreciation to roll-forward the RAB.<sup>188</sup> We are also proposing to apply forecast depreciation, which we discuss further in chapter 5.

In developing the CESS we took into account the capex incentive objective, capex criteria, capex objectives, and the CESS principles. We also developed the CESS to work alongside other incentive schemes that apply to distributors including the EBSS, STPIS, and DMIS— which ActewAGL will be subject to in the next regulatory control period.

For capex, the sharing of underspends and overspend amounts happens at the end of each regulatory control period when we update a distributor's RAB to include new capex. If a

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<sup>181</sup> AER, *Capital expenditure incentive guideline for electricity network service providers*, pp. 5–9.

<sup>182</sup> ActewAGL, *Submission on preliminary framework and approach*, April 2017, pp. 18–19; Consumer Challenge Panel (Sub-panel 10), *Submission on the AER's preliminary framework and approach*, 21 April 2017, p. 14.

<sup>183</sup> NER, cl. 6.5.8A(e).

<sup>184</sup> NER, cl. 6.4A(a); the capex criteria are set out in cl. 6.5.7(c) of the NER.

<sup>185</sup> NER, cl. 6.5.8A(c).

<sup>186</sup> NER, cl. 6.5.7(a).

<sup>187</sup> AER, *Capital expenditure incentive guideline for electricity network service providers*, pp. 5–9.

<sup>188</sup> AER, *Capital expenditure incentive guideline for electricity network service providers*, pp. 10–12.

distributor spends less than its approved forecast during a period, it will benefit within that period. Consumers benefit at the end of that period when the RAB is updated to include less capex compared to if the business had spent the full amount of the capex forecast. This leads to lower prices in the future.

Without a CESS the incentive for a distributor to spend less than its forecast capex declines throughout the period.<sup>189</sup> Because of this a distributor may choose to spend capex earlier, or spend on capex when it may otherwise have spent on opex, or less on capex at the expense of service quality—even if it may not be efficient to do so.

With the CESS a distributor faces the same reward and penalty in each year of a regulatory control period for capex underspends or overspends. The CESS will provide a distributor with an ex ante incentive to spend only efficient capex in each year of the regulatory control period. In this way, a distributor will be more likely to incur only efficient capex when subject to a CESS, so any capex included in the RAB is more likely to reflect the capex criteria. In particular, if a distributor is subject to the CESS, its capex is more likely to be efficient and to reflect the costs of a prudent distributor.

In addition, when the CESS, EBSS and STPIS apply to a distributor then incentives for opex, capex and service performance are balanced. This encourages a distributor to make efficient decisions on when and what type of expenditure to incur, and to balance expenditure efficiencies with service quality.

ActewAGL noted its in-principle support for the application of a CESS, while indicating concern that the application of some aspects of the current scheme, particularly the inclusion in the scheme of capex for customer initiated works, is not appropriate.<sup>190</sup>

We considered this issue at length during the development of the CESS and found there was no convincing reason why we should allow exclusions for nominated uncontrollable events. In particular, while we accepted that some events may be uncontrollable, in most cases, a business will still have the ability to control the costs associated with such events. We were also concerned that allowing exclusions would increase the risk that we would dilute a NSP's incentives to improve its efficiency.<sup>191</sup>

Further, as discussed in our explanatory statement, in relation to customer initiated capex, we were not satisfied that works driven by customers warranted different treatment under the CESS to other capex incurred by a business. We considered the contingent projects and pass-through mechanisms in the NER are the mechanisms to ensure a business has sufficient funds to be able deliver material capex not approved as part of forecast capex in an initial regulatory determination.<sup>192</sup>

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<sup>189</sup> As the end of the regulatory period approaches, the time available for the distributor to retain any savings gets shorter. So the earlier a distributor incurs an underspend in the regulatory period, the greater its reward will be.

<sup>190</sup> ActewAGL, *Submission on preliminary framework and approach*, April 2017, pp. 18–19.

<sup>191</sup> AER, *Explanatory Statement, capital expenditure sharing scheme*.

<sup>192</sup> AER, *Explanatory Statement, capital expenditure sharing scheme*.

### 3.4 Demand management incentive scheme and innovation allowance mechanism

This section sets out our proposed approach and reasons for applying our new demand management incentive scheme (DMIS) and demand management allowance mechanism (Allowance Mechanism) to ActewAGL in the 2019–24 regulatory control period.

We apply a demand management incentive scheme (current scheme) in our distribution determination for the current regulatory control period.<sup>193</sup>

Our current scheme consists of two parts. The first is the demand management innovation allowance (DMIA) which is incorporated into ActewAGL's revenue allowance for each year of the regulatory control period. ActewAGL prepares an annual report on their expenditure under the DMIA in the previous year, which we then assess against specific criteria.<sup>194</sup> The second element is a forgone revenue component, which allows a distributor to recover forgone revenues that are directly attributable to a non-tariff demand management project or program approved under the DMIA. Compensation for foregone revenue is not applied where a distributor is subject to a revenue cap rather than a price cap.

Currently, only the DMIA (Part A of the scheme) applies to ActewAGL because the recovery of forgone revenue under Part B has not been applied. Since we will apply a revenue cap to ActewAGL in the next regulatory control period compensation for foregone revenue will not be relevant.

On 20 August 2015, the AEMC published a rule determination changing the application of the current scheme.<sup>195</sup> There are now two parts of the framework under the NER:

- The DMIS, with the objective to provide distributors with an incentive to undertake efficient expenditure on relevant non-network options relating to demand management.
- The Allowance Mechanism, with the objective to provide distributors with funding for research and development in demand management projects that have the potential to reduce long term network costs.

In contrast, the objective under the current scheme has been to provide incentives for distributors to implement efficient non-network alternatives, or to manage the expected demand for standard control services in some other way, or to efficiently connect embedded generators. The objectives of the new DMIS and Allowance Mechanism are therefore different to that under the current scheme.

The DMIS and Allowance Mechanism will not affect the classification of distribution services, the form of the control mechanisms as specified in this F&A paper, the formulas that give effect to those mechanisms or the pricing of services provided by dual function assets.

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<sup>193</sup> NER, version 52, cl. 6.6.3 (a).

<sup>194</sup> The DMIA excludes the costs of demand management initiatives approved in our determination for the 2012–17 period.

<sup>195</sup> AEMC, *Rule Determination: National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, August 2015.

We are currently developing a new DMIS and Allowance Mechanism. We published a consultation paper in January, facilitated a stakeholder forum in April, and ran a stakeholder videoconference in June.<sup>196</sup> We expect to publish the new DMIS and Allowance Mechanism by late 2017.

### 3.4.1 AER's proposed position

We are currently developing a new DMIS and Allowance Mechanism consequent to the rule change in August 2015, to apply to ActewAGL in the next regulatory control period. ActewAGL and CCP sub-panel 10 supported in principle our preliminary position to apply the new DMIS and Allowance Mechanism.<sup>197</sup>

### 3.4.2 AER's assessment approach to the DMIS

The NER require us to take several factors into account in developing and implementing a DMIS for ActewAGL.<sup>198</sup> These are:

#### DMIS Objective

- The DMIS should provide ActewAGL with an incentive to undertake efficient expenditure on relevant non-network options relating to demand management.

#### Benefits to consumers

- The DMIS should reward ActewAGL for implementing relevant non-network options will deliver net cost savings to electricity consumers.

#### Balanced incentives

- The DMIS should balance the incentives between expenditure on network options and non-network options relating to demand management.
- The DMIS should take into account the net economic benefits delivered to all those who produce, consume and transport electricity in the market associated with implementing relevant non-network options.
- The level of incentive the DMIS provides should be reasonable considering the long term benefit to retail customers.
- The DMIS should not include costs that are recoverable from another source, including under a relevant distribution determination.
- The DMIS should not impose penalties on distributors.

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<sup>196</sup> For details on our consultation process, see our demand management project page under: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism> .

<sup>197</sup> ActewAGL Distribution, *Response to AER preliminary framework and approach*, April 2017, p. 20; Consumer Challenge Panel (Sub-panel 10), *Submission on preliminary framework and approach for ActewAGL*, 21 April 20147, p. 13.

<sup>198</sup> NER, cl.6.6.3(c).

- The length of a regulatory control period should not limit the DMIS's incentives if this would not contribute to achieving the objective of the DMIS.

### 3.4.3 Reasons for AER's proposed position on DMIS

This section outlines the reasons for our intention to apply the DMIS to ActewAGL in the 2019–24 regulatory control period.

The usage patterns of geographically dispersed consumers determine how electrical power flows through a distribution network. Since consumers use energy in different ways, different network elements reach maximum utilisation levels at different times. Distributors have historically planned their network investment to provide sufficient capacity for these situations. Peak demand periods are typically brief and infrequent, but network infrastructure is built to operate during these peak periods without service interruptions. Hence, at other times there is significant redundant capacity.

This underutilisation means that augmentation of network capacity may not always be the most efficient means of catering for increasing peak demand. In the context of providing distribution services, demand management refers to any effort by a distributor to modify the drivers of network usage, including reducing peak demand or changing the demand profile.<sup>199</sup> Demand management that effectively reduces network utilisation during peak usage periods can be an economically efficient way of deferring the need for network augmentation.

#### DMIS Objective

The DMIS must incentivise distributors to undertake non-network initiatives relating to demand management. Developing such incentives requires considering the impacts of control mechanisms in providing incentives. It also requires considering how a DMIS will promote cost efficient non-network options that relate to and are likely to achieve demand management outcomes. Our consultation paper discussed a range of mechanisms that could contribute to the achievement of this objective.<sup>200</sup>

#### Benefits to consumers

Customers ultimately will pay for any demand management incentives. Therefore, the rewards for demand management should target implementing non-network projects that will bring net cost savings to retail customers.<sup>201</sup> The NER recognise that these net cost savings to retail customers could be via the net economic benefits delivered from implementing relevant non-network options.<sup>202</sup> We will design the DMIS so its expected long term benefits

<sup>199</sup> For example, agreements between distributors and consumers to switch off loads at certain times or allowing distributors to directly control consumer usage via load control devices reduces the demand for power drawn from the distribution network at peak times.

<sup>200</sup> AER, *Consultation Paper- Demand management incentive scheme and innovation allowance mechanism*, January 2017.

<sup>201</sup> NER, cl. 6.6.3(c)(2).

<sup>202</sup> NER, cl. 6.6.3(c)(3).

exceed the costs to consumers resulting from any associated adjustment to regulated revenues. The NER recognise that the operation of the DMIS may result in benefits that accrue over multiple periods. We intend to assess projects, for which distributors apply for incentives under the DMIS, using criteria that will balance the incentives between expenditure on network options and non-network options relating to demand management.

We must also design the DMIS so the costs to consumers resulting from the associated adjustment to regulated revenues do not exceed its long term expected benefits, including when we take into account the net economic benefits across all participants in the market. In balancing this, we recognise that the operation of the DMIS may result in cost impacts within a regulatory control period where the benefits are unlikely to be revealed until later periods.

The DMIS will encourage demand management initiatives which are likely to provide long term efficiency gains to energy consumers that will outweigh any short term price increases. For instance, these initiatives might reduce the costs of investment in new infrastructure. This might occur through the deferral of, or removal of the need for, network augmentation/expansion or replacement/refurbishment expenditures, such as via a more efficient use of existing infrastructure.

The DMIS will be designed so all costs recovered from other sources will be excluded from its incentive payments. In developing the DMIS, we are having regard to the effect that it could have on the incentives created by the EBSS, CESS and STPIS, and vice versa. We are also avoiding imposing penalties as part of the DMIS.

### **3.4.4 AER's assessment approach to the Allowance Mechanism**

The NER require us to take several factors into account in developing and implementing an Allowance Mechanism for ActewAGL.<sup>203</sup> These are:

#### **Allowance Mechanism Objective**

- The Allowance Mechanism should provide ActewAGL with funding for research and development in demand management projects that have the potential to reduce long term network costs.

#### **Benefits to consumers**

- Projects to which the Allowance Mechanism applies should have the potential to deliver ongoing reductions in demand or peak demand. They should be innovative, and should not be otherwise efficient and prudent non-network options that a distributor should have provided for in its regulatory proposal.
- The Allowance Mechanism should provide a reasonable level of the allowance considering the long term benefit to retail customers. It should only provide funding that is not available from any another source, including under a relevant distribution determination.

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<sup>203</sup> NER, cl. 6.6.3A(c).

- The Allowance Mechanism will require distributors to publish reports on the nature and results of demand management projects that are the subject of the allowance.

### **3.4.5 Reasons for AER's proposed position on Allowance Mechanism**

This section outlines the reasons for our position to apply the Allowance Mechanism to ActewAGL in the next regulatory control period.

Distributors have historically planned their network investment to provide sufficient capacity for the periods where the network elements reach maximum utilisation levels. Peak demand periods are typically brief and infrequent, but network infrastructure is built to operate during these peak periods without service interruptions. Hence, at other times there is significant redundant capacity. Demand management that effectively reduces network utilisation during peak usage periods can be an economically efficient way of deferring the need for network augmentation and reducing long term network costs.

Research and development demand management projects will drive innovation in non-network solutions and have the potential to reduce long term network costs.

#### **Allowance Mechanism Objective**

The Allowance Mechanism objective is to provide funding for research and development in demand management projects that have the potential to reduce long term network costs.

We will consider methods to encourage the selection of research and development projects which have the potential to reduce long term network costs via demand management methods.

#### **Benefits to consumers**

The Allowance Mechanism design will aim to fund demand management with the potential to reduce long term network costs. It will fund projects that are innovative and would not be otherwise efficient and prudent non-network options that a distributor should have provided for in its regulatory proposal. We should be willing to remove funding ex-post for projects that fall short of this principle.

We consider there will be merit in clarifying the definition of innovative projects and of non-network projects, and for the development of criteria for assessment of projects as part of the designing of the Allowance Mechanism. For example, clarification of innovative tariff trials may be required.

The Allowance Mechanism will be designed so only funding is supplied which is not available from any another source, including under a relevant distribution determination, and this will form an assessment criteria for projects.

The design of the Allowance Mechanism will require distributors to publish reports on the nature and results of demand management projects that receive the allowance. Publication

of such reports enables the knowledge gained from these projects to be leveraged by other industry participants, with potentially greater consumer benefits.

## 4 Expenditure forecast assessment guideline

This chapter sets out our intention to apply our expenditure forecast assessment guideline (the EFA guideline)<sup>204</sup> including the information requirements applicable to ActewAGL for the 2019–24 regulatory control period. The EFA guideline sets out our expenditure assessment approach developed and consulted upon during the Better Regulation program. It outlines the assessment techniques we will use to assess a distributor's proposed expenditure forecasts, and the information we require from the distributor.

The EFA guideline uses a nationally consistent reporting framework that allows us to compare the relative efficiencies of distributors and decide on efficient expenditure forecasts. The NER require ActewAGL to advise us by 30 June 2017 of the method they propose to use to prepare their forecasts.<sup>205</sup> In the F&A we must advise whether we will deviate from the EFA guideline.<sup>206</sup> This will provide clarity on how we will apply the EFA guideline and the information ActewAGL should include in its regulatory proposals. This contributes to an open and transparent process and makes our assessment of expenditure forecasts more predictable.<sup>207</sup>

The EFA guideline contains a suite of assessment/analytical tools and techniques to assist our review of the expenditure forecasts distributors include in their regulatory proposals. We intend to have regard to the assessment tools set out in the guideline. The tool kit includes:

- models for assessing proposed replacement and augmentation capex
- benchmarking (including broad economic techniques and more specific analysis of expenditure categories)
- methodology, governance and policy reviews
- predictive modelling and trend analysis
- cost benefit analysis and detailed project reviews.<sup>208</sup>

We exercise judgement to determine the extent to which we use a particular technique to assess a regulatory proposal. We use the techniques we consider appropriate depending on the specific circumstances of the determination. The guideline is flexible and recognises that we may employ a range of different estimating techniques to assess an expenditure forecast.

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<sup>204</sup> We were required to develop the EFA guideline under clauses 6.4.5 and 11.53.4 of the NER. We published this guideline on 29 November 2013. It can be located at [www.aer.gov.au/node/18864](http://www.aer.gov.au/node/18864).

<sup>205</sup> NER, cl. 6.8.1A(b)(1).

<sup>206</sup> NER, cl. 6.8.1(b)(2)(viii).

<sup>207</sup> As per the requirement of NER, cl. 6.8.2(c2) ActewAGL is required to submit expenditure assessment information in its regulatory proposal. ActewAGL's response to Reset Regulatory Information Notice pertaining to the forecast data will satisfy the information requirements contained in the AER's Expenditure Forecast Assessment Guideline as set out in this F&A.

<sup>208</sup> AER, *Explanatory statement: Expenditure assessment guideline for electricity transmission and distribution*, 29 November 2013.

ActewAGL raised concerns about our benchmarking methodology and approach previously.<sup>209</sup> We received three submissions in response to our preliminary F&A approach to implement the EFA guideline.<sup>210</sup> CCP sub-panel 10 and SA Power Networks supported the use of benchmarking to assess the efficiency of proposed expenditure forecasts.<sup>211</sup> However, ActewAGL and SA Power Networks considered we should commence an open and transparent consultation process to review our benchmarking approach following the Full Federal Court appeal outcome.<sup>212</sup>

The Full Federal Court handed down its decision 24 May 2017. We are carefully considering this decision.

We will continue to develop and use economic benchmarking to inform our expenditure decisions. Economic benchmarking remains a tool in assessing the relative efficiency of network services providers. It also provides a source of information to assist both service providers and other interested parties about the relative productivity of individual businesses and the trends in productivity for the industry.

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<sup>209</sup> ActewAGL in its letter to the AER: *Request for the AER to make, or make an amended or replacement framework and approach*, 28 October 2016, p. 5.

<sup>210</sup> ActewAGL, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 21–23; SA Power Networks, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 2–3; Consumer Challenge Panel 10, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 19–20.

<sup>211</sup> SA Power Networks, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 2; Consumer Challenge Panel 10, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 19–20.

<sup>212</sup> ActewAGL, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 21–23; SA Power Networks, *Response to AER's preliminary framework and approach for NSW DNSPs*, 21 April 2017, p. 2–3.

## 5 Depreciation

As part of the process of rolling forward a distributor's RAB to the start of the next regulatory control period, we update the RAB for actual capex incurred during the current regulatory control period and also adjust for depreciation. This section sets out our proposed approach on the form of depreciation to be used when ActewAGL's RAB is rolled forward to the commencement of the 2024–29 regulatory control period.

The depreciation we use to roll forward the RAB can be based on either:

- Actual capex incurred during the regulatory control period (actual depreciation). We roll forward the RAB based on actual capex less the depreciation on the actual capex incurred by the distributor; or
- The capex allowance forecast at the start of the regulatory control period (forecast depreciation). We roll forward the RAB based on actual capex less the depreciation on the forecast capex approved for the regulatory control period.

The choice of depreciation approach is one part of the overall capex incentive framework.

Consumers benefit from improved efficiencies through lower regulated prices. Where a CESS is applied, using forecast depreciation maintains the incentives for distributors to pursue capex efficiencies, whereas using actual depreciation would increase these incentives. There is more information on depreciation as part of the overall capex incentive framework in our capex incentives guideline.<sup>213</sup> In summary:

- If there is a capex overspend, actual depreciation will be higher than forecast depreciation. This means that the RAB will increase by a lesser amount than if forecast depreciation was used. As a result, the distributor will earn less revenue into the future (i.e. it will bear more of the cost of the overspend into the future) than if forecast depreciation had been used to roll forward the RAB.
- If there is a capex underspend, actual depreciation will be lower than forecast depreciation. This means that the RAB will increase by a greater amount than if forecast depreciation was used. Hence, the distributor will earn greater revenue into the future (i.e. it will retain more of the benefit of an underspend into the future) than if forecast depreciation had been used to roll forward the RAB.

The incentive from using actual depreciation to roll forward the RAB also varies with the life of the asset. Using actual depreciation will provide a stronger incentive for the distributor to underspend capex on shorter lived assets compared to longer lived assets as this will lead to a relatively larger increase in the RAB. Use of forecast depreciation, on the other hand, leads to the same incentive for capex regardless of asset lives. This is because using forecast depreciation does not affect the distributor's incentive on capex as the distributor does not lose the full cost of any overspend and is not able to keep all the benefits of any

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<sup>213</sup> AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, pp. 10–12.

underspend. To this end, using forecast depreciation means the capex incentive is focussed on the return on capital.

## 5.1 AER's proposed position

We propose to use the forecast depreciation approach to establish the RAB at the commencement of the 2024–29 regulatory control period for ActewAGL. We consider this approach will provide sufficient incentives for ActewAGL to achieve capex efficiency gains over the 2019–24 regulatory control period.

## 5.2 AER's assessment approach

We have to decide for our distribution determination whether we will use actual or forecast depreciation to establish a distributor's RAB at the commencement of the following regulatory control period.<sup>214</sup>

We set out in our capex incentives guideline our process for determining which form of depreciation we propose to use in the RAB roll forward process.<sup>215</sup> Our decision on whether to use actual or forecast depreciation must be consistent with the capex incentive objective. We must have regard to:<sup>216</sup>

- any other incentives the service provider has to undertake efficient capex
- substitution possibilities between assets with different lives
- the extent of overspending and inefficient overspending relative to the allowed forecast
- the capex incentive guideline
- the capital expenditure factors.

## 5.3 Reasons for AER's proposed position

Consistent with our capex incentives guideline, we propose to use the forecast depreciation approach to establish the RAB for ActewAGL at the commencement of the 2024–29 regulatory control period. We note that ActewAGL supported our preliminary position to use the forecast depreciation approach to establish the opening RAB.<sup>217</sup> The CCP also agreed with our preliminary position on the depreciation approach.<sup>218</sup> We note the CCP's concern about any deviation from the straight-line depreciation method used to forecast the depreciation building block.<sup>219</sup> We will consider such issues during the assessment of the regulatory proposal.

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<sup>214</sup> NER, cl. S6.2.2B.

<sup>215</sup> NER, cl. 6.4A(b)(3).

<sup>216</sup> NER, cl. S6.2.2B.

<sup>217</sup> ActewAGL Distribution, *Response to AER preliminary framework and approach*, April 2017, p. 24.

<sup>218</sup> Consumer Challenge Panel 10, *Submission on preliminary framework and approach for ActewAGL*, 21 April 2017, pp. 18–19.

<sup>219</sup> Consumer Challenge Panel 10, *Submission on preliminary framework and approach for ActewAGL*, 21 April 2017, p. 19.

We had regard to the relevant factors in the NER in developing the approach for deciding on the form of depreciation set out in our capex incentives guideline.<sup>220</sup>

Our approach is to apply forecast depreciation except where:

- there is no CESS in place and therefore the power of the capex incentive may need to be strengthened, or
- a distributor's past capex performance demonstrates evidence of persistent overspending or inefficiency, thus requiring a higher powered incentive.

In making our decision on whether to use actual depreciation in either of these circumstances we will consider:

- the substitutability between capex and opex and the balance of incentives between these
- the balance of incentives with service
- the substitutability of assets with different asset lives.

We have chosen forecast depreciation as our default approach because, in combination with the CESS, it will provide a 30 per cent reward for capex underspends and 30 per cent penalty for capex overspends, which is consistent for all types of asset categories. In developing our capex incentives guideline, we considered this to be a sufficient incentive for a distributor to achieve efficiency gains over the regulatory control period in most circumstances.

The opening RAB at the commencement of the 2019–24 regulatory control period will be established using forecast depreciation, as stated in our previous determination that applies to ActewAGL for the 2015–19 regulatory control period. The use of forecast depreciation to establish the opening RAB for the commencement of the 2024–29 regulatory control period therefore maintains the current approach. ActewAGL is currently subject to a CESS and we propose to continue to apply the CESS in the 2019–24 regulatory control period. We discussed this in section 3.3.

For ActewAGL, we consider the incentive provided by the application of the CESS in combination with the use of forecast depreciation and our other ex post capex measures should be sufficient to achieve the capex incentive objective.<sup>221</sup> Our ex post capex measures are set out in the capex incentives guideline. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.

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<sup>220</sup> AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, pp. 10–12.

<sup>221</sup> AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, pp. 13–19 and 20–21.

## 6 Dual function assets

Dual function assets are high voltage transmission assets forming part of the distribution network. Transmission network service providers usually operate these assets. Considering transmission assets as part of a distribution determination avoids the need for a separate transmission proposal. Where a network service provider owns, controls or operates dual-function assets, we are required to consider whether we should price these assets according to the transmission or distribution pricing principles.

Our decision continues the current transmission pricing approach, consistent with ActewAGL's submitted preference.

### 6.1 AER's decision

Our decision on dual function asset pricing is binding on us and ActewAGL for the 2019–24 regulatory control period.

Our decision is to apply transmission pricing to ActewAGL's dual function assets. This is consistent with the current approach, our draft decision, and ActewAGL's preference.<sup>222</sup> We also accept ActewAGL's submitted value of its dual function assets.

**Table 6.1 ActewAGL's dual function assets**

	ActewAGL
Dual function assets (\$m)	\$189.71 million
Proportion of distribution RAB (%)	19 %
Current regulatory period pricing	Transmission
Service provider preference	Transmission
AER decision	Transmission

### 6.2 AER's assessment approach

Dual function asset rules establish transmission pricing as the default approach where the assets form a material proportion of the distributor's regulatory asset base (RAB). The NER require us, in deciding pricing approaches, to consider impacts on distribution prices and consumption, production and investment. We may also account for other factors we consider relevant.

<sup>222</sup> ActewAGL, *Response to AER query, Information required by the AER for consideration of the pricing treatment of ActewAGL Distribution's (AAD's) dual function assets*, November 2016, p. 3.

Our decisions on dual function assets incorporate two main stages. First, we must be satisfied that relevant assets conform to the NER definition. Having satisfied ourselves on this first issue, we then consider alternative pricing approaches.

Distribution and transmission pricing represent different ways of recovering service costs. Under transmission pricing, distributors may allocate dual function asset costs to both a TNSP's broader customer base and the distributor's customers. However, under distribution pricing rules, distributors with dual function assets may not allocate costs to a TNSP.

Electricity supply costs transfer along the supply chain, or downstream, onto the next service provider in the process. Hence, generators pass generation costs to retailers who pass them to customers. In the same way, TNSPs pass their costs to distributors, who in turn pass those costs to retailers and then to customers. Costs may not be passed back up the supply chain from distributors to TNSPs, except under transmission pricing rules. Therefore, under distribution pricing rules, a distributor's own customers pay the full cost of dual function assets.

Because transmission networks are upstream of distribution networks, they usually service larger numbers of electricity consumers than distribution networks. Therefore, where TNSPs recover the same service costs, transmission pricing usually provides for lower per unit prices than distribution pricing. We note that this is not necessarily an appropriate outcome. The NER require us to determine efficient service costs. In principle, electricity consumers who stand to benefit from dual function assets should pay for those services.

In some cases, the potential transmission and distribution customer bases for cost recovery purposes are the same. In such cases, network service providers would recover dual function asset costs from the same number of customers. We expect that in such cases price impacts for individual customers under both pricing approaches would be equivalent.

We applied a three part test to determine application of either transmission or distribution pricing rules. First, we considered the value of dual function assets as a proportion of the distributor's RAB.<sup>223</sup> Second, we considered whether regulating prices under distribution rules rather than transmission would:

- result in materially different prices for distribution customers<sup>224</sup>
- impact on future consumption, production and investment decisions.<sup>225</sup>

Third, we took into account other matters we considered relevant. Specifically, we considered cost reflectivity, or who benefits from the assets and administrative cost implications of changing the current approach. Customers benefitting from dual function assets should contribute to their cost recovery. The NER define dual function assets as supporting the higher voltage transmission network. Therefore, our default assumption is that a broader customer set than just the distributor's customers are benefiting from shared

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<sup>223</sup> NER, cl. 6.25(b).

<sup>224</sup> NER, cl. 6.25(c)(1).

<sup>225</sup> NER, cl. 6.25(c)(2).

assets. We also consider that we should avoid administrative costs where possible. Finally, we consider the current approach should continue unless we identify sufficient reasons to change the approach.

### 6.3 Reasons for AER's decision

Our decision is that transmission pricing will continue to apply to ActewAGL's dual function assets.

The current regulatory control period is the first in which ActewAGL has operated dual function assets. These arise from the ACT Government's decision to establish a second interconnector between the ACT and NSW. This new interconnection is in the ACT's south and is in addition to an existing northern interconnection that TransGrid owns. The ACT Government decided to establish the second supply point, obliging ActewAGL and TransGrid to give effect to this decision. The new interconnection assets have operated since March 2012.

#### ActewAGL's dual function asset value

On 30 June 2012 ActewAGL submitted that the value of its dual function assets was \$45.6 million, or 6.3 per cent of its RAB.<sup>226</sup> On 4 November 2016 ActewAGL submitted that the value of its dual function assets is now \$189.7 million, or 19 per cent of its RAB. In our Preliminary F&A we noted this increase in dual function asset value is significant and would require further explanation by ActewAGL. Under the NER we are required to satisfy ourselves that relevant assets conform to the NER definition.<sup>227</sup>

In response to our Preliminary F&A, ActewAGL submitted further information regarding the value of its dual function assets.<sup>228</sup> As submitted by ActewAGL, the increase in dual function asset value is the result of both new investment and an amended methodology for categorising network assets. In table 6.2 we summarise the growth in ActewAGL's dual function asset value.

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<sup>226</sup> ActewAGL, *Letter to AER*, 30 June 2012.

<sup>227</sup> NER, cl. 6.24.2.

<sup>228</sup> ActewAGL, *Letter to AER: Preliminary framework and approach – dual function assets*, 19 April 2017.

**Table 6.2 Changing value of ActewAGL's dual function assets**

Stage	Submitted value
ActewAGL's initial 2009 assessment	\$45.46 million
ActewAGL's revised 2009 assessment	\$75.4 million
New 2009–14 investment and roll forward to 2014	\$154.0 million
Roll forward to 2016	\$189.7 million

In respect of the revised assessment of its dual function asset value as at 2009, ActewAGL submitted that it has now adopted industry practice. Specifically, ActewAGL referenced the approach used by Ausgrid to value its own dual function asset values. ActewAGL described Ausgrid's approach as including exit assets<sup>229</sup> and using pro rata values of assets shared between transmission and distribution services.

Our engineering advisors assessed ActewAGL's additional information and asset descriptions. They advised that ActewAGL's revised assessment approach is consistent with that used by Ausgrid and that this approach is consistent with the NER definition. They further advised that, while we could undertake further detailed assessment of the asset list<sup>230</sup> submitted by ActewAGL, it is unlikely that such assessment would materially vary the dual function asset value submitted by ActewAGL.

We are therefore satisfied that the proportion of ActewAGL's submitted dual function asset value attributable to the revised assessment approach does conform to the NER dual function asset definition. We are also satisfied that dual function asset value attributable to new investment and the roll forward mechanism conforms to the NER definition.

### Price differences for distribution customers

From the beginning of the 2015–19 regulatory control period, under the existing dual function asset determination, the cost of ActewAGL's dual function assets have been recovered from both ActewAGL's distribution customers and TransGrid's broader customer base. ActewAGL's distribution customers have therefore received a price benefit. The price impact of the current approach on TransGrid's NSW customers is negligible because the costs in question are small compared to TransGrid's total asset base.

<sup>229</sup> In a transmission context "exit assets" are transmission assets dedicated to the use of a specific distributor. While the cost of dual function assets is usually shared between customers of the distributor and customers of the local transmission network, exit asset costs are only recovered from the distributor's customers. This means that classifying exit assets as dual function assets results in no change to relative cost recovery between distribution and transmission customers and therefore has no price impact on customers.

<sup>230</sup> ActewAGL, email to AER staff, 6 April 2017.

If we were to now change our approach to ActewAGL's dual function assets, for example by determining that the assets no longer conformed to the NER dual function asset definition, ActewAGL's distribution customers would face a material price increase. TransGrid customers, however, would experience little to no price difference. We have taken these potential price impacts into account in considering our dual function asset determination.<sup>231</sup>

### **Impact on future consumption, production and investment decisions**

We expect relative price changes from changing our approach, as described above, would impact ActewAGL customers', or prospective customers', future consumption, production and investment decisions. We have taken these potential impacts into account in considering our dual function asset determination.<sup>232</sup>

### **Who benefits from ActewAGL's dual function assets**

We, ActewAGL and TransGrid expect electricity predominantly to run from NSW into the ACT over the new interconnection. In other words, from TransGrid to ActewAGL. Therefore, these assets were expected to predominantly provide services to ActewAGL's distribution customers. However, there are important exceptions. Whenever TransGrid's supply to the Cooma region of NSW, south of the ACT, is interrupted, the new ACT interconnector will be able to maintain supply to that region by sending electricity from the ACT to NSW. Further, as part of the second interconnector project, TransGrid customers south of the ACT now benefit from upgraded electricity infrastructure and improved service reliability.

In terms of cost reflectivity, ActewAGL's dual function assets support TransGrid's transmission network. As such, they benefit a broader set of customers than just ActewAGL's distribution customer base. For these reasons we determined, for the 2015–19 F&A, that the new ACT interconnector was suitable for the application of transmission pricing rules. We are unaware of any change in the use of the second ACT interconnector that would justify a change in pricing approach for the upcoming regulatory control period.

We expect that the assets continue to predominantly provide for electricity flows from NSW into the ACT, with occasional instances of electricity flowing in the other direction. Consistent with our determination to apply transmission pricing rules during the current regulatory control period, we consider that, even as stand-by capacity, TransGrid's customers in the Cooma region receive a benefit from the second ACT interconnection. On this basis we propose to continue to apply transmission pricing to ActewAGL's dual function assets.

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<sup>231</sup> NER, cl. 6.25(c).

<sup>232</sup> NER, cl. 6.25(c)(2).

## Appendix A: Rule requirements for classification

We must have regard to four factors when classifying distribution services.<sup>233</sup>

- the form of regulation factors in section 2F of the NEL:
  - the presence and extent of any barriers to entry in a market for electricity network services
  - 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
  - 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
  - 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
  - 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
  - the presence and extent of any substitute for, and the elasticity of demand in a market for, elasticity or gas (as the case may be)
  - 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.<sup>234</sup>
- 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 present regulatory system (as the case requires)<sup>235</sup>
- the desirability of consistency in the form of regulation for similar services (both within and beyond the relevant jurisdiction)<sup>236</sup>
- any other relevant factor.<sup>237</sup>

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<sup>233</sup> NER, cl. 6.2.1(c).

<sup>234</sup> NEL, s. 2F.

<sup>235</sup> NER, cl. 6.2.1(c)(2).

<sup>236</sup> NER, cl. 6.2.1(c)(3).

<sup>237</sup> NER, cl. 6.2.1(c).

The NER specify additional requirements for services we have regulated before.<sup>238</sup> They are:

- There should be no departure from a previous classification (if the services have been previously classified); and
- If there has been no previous classification - the classification should be consistent with the previously applicable regulatory approach.

We must have regard to six factors when classifying direct control services as either standard control or alternative control services.<sup>239</sup>

- the potential for development of competition in the relevant market and how the classification might influence that potential
- the possible effects of the classification on administrative costs of us, the distributor and users or potential users
- the regulatory approach (if any) applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made
- the desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction)
- the extent that costs of providing the relevant service are directly attributable to the customer to whom the service is provided, and
- any other relevant factor.<sup>240</sup>

In classifying direct control services that have previously been subject to regulation under the present or earlier legislation, we must also follow the requirements of clause 6.2.2(d) of the NER.

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<sup>238</sup> NER, cl. 6.2.1(d).

<sup>239</sup> NER, cl. 6.2.2(c).

<sup>240</sup> NER, cl. 6.2.2(c).

## Appendix B: Proposed service classification of ACT distribution services<sup>241</sup>

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
<b>Common distribution services</b>	<p>The suite of services involved in the use of the distribution network for the conveyance of electricity (including the service that ensures the integrity of the related distribution system) and includes but is not limited to the following:</p> <ul style="list-style-type: none"> <li>• the planning, design, repair, maintenance, construction and operation of the distribution network</li> <li>• the relocation of assets that form part of the distribution network but not relocations requested by a third party (including a customer)</li> <li>• works to fix damage to the network (including emergency recoverable works) or to support another distributor during an emergency event</li> <li>• network demand management for distribution purposes</li> <li>• training internal staff and contractors undertaking direct control services</li> </ul>	Standard control	Standard control

<sup>241</sup> The examples and activities listed in the 'Further description' column are not intended to be an exhaustive list and some distributors may not offer all activities listed. Rather the examples provide a sufficient indication of the types of activities captured by the service.

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
	<ul style="list-style-type: none"> <li>activities related to 'shared asset facilitation' of distributor assets</li> <li>emergency disconnect for safety reasons and work conducted to determine if a customer outage is related to a network issue</li> <li>bulk supply metering</li> <li>rectification of simple customer fault (e.g. fuse) relating to a life support customer</li> <li>neutral integrity test – where a distributor will identify the source of a fault following detection from a network issued device. Rectification work to render the network safe is limited to distribution network infrastructure.</li> </ul> <p>Such services do not include a service that has been separately classified including any activity relating to that service.</p>		

### Ancillary services – Services closely related to common distribution services but for which a separate charge applies

Design related services	<p>Activities includes:</p> <ul style="list-style-type: none"> <li>provision of design information, design rechecking services in relation to connection and relocation works provided contestably.</li> <li>specialist services where the design is non-standard, technically complex or environmentally sensitive and any enquiries related to distributor assets.</li> </ul>	Alternative control	Alternative control (specific monopoly service)
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Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
	<ul style="list-style-type: none"> <li>the provision of engineering consulting (related to the shared distribution network).</li> </ul>		
Connection application related services	<p>Activities include:</p> <ul style="list-style-type: none"> <li>assessing connection applications or a request to undertake relocation of network assets as contestable works and preparing offers</li> <li>processing preliminary enquiries requiring site specific or written responses</li> <li>undertaking planning studies and associated technical analysis (e.g. power quality investigations) to determine suitable/feasible connection options for further consideration by applicants</li> <li>site inspection in order to determine the nature of the connection service sought by the connection applicant and ongoing co-ordination for large projects</li> <li>registered participant support services associated with connection arrangements and agreements made under Chapter 5 of the NER.</li> </ul>	Alternative control	Alternative control (specific monopoly service)
Access permits, oversight and facilitation	<p>Activities include:</p> <ul style="list-style-type: none"> <li>a distributor issuing access permits or clearances to work to a person authorised to work on or near distribution systems including high and low voltage.</li> <li>a distributor issuing confined space entry permits and associated safe entry equipment to a person authorised</li> </ul>	Alternative control	Alternative control (specific monopoly service)

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
	<p>to enter a confined space.</p> <ul style="list-style-type: none"> <li>• a distributor providing access to switch rooms, substations and the like to a non-LNSP party who is accompanied and supervised by a distributor's staff member. May also include a distributor providing safe entry equipment (fall-arrest) to enter difficult access areas.</li> <li>• facilitation of generator connection and operation of the network</li> <li>• facilitation of activities within clearances of distributor's assets, including physical and electrical isolation of assets</li> <li>• assessing an application from a manufacturer to consider approval of alternative material and equipment items that are not specified in the distributor's approved materials list.</li> </ul>		
Network related property services	<p>Property tenure services related to obtaining deeds of agreement, deeds of indemnity, leases, easements or other property tenure in relation to property rights associated with connection or relocation.</p> <p>Conveyancing inquiry services relating to the provision of property conveyancing information at the request of a customer.</p>	Alternative control	Alternative control (specific monopoly service)
Site establishment services	<p>Activities include, but not limited to:</p> <ul style="list-style-type: none"> <li>• Site establishment, including liaising with the Australian</li> </ul>	Alternative control	Alternative control (specific monopoly service)

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
	<p>Energy Market Operator (AEMO) or market participants for the purpose of establishing NMIs in market systems, for new premises or for any existing premises for which AEMO requires a new NMI and for validation of and updating network load data. This includes processing and assessing requests for a permanently unmetered supply device.</p> <ul style="list-style-type: none"> <li>• Site alteration, updating and maintaining national metering identifier (NMI) and associated data in market systems.</li> <li>• NMI extinction, processing a request by the customer or their agent for permanent disconnection and the extinction of a NMI in market systems.</li> <li>• Confirming or correcting metering or network billing information in market business to business or network billing systems, due to insufficient or incorrect information received from retailers or metering providers.</li> </ul>		
Network safety services	<p>Examples include:</p> <ul style="list-style-type: none"> <li>• provision of traffic control services by the distributor where required</li> <li>• fitting of tiger tails, high load escort,</li> <li>• de-energising wires for safe approach (e.g. for tree pruning).</li> </ul> <p>work undertaken to determine the cause of a customer fault where there may be a safety impact on the network</p>	N/A	Alternative control (potentially contestable)

Service group/Activities included in service group	Further description or related component.	Current Classification 2014–19	Proposed classification 2019–24
Rectification works to maintain network safety	Activities include issues identified by the distributor and work involved in managing and resolving pre-summer bush fire inspection customer vegetation defects or aerial mains where the customer has failed to do so.	N/A	Alternative control (specific monopoly service)
Network tariff change request	<p>Activities including a retailer's customer or retailer requesting an alteration to an existing network tariff (for example, a change from a Block Tariff to a Time of Use tariff), requiring the distributor to conduct tariff and load analysis to determine whether the customer meets the relevant tariff criteria.</p> <p>Where a distributor processes changes in its IT systems to reflect a tariff change request.</p>	Alternative control	Alternative control (specific monopoly service)
Services provided in relation to a Retailer of Last Resort (ROLR) event	<p>The distributors may be required to perform a number of services as a distributor when a ROLR event occurs. For example:</p> <p>Preparing lists of affected sites and reconciling data with AEMO listings, arranging estimate reads for the date of the ROLR event, preparing final invoices and miscellaneous charges for affected customers, extracting customer data, providing it to the ROLR and handling subsequent enquiries.</p>	Alternative control	Alternative control (specific monopoly service)
Planned Interruption – Customer requested	Where the customer requests to move a planned interruption and agrees to fund the additional cost of performing this distribution service outside of normal business hours.	N/A	Alternative control (specific monopoly service)
Attendance at customers' premises to perform a statutory right where	A follow up attendance at a customer's premises to perform a statutory right where access was prevented or declined by	Alternative control	Alternative control

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
access is prevented.	the customer on the initial visit. This includes the costs of arranging, and the provision of, a security escort or police escort (where the cost is passed through to the distributor).		(specific monopoly service)
Inspection services – private electrical installations	Inspection of and reinspection by a distributor of: <ul style="list-style-type: none"> <li>• private electrical wiring work undertaken by an electrical contractor</li> <li>• private inspection of privately owned low voltage or high voltage network infrastructure (i.e. privately owned distribution infrastructure before the meter).</li> </ul>	N/A	Alternative control (specific monopoly service)
Provision of training to third parties for network related access	Training services provided to third parties that result in a set of learning outcomes that are required to obtain a distribution network access authorisation specific to a distributor’s network. Such learning outcomes may include those necessary to demonstrate competency in the distributor’s electrical safety rules, to hold an access authority on the distributor’s network and to carry out switching on the distributor’s network. Examples of training might include high voltage training, protection training or working near power lines training.	N/A	Alternative control
Off-peak conversion	Customer requested alteration of load control equipment for the purposes of converting a customer from peak to off-peak electricity supply.	Alternative control	Alternative control (specific monopoly service)
Large scale embedded generator connection services	Over 30 kW.	Alternative control	Alternative control (specific monopoly service)

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
<p><b>Metering services – ActewAGL will remain responsible for the provision of type 5 and 6 meters up to 30 November 2017. ActewAGL will continue to be responsible for those meters until they are replaced (and entitled to levy associated charges). We refer to these meters as ‘legacy meters’. New meters (that will be type 1 to 4 meters) installed from 1 December 2017 are referred to as ‘contestable meters’.</b></p>			
Type 1 to 4 metering services	Type 1 to 4 meters and supporting services are competitively available.	Unclassified	Unclassified
Type 5 and 6 meter provision (prior to 1 December 2017)	Recovery of the capital cost of type 5 and 6 metering equipment installed prior to 1 December 2017.	Alternative control	Alternative control (specific monopoly service)
Type 7 metering services	Administration and management of type 7 metering installations in accordance with the NER and jurisdictional requirements. Includes the processing and delivery of calculated metering data for unmetered loads, and the population and maintenance of load tables, inventory tables and on/off tables.	Alternative control	Standard control
Types 5 and 6 meter maintenance, reading and data services (legacy meters)	Meter maintenance covers works to inspect, test, maintain and repair meters. Meter reading refers to quarterly or other regular reading of a meter. Metering data services are those that involve the collection, processing, storage and delivery of metering data and the management of relevant NMI Standing Data in accordance with the NER.	Alternative control	Alternative control (specific monopoly service)
Special meter reading and testing (legacy meters)	Special meter reading and testing services include: <ul style="list-style-type: none"> <li>• Special meter reading for type 5 and 6 meters and move in and move out metering reading (type 5 and 6 meters)</li> </ul>	Alternative control	Alternative control (specific monopoly service)

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
	<ul style="list-style-type: none"> <li>Type 5 meter final read on removed type 5 metering equipment</li> <li>Special meter test (for type 5 and 6 meter)</li> <li>Type 5 and 6 non-standard meter data services</li> <li>Type 5 and 6 current transformer testing</li> </ul>		
Emergency maintenance of failed metering equipment not owned by the distributor (contestable meters)	The distributor is called out by the customer or their agent (e.g. retailer, metering coordinator or metering provider) due to a power outage where an external metering provider's metering equipment has failed or an outage has been caused by the metering provider and the distributor has had to restore power to the customer's premises. This may result in an unmetered supply arrangement at this site. This fee will also be levied where a metering provider has requested the distributor to check a potentially faulty network connection and when tested by the distributor, no fault is found.	Alternative control	Alternative control (specific monopoly service)
Meter recovery and disposal – type 5 and 6 (legacy meters)	Activities include: <ul style="list-style-type: none"> <li>at the request of the customer or their agent to remove and dispose of type 5 or 6 current transformer (CT) meters where a permanent disconnection has been requested.</li> <li>disposing of type 5 or 6 whole current (WC) meters which may otherwise be removed and disposed of by the incoming metering provider.</li> </ul>	N/A	Alternative control (specific monopoly service)
Distributor arranged outage for	At the request of a retailer or metering coordinator provide	N/A	Alternative control

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
purposes of replacing metering	notification to affected customers and facilitate the disconnection/reconnection of customer metering installations where a retailer planned interruption cannot be conducted.		(specific monopoly service)
Customer requested provision of additional metering/consumption data	Customer requested provision of data in excess of requirements under Rule 28 of the National Electricity Retail Rules (two requests per annum are permitted under the rules).	N/A	Alternative control (specific monopoly service)

### Connection services

Connection services	<p><b>Connection services include:</b></p> <p><b>Premises connection services</b> includes any additions or upgrades to the connection assets located on the customer's premises (Note: excludes all metering services).</p> <p><b>Extensions</b> include an enhancement required to connect a power line or facility outside the present boundaries of the transmission or distribution network owned or operated by a network service provider.</p> <p><b>Network augmentations</b> include any shared network enlargement/enhancement undertaken by a distributor which</p>	Standard control	Standard control
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Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
	is not an extension.		
Reconnections/Disconnections	<p>Disconnection<sup>242</sup> and/or reconnection services (some provided in accordance with the National Energy Retail Rules). Examples include (but are not limited to):</p> <ul style="list-style-type: none"> <li>• Disconnection visit (site visit only)</li> <li>• Disconnection visit (disconnection completed - technical)</li> <li>• Disconnection visit (disconnection completed)</li> <li>• Pillar box/pole top disconnection - completed</li> <li>• Reconnection/disconnection outside of business hours</li> <li>• Vacant property - site visit only</li> <li>• Vacant property disconnection (disconnection completed)</li> <li>• Shared service fuse replacement</li> <li>• Rectification of illegal connections</li> <li>• Temporary connections</li> <li>• Remove or reposition connection</li> <li>• Single phase to three phase.</li> </ul>	Alternative control	Alternative control (specific monopoly service)

## Unregulated distribution services

<sup>242</sup> Disconnection services related to business as usual activities and not disconnection services that may be related to a customer changing over meter types.

Service group/Activities included in service group	Further description	Current Classification 2014–19	Proposed classification 2019–24
Distribution asset rental	Rental of distribution assets to third parties (e.g. office space rental, pole and duct rental for hanging telecommunication wires etc.).	N/A	Unclassified distribution service
Contestable metering support roles	Includes metering coordinator (except where the distributor is the initial metering coordinator), metering data provider and metering provider for meters installed or replaced after 1 December 2017.	N/A	Unclassified distribution service
Provision of training to third parties for non-network related issues	Training programs provided to third for non-network related issues	N/A	Unclassified distribution service
Type 5 and 6 meter data management to other electricity distributors	The provision of type 5 and 6 meter data management to other electricity distributors.	Unclassified distribution service	Unclassified distribution service