Issues Paper

AusNet Services electricity transmission revenue proposal

1 April 2022 to 31 March 2027

December 2020

AUSTRALIAN
ENERGY
REGULATOR

Contents

1 Introduction

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. We regulate electricity networks in all jurisdictions except Western Australia. Our work is guided by the National Electricity Objective (NEO) which promotes efficient investment in, and operation and use of, electricity services in the long term interests of consumers.[1] As part of this, we set the maximum revenues that networks are allowed to recover from consumers through their network charges (this is known as the 'revenue cap' form of control). The amount of these revenues is based on our assessment of efficient costs and a realistic expectation of forecast electricity demand. By only allowing efficient costs we regulate network tariffs so that consumers pay no more than necessary for the safe and reliable delivery of electricity.

Victorian households and businesses consume electricity, which is supplied through a network of 'poles and wires.' The electricity network in Victoria is commonly divided into two parts:

- a transmission network, which carries electricity from the large generators to the major load centres
- a distribution network, which carries electricity from the points of connection with the transmission network to virtually every building, house and apartment in Victoria.

AusNet Services owns and operates Victoria's shared electricity transmission network.[2]

In Victoria, responsibility for planning and augmenting the transmission system is separated from ownership of the transmission assets. As the transmission network owner, AusNet Services provides shared transmission services to the Australian Energy Market Operator (AEMO) and connection services to generators, distributors and large industrial customers. Transmission customers, including AEMO, make decisions regarding the augmentation of the transmission system. AusNet Services does not include these augmentation plans or associated costs in its revenue proposal.

Although our decision influences the total revenue AusNet Services can recover from its transmission customers, we do not set transmission charges for each customer or the retail prices that end consumers pay:

- the pricing methodology prescribes the way the business recovers its revenue and in Victoria, AEMO is responsible for pricing prescribed Transmission Use of System (TUOS) services and prescribed common transmission services, while AusNet Services is responsible for pricing connection services

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[1]   NEL, s. 7.

[2]   The relevant licenced entity is AusNet Services Transmission Group Pty Ltd (ABN 78 079 798 173).

- retail prices are set by electricity retailers and include the costs associated with transmission, distribution, generation, and the costs incurred by retailers in selling the electricity.

Regulatory determinations usually occur every five years for each regulated business. We use an incentive approach where, once regulated revenues are set for a five year period, networks who keep actual costs below the regulatory forecast of costs retain part of the benefit. This benchmark incentive framework is a foundation of the AER's regulatory approach and promotes the delivery of the NEO. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

On 29 October 2020, AusNet Services submitted its revenue proposal for the five years commencing 1 April 2022. This issues paper highlights some of the key elements of the proposal, and how stakeholders can assist in our review of AusNet Services' proposal.

While the AER has conducted an initial review of AusNet Services proposal, we have not yet formed a final view on the proposal. We have not yet considered all the materials and evidence that support the claims made by AusNet Services or applied all our regulatory tools to test the robustness of the proposal.

A key part of our review is consultation with stakeholders. The purpose of publishing this issues paper, required under clause 6A.11.3(b1) of the NER, is to assist stakeholders by identifying those aspects of the proposal which, after our preliminary review, are likely to be relevant to our assessment of the proposal. Stakeholders can assist our process by providing their views on these aspects. Stakeholders should feel free to comment on any aspect of the regulatory proposal.

The Coronavirus (COVID-19) will impact both our approach to stakeholder consultation and the ability of all market participants to engage. In particular, we cannot hold a face-to-face public forum and will instead hold an online public forum on 16 December 2020. The details of how to participate in this public forum are available on our website.

In line with the recently released Statement of Expectations, the AER would like to acknowledge the changing operating environment and the potential for this to impact on AusNet Services' five year forecast. We propose to adopt a greater degree of flexibility in our approach to requesting and receiving information (from all stakeholders) as well as the way we consider the extenuating circumstances in our analysis.

1.1 How can you get involved?

Consumer engagement is not only something we must have regard to when making our revenue determinations, but is a valuable input which we encourage. When we receive submissions from stakeholders that address issues in the proposal and provide evidence and analysis, our decision-making process is strengthened.

An online public forum on AusNet Services' proposal will be held on 16 December 2020. As part of our review we are also seeking written submissions from stakeholders on the proposal and views on where our assessment should focus. We are holding the public forum relatively early in our consideration process. We hope this provides an insight into the key issues and we encourage stakeholders to comment on topics of interest.

The decisions we make and the actions we take affect a wide range of individuals, businesses and organisations. Hearing from those affected by our work helps us make better decisions, provides greater transparency and predictability, and builds trust and confidence in the regulatory regime.

Throughout this review we will also have the benefit of advice from our Consumer Challenge Panel (CCP23).[3] The expert members of the CCP help us to make better regulatory decisions by providing input on issues of importance to consumers and bringing consumer perspectives to our processes. The table below sets out the key milestones planned for this review:

Table 1 Key dates for AusNet Services' electricity transmission determination

Milestone	Date
AusNet Services submitted its regulatory proposal to AER	29 October 2020
AER to release Issues Paper	11 December 2020[4]
AER to hold an public forum on AusNet Services' proposal and issues paper	16 December 2020
Submissions on regulatory proposal due	12 February 2021
AER to make draft decision	30 June 2021
AER to hold public forum on draft decision	July 2021
AusNet Services to submit revised regulatory proposal to AER	September 2021
Submissions on draft decision and revised proposal due	November 2021
AER to make final decision	January 2022

Note: Timelines are indicative and subject to change.

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[3] Consumer Challenge Panel members advising the AER on this review are Robyn Robinson, David Prins and Mark Henley. https://www.aer.gov.au/about-us/consumer-challenge-panel

[4] The AER has expedited the publication of this Issues Paper to facilitate the holding of a Public Forum in mid-December 2020. We have done this to avoid the January holiday period. Holding the Public Forum at a later date is not an alternative as the NER states the AER must publish an issues paper not more than 40 business days after the TNSP submits its initial proposal. As a result of the limited time available, the issues presented in this paper are preliminary observations only.

1.2 Our initial observations

AusNet Services' regulatory proposal is available on the AER website.[5] This paper sets out the key issues evident from our initial review of the regulatory proposals. While we welcome submissions on any aspect of AusNet Services' proposal, we are particularly interested in submissions on the following areas:

- Operating expenditure – See section 4.3.2

  o AusNet Services' proposed opex of $1370.7 million is 12 per cent higher than both estimated and forecast opex for the current regulatory period

  o 60 per cent of AusNet Services' proposed opex is attributed to easement land tax – a levy applied by the Victorian Government and recovered through regulated revenues

  o AusNet Services proposed five step changes totalling $108.7 million ($2021–22).[6] The key step changes included:

    A. Council rates were expected to rise from $1 million ($2021–22) to $14.3 million ($2021–22) per annum due to a change in the methodology used to value terminal station assets. This resulted in a step change of $71.5 million ($2021–22)[7] and represented a significant portion of AusNet Services' opex proposal. Our assessment will need to verify that the forecasts are prudent and efficient.

    B. AusNet Services proposed to enhance its cyber security program to comply with new regulatory obligations by the next regulatory control period. The cost of these upgrades were forecast at $27.9 million ($2021–22).[8] Our assessment will consider the latest advice from relevant commonwealth bodies and our treatment of similar costs from recent decisions.

- Capital expenditure – See section 4.2.2 and 4.2.3

  o AusNet Services' proposed capex of $796.2 million ($2021–22) is 9 per cent higher than both estimated and forecast capex for the current regulatory period. A majority of AusNet Services' forecast capex (53 per cent) was for major station replacement projects.[9]

  o the major stations capex forecast included several existing projects and 15 new projects at terminal stations where AusNet Services considered it economic to replace assets in the next regulatory period. Compared to the current period, more of the new projects involved replacing 500 kV equipment (one in the current period compared to five in the 2022–27 regulatory control period), which AusNet

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5   https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausnet-services-determination-2022-27

6   AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 146.

7   AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 147.

8   AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 149.

9   AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 70.

Services submitted was more costly to replace compared to the 220 kV equipment which has been the historical focus of its asset replacement activities.[10]

 o our role is to ensure that AusNet Services' forecast capex for 2022–27 reasonably reflects the capex criteria;[11] efficiency, prudency and a realistic expectation of the demand forecast and cost inputs required to achieve the capex objectives under the NER.

- our preliminary analysis of the drivers of revenue in the regulatory proposal, particularly, we are interested in stakeholder views on the following drivers of revenue:

 1. Opex – set out in section 4.3

 2. Capex – set out in section 4.2

 3. Rate of Return – set out in section 3.2.1

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[10] AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 99.

[11] Under the NER, we must accept the proposed forecast of total capex if we are satisfied it reasonably reflects the capital expenditure criteria set out in clause 6A.6.7(c) of the NER. The capex criteria relate to the efficient costs incurred by a prudent operator in light of realistic demand forecasts and cost inputs. This is set out in detail in Section 4.2 – Capex.

2 What would this proposal mean for customers?

AusNet Services' revenue proposal sets out the revenue that AusNet Services proposes to recover from consumers over the next regulatory period. This section provides an overview of AusNet Services' proposal.

2.1 Proposed Revenue

AusNet Services has proposed total revenue of $2826.8 million ($nominal, smoothed), to be recovered from Victorian electricity customers over the five years from 1 April 2022 to 31 March 2027 (see Table 2). In nominal terms (including the impact of inflation) the proposal is seeking higher revenues than what we approved for the 2017–22 regulatory control period, with an increase of 3.3 per cent proposed for AusNet Services.[12]

Table 2 Summary of proposed revenue ($nominal, smoothed)

($ million)	2022–23*	2023–24*	2024–25*	2025–26*	2026–27*	Total 2022–27*	% change from 2017–22*
AusNet Services	569.0	567.2	565.4	563.5	561.7	2826.8	3.3%

Source: AusNet Services TTR 2022–27, *Post Tax Revenue Model*, 29 October 2020.

Note: Years are from 1 April to 31 March.

A transmission business recovers revenue from its customers via network charges. The pricing methodology prescribes the way the business recovers this revenue.[13] In Victoria, AEMO is responsible for pricing prescribed Transmission Use of System (TUOS) services and prescribed common transmission services, while AusNet Services is responsible for pricing connection services.[14] AusNet Services' revenue proposal would contribute a $2 increase in the transmission component of the average annual residential electricity bill in Victoria over the 2022–27 regulatory control period, or about $0.4 per year.[15]

AusNet Services' proposed pricing methodology for the 2022–27 regulatory control period is largely identical to the current pricing methodology. We note AEMO is currently consulting on emerging developments in the NEM and their effect on network pricing and investment.[16] The consultation will inform AEMO's pricing methodology for the regulatory control period beginning 1 July 2022, which AEMO will submit to the AER in May 2021.

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[12]   In real terms ($2021–22), the proposed total revenue is $164 million (or 5.9 per cent) lower compared to the total revenue approved for the 2017–22 regulatory control period.

[13]   NER cl.6A.24.1(b).

[14]   AEMO is the coordinating Network Service Provider in Victoria. See AusNet Services, *Regulatory Proposal 2022–27 Appendix 14A: Proposed Pricing Methodology*, 29 October 2020, p. 4.

[15]   Transmission accounts for approximately 5.5% of the total electricity bill for a typical residential customer on a single rate tariff in Victoria.

[16]   See AEMO's website (https://aemo.com.au/en/consultations/current-and-closed-consultations/transmission-use-of-system-pricing-methodology-vic).

AusNet Services noted AEMO's review may have interactions with AusNet Services' proposed pricing methodology.

Our transmission determination imposes control over revenues that a transmission business can recover from its provision of prescribed transmission services.[17] But we do not determine the terms and conditions of negotiated transmission services.[18] In Victoria, AusNet Services and AEMO must prepare a negotiating framework that sets out procedures for negotiating the terms and conditions of access to a negotiated transmission service.

AusNet Services' proposed negotiating framework for the 2022–27 regulatory control period is largely identical to the current negotiating framework.[19]

2.2 Consumer engagement and delivering improved outcomes for customers

In the regulatory process, strong consumer engagement can help us test network service providers' expenditure proposals, and can raise alternative views on matters such as service priorities, capex and opex proposals, and tariff structures.

We will use a range of considerations to demonstrate whether consumers have been genuinely engaged in the development of AusNet Services' 2022–27 proposal. The framework for considering consumer engagement in our recent Victorian electricity draft decisions includes the following elements:[20]

- nature of engagement
- breadth and depth of engagement
- clearly evidenced impact
- assessment of outcomes.

Nature of engagement

Whilst only generators, large industrial customers and distributors engage directly with the transmission network, AusNet Services recognises that all Victorians depend on it to meet their energy needs.[21]

AusNet Services established a Transmission Revenue Reset Customer Advisory Panel to assist in its stakeholder engagement in the lead up to its 2022−27 Revenue

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[17] As noted earlier, the pricing methodology sets out the approach to setting the prices through which a transmission business recovers revenues for the provision of prescribed transmission services.

[18] Negotiated transmission services are a class of service defined in Chapter 10 of the NER. They broadly include services provided in relation to generation or direct connect customer connection to the shared transmission network.

[19] AusNet Services prepared the proposed negotiating framework jointly with AEMO, due to the arrangements in Victoria.

[20] See table 7; AER, *Draft Decision, Jemena distribution determination 2021–26, Overview*, September 2020, p. 43.

[21] AusNet Services, *Regulatory Proposal 2022–27 – Overview Document,* 29 October 2020, p. 3.

Determination.[22] The panel included consumer advocacy groups and representatives of direct connect industrial customers, distribution networks and generators who contributed input via stakeholder meetings.[23]

AusNet Services' ongoing engagement program included a series of 'deep dive' workshops and complementary briefing sessions. Open forums were held. In the lead up to releasing its revenue proposal. AusNet Services indicated its proposal has also benefited from ongoing customer engagement and research programs. [24]

AusNet Services developed its proposal during the COVID-19 pandemic and as a result, there was some interruption to its consumer engagement.

Questions
1. To what extent do you consider AusNet Services has engaged with (as opposed to simply seeking feedback from) consumers to inform the proposal?
2. To what extent have consumers been provided with impartial support to engage with energy sector issues?

Breadth and depth of engagement

AusNet Services has identified key stakeholder concerns to date as:

- affordability
- relationship management
- improved connections for new generators.[25]

AusNet Services undertook customer satisfaction interviews with stakeholders to gain a better understanding of its transmission customer and stakeholder needs in order to influence the positions taken in its regulatory submission.[26]

Questions
3. To what extent do you consider you were able to influence the topics engaged on by AusNet Services?
4. To what extent were you able to access and resource independent research and engagement?

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[22] AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 3.

[23] AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 3.

[24] AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, pp. 12–13.

[25] AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 14.

[26] AusNet Services, *TRR 2022–27 – Appendix 3A Customer Satisfaction Interviews Summary Report*, 29 October 2020, p. 3.

Clearly evidenced impact

All engagement activity has been attended by AusNet Services' General Manager of Regulation.

AusNet Services' stated its consumer engagement revealed affordability is the key concern for its customers.[27] Most customers surveyed by AusNet Services consider that bills are increasing and that affordability, particularly for the vulnerable customers, is a strong concern. For business and large users, increasing energy costs can affect the viability of their business.[28] To address this concern, AusNet Services states in its proposal it will absorb several operating expenditure step changes and include a forecast of productivity improvements in its operating expenditure forecast.[29]

AusNet Services' stated customers raised the need for better communication when outages occur. Large customers wanted better managed strategic relationships. In response to this, AusNet Services has proposed to invest more to improve the communication and management of planned and unplanned outages. AusNet Services has established a team of dedicated customer relationship managers to provide a direct contact point for large users and proactively address customer concerns and issues. Regular meetings are now held.[30]

The complex generator connection processes in Victoria, with transmission functions split between AusNet Services and AEMO, was also highlighted by stakeholders as an area that required improvement. In response to this, AusNet Services is developing and implementing ways to improve the customer experience and eliminate 'pain points' for new generators seeking to connect to the network.[31]

Question
5. To what extent do you consider AusNet Services' proposal ties to your expressed views as a consumer?

Assessment of outcomes

We will now assess AusNet Services' revenue proposal to determine if it is in the long-term interests of consumers. We recognise that AusNet Services' proposal has been prepared during a time of uncertainty, as a result of the COVID-19 pandemic.

We understand AusNet Services has developed a post-lodgement consumer engagement plan with its consumer advisory panel and interested stakeholders to address new

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27   AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 13.

28   AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 14.

29   AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 14.

30   AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 14.

31   AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 14.

information, test consumer views and to review the impact of COVID-19 (for example, on demand forecasts).[32]

We encourage AusNet Services to continue with its consumer engagement during the course of the regulatory determination and beyond to ensure that stakeholder views are reflected in its proposals to us.

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[32]   AusNet Services, *TRR 2022–27 – Overview Document,* 29 October 2020, p. 15.

3 What's driving the change in revenue over time

In section 2 we outlined the proposed revenue in nominal terms, taking into account the expected inflation. The changing impact of inflation over time makes it difficult to compare revenue from one period to the next on a like-for-like basis. To do this, we use 'real' values based on a common year (in this case 2021–22), which have been adjusted to remove the impact of inflation.

In real terms Figure 1 shows a relatively steady decline from 2014–15. This decline is largely driven by a decline in the rate of return over recent years.

Figure 1 Changes in regulated revenue over time ($million, 2021–22)
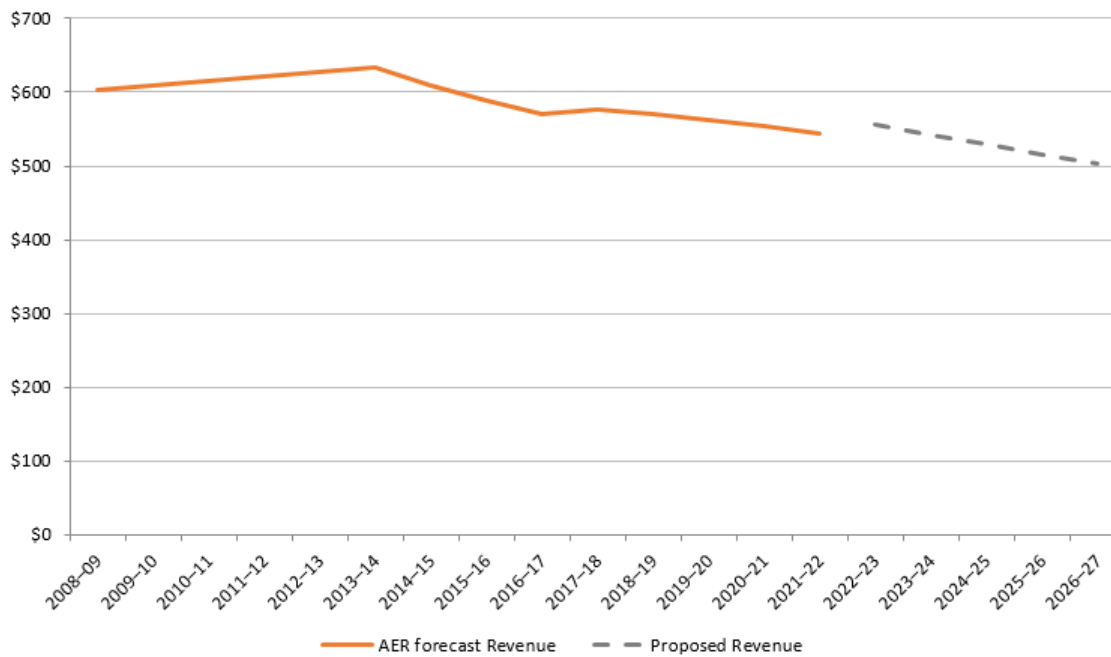
Source: AER, *Final decision PTRM AusNet Services for 2017–22 and 2012–17 regulatory control periods*; AusNet Services, *TTR 2022–27 PTRM*, 29 October 2020.

Note: Years are from 1 April to 31 March.

3.1 Impact on transmission prices

AusNet Services' proposed revenue, if accepted, would translate to transmission price decreases for Victorian consumers of 1.8 per cent per annum in real terms.

Figure 2 shows the expected price path derived from AusNet Services' revenue proposal. As reflected in Figure 2, prices have declined slightly in real terms through the 2017–22 regulatory control period.

AusNet Services' proposal is for decreases in the average price path over the 2022–27 regulatory control period. A key component in this trend is the expected forecast energy consumption. We note that more recent data from AEMO suggests energy consumption forecasts could turn out lower than adopted in AusNet Services' proposal. If so, prices would rise proportionally to the difference in the proposed versus revised energy forecasts, all else being equal.

Figure 2 AusNet Services – change in 2017–22 average revenue to proposed average revenue for 2022–27 – by component ($million, 2021–22)
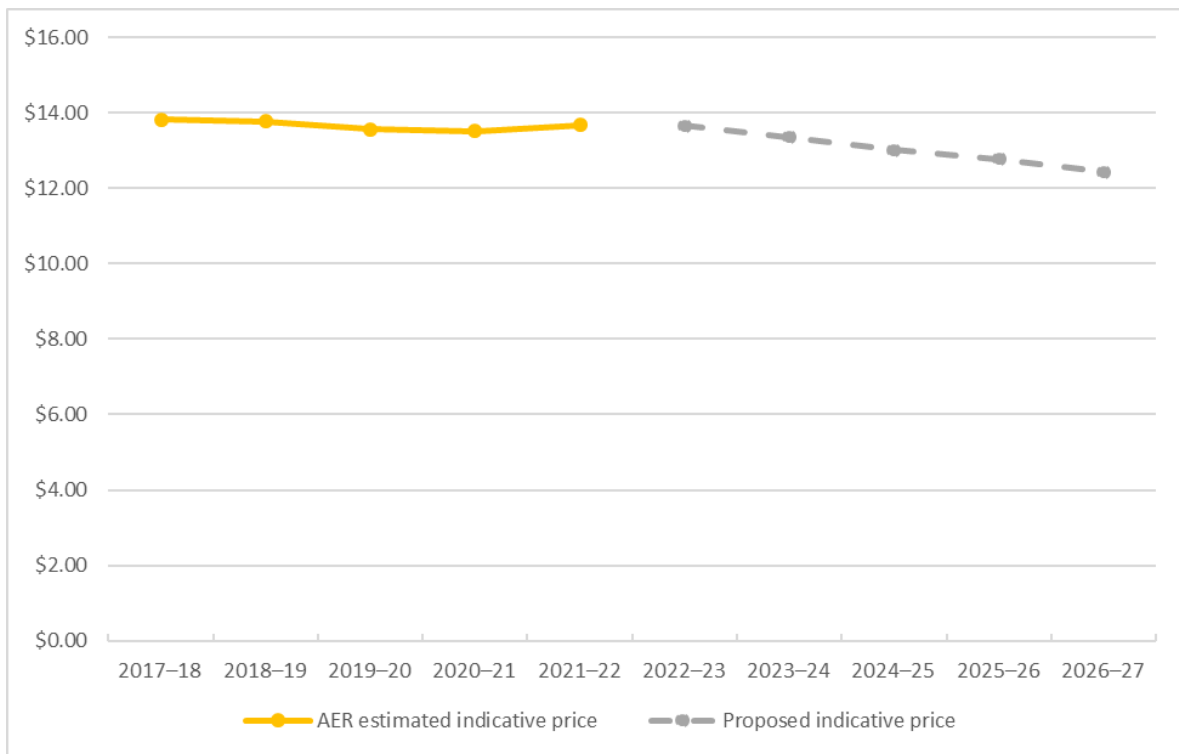
Source: AER Final decision PTRM for 2017–22 regulatory control period; AusNet Services Regulatory Proposal PTRM 2022–27 regulatory control period; AEMO, 2020 Electricity Statement of Opportunities (ESOO).

Note: The 2017–18 to 2020–22 indicatives prices are calculated based on the 2017–22 allowed revenue for AusNet Services and the actual/estimated energy consumption data for Victoria sourced from the AEMO Electricity Statement of Opportunities report 2020 (data modified from calendar year to financial year basis). The 2022–27 indicative prices are calculated based on AusNet Services' proposed revenue and forecast energy.

Years are from 1 April to 31 March.

3.2 How we determine forecast revenue

The total revenue AusNet Services has proposed reflects its forecast of the efficient cost of providing its transmission network services over the 2022–27 regulatory control period.

This revenue proposal, and our assessment of it under the NEL and NER, are based on a 'building block' approach (see Figure 3) which looks at five cost components:

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business)

- depreciation of the RAB (or return of capital, to return the initial investment to investors over time)

- forecast opex - the operating, maintenance and other non-capital expenses, incurred in the provision of network services

- revenue increments or decrements resulting from the application of incentive schemes such as the opex Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS)

- the estimated cost of corporate income tax.

Figure 3 The building block model to forecast network revenue
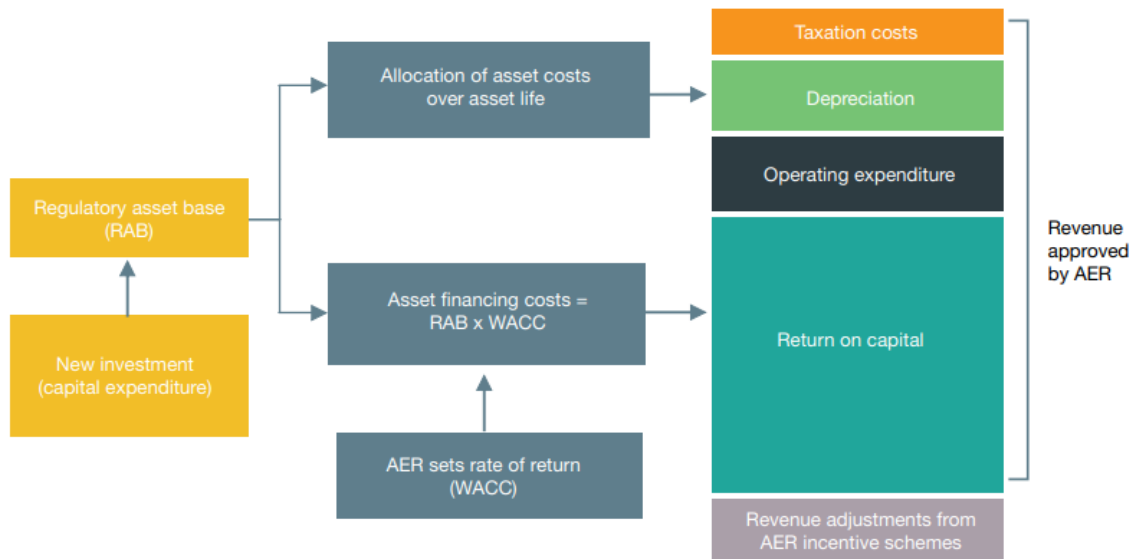
We use an incentive approach where, once regulated revenues are set for a five year period, networks who keep actual costs below the regulatory forecast of costs retain part of the benefit. This benchmark incentive framework is a foundation of the AER's regulatory approach and promotes the delivery of the NEO and National Gas Objective. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

Our assessment breaks these costs down further. For example:

- capex – the capital costs and expenditure incurred in the provision of network services – mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. The forecast capex approved in our decisions directly affects the size of the capital base and therefore the revenue generated from the return on capital and depreciation building blocks. All else being equal, higher forecast capex will lead to a higher RAB and higher return on capital and regulatory depreciation allowances

- the RAB accounts for the value of regulated assets over time. To set revenue for a new regulatory control period, we take the opening RAB value from the end of the last period and roll it forward year-by-year by indexing it for inflation, adding new capex, and subtracting depreciation and other possible factors (for example, disposals or customer contributions).[33] This gives us a closing value of the RAB at the end of each year of the regulatory control period. The value of the RAB is used to determine:

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[33]   The term 'rolled forward' means the process of carrying over the value of the RAB from one regulatory year to the next. This is reflected in the AER's roll forward model (RFM).

o the return on capital building block, which is the product of the RAB and our approved rate of return (see section 3.2.1)

o regulatory depreciation (or the return of capital).

There are two aspects of our approach to forecast revenue that were recently reviewed. The outcomes of these reviews—discussed in sections 3.2.1 and 3.2.2 below—may impact our final decisions for these businesses.

3.2.1   Rate of return

The return (the 'return on capital') each business is to receive on its RAB continues to be a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB. The allowed rate of return is a forecast of the cost of funds a network business requires to attract investment in the network.

We estimate the rate of return by combining the returns of the two sources of funds for investment: equity and debt. The return on equity is the return shareholders of the business will require for them to continue to invest. The return on debt is the interest rate the network business pays when it borrows money to invest.

We will apply the 2018 rate of return instrument (the instrument) published by us and the values therein to calculate the rate of return for AusNet Services.[34] AusNet Services has proposed its rate of return in accordance with the instrument.

Table 3 Key rate of return values

	AusNet Services' proposal	2018 Instrument
Return on equity	4.59% (indicative)	Risk free rate + 3.66%
Risk free rate	0.93%[35] (indicative)	Based on criteria in the instrument
Market risk premium	6.1%	6.1%
Equity beta	0.6	0.6
Equity risk premium (market risk premium*equity beta)	0.6*6.1%=3.66%	0.6*6.1%=3.66%
Return on debt (nominal pre-tax)	4.35% (indicative)	Based on criteria in the instrument
Gearing	60%	60%
Gamma (value of imputation credits)	0.585	0.585

Source: AER analysis and AusNet Services' Revenue Proposal 2022–27.

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[34] AER, *Rate of return instrument,* 17 December 2018; AER, Rate of return instrument explanatory statement, December 2018. Available at: https://www.aer.gov.au/networks-pipelines/guidelines-schemes-modelsreviews/rate-of-return-guideline-2018/final-decision.

[35] This is based on a placeholder risk free rate averaging period of 21 business days ending 30 June 2020.

3.2.2 Corporate income tax

The building block approach to calculating the annual revenue includes an amount for the estimated cost of corporate income tax payable by the business. We forecast tax consistent with the requirements of the NER.[36]

In December 2018, we completed a review of our regulatory tax approach.[37] The final report presented analysis of the current tax management practices of the regulated networks and identified some required changes to the estimation of the tax expenses. The changes to our regulatory tax approach required amending our models to:

- recognise immediate tax expensing of some capex forecast for a regulatory control period

- adopt the diminishing value (DV) method for tax depreciation to all future capex except for a limited number of assets which must be depreciated using the straight-line (SL) depreciation method under the tax law.[38]

In its proposal, AusNet Services used our latest PTRM template (version 4) which incorporates the immediate expensing and DV changes above. AusNet Services' proposal adopted immediate expensing of forecast capex based on the level that is consistent with its treatment in the current regulatory control period. Additionally, AusNet Services has allocated some capex to be depreciated using the SL method for tax depreciation. We will assess the appropriateness of the proposed amounts of immediate expensing and capex allocated for SL depreciation based on the approach we took in our recent determinations.

AusNet Services has forecast tax of $1.2 million ($nominal) with this amount to be recovered in the first year of the 2022–27 regulatory control period. Zero tax is forecast for the remaining four years.

To show the impact of the changes arising from both the tax review and the change to the value of gamma (which was 0.4 immediately preceding the 2018 rate of return instrument), the comparative tax forecast for AusNet Services using the proposal inputs entered into our previous PTRM template (version 3) is $20.1 million ($nominal).

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[36]   NER, cl. 6A.6.4.

[37]   AER, *Final report: Review of regulatory tax approach*, December 2018, p. 76.

[38]   Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

4 Key elements of AusNet Services' revenue proposal

AusNet Services' proposal would allow it to recover $2647.1 million ($2021–22, smoothed) from its customers over the 2022–27 period. This is a 5.8 per cent decrease from our decision in 2017–22. Figure 4 highlights changes in AusNet Services' proposal at the building block level to illustrate what is driving its proposed decrease in total revenue from 2017–22 to 2022–27.

Figure 4   Changes in building blocks: AusNet Services' total revenue 2017–22 to forecast revenue 2022–27 ($million, 2021–22, unsmoothed)
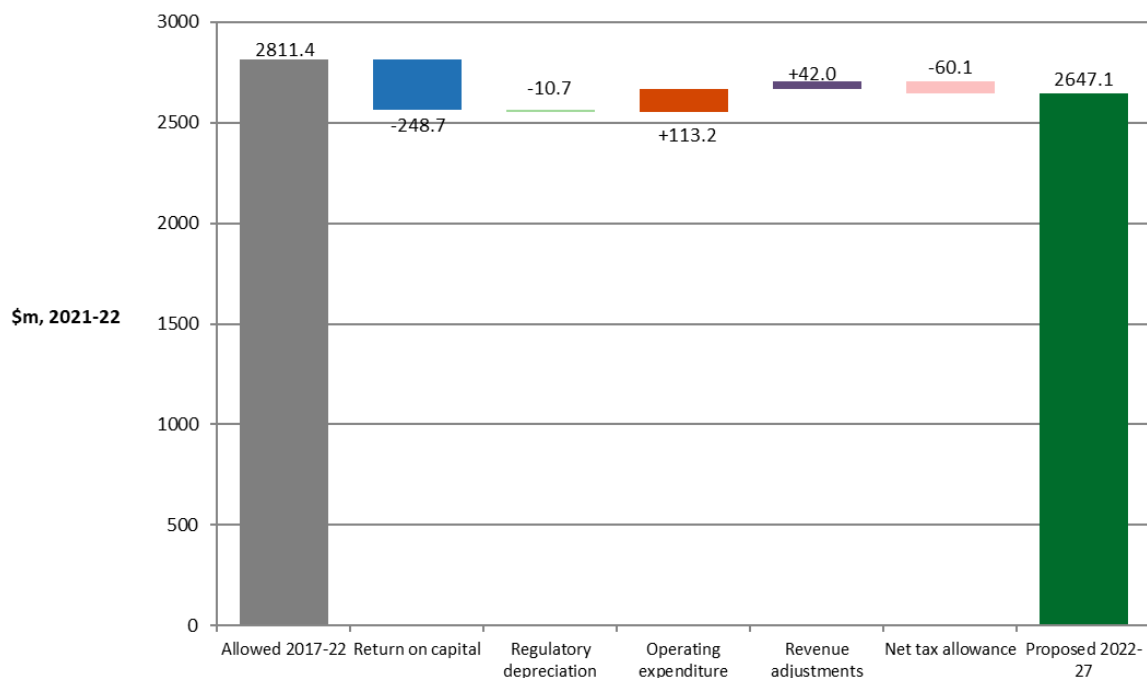
Source: AER Final decision PTRM for 2017–22 regulatory control period; AusNet Services, *TRR 2022–27 PTRM*, 29 October 2020.

4.1 RAB and depreciation

The RAB is the value of assets used by AusNet Services to provide network services. The value of the RAB substantially impacts AusNet Services' revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and depreciation (return of capital) components of the revenue determination.

Figure 5 shows the growth in value of AusNet Services' RAB over time.

Figure 5 AusNet Services' RAB value over time ($million, 2021–22)
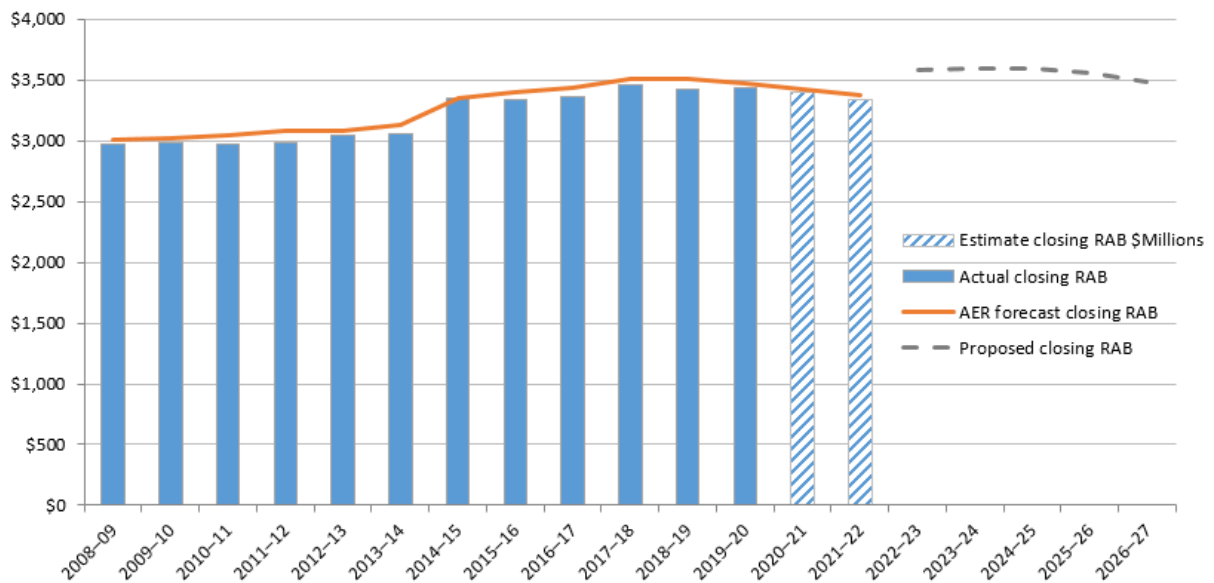
Source: AER Final decision PTRM and RFM for 2017–22 regulatory control period; AusNet Services Regulatory Proposal PTRM and RFM for 2022–27 regulatory control period.

Note: Years are from 1 April to 31 March.

AusNet Services has proposed to roll in $294 million of 'growth assets' into the RAB as at 1 April 2022. This explains the apparent step up in the RAB for 2022–23 in Figure 5.[39] The amount of growth assets has increased roughly threefold compared to the amount approved in the 2017–22 revenue determination. The growth assets are capital expenditure works done by AusNet Services during a regulatory control period as a result of requests from AEMO or distribution network service providers. While the assets constructed due to these requests provide prescribed transmission services, the forecast capex associated with these assets sit outside of the revenue determination. This is because AusNet Services is not responsible for the planning of these expenditures. The amounts are rolled into the RAB at the start of the next regulatory control period if they satisfy the relevant criteria for inclusion in accordance with the NER.[40]

Regulatory depreciation is provided so investors recover their investment over the economic life of the asset (return of capital). Regulatory depreciation is proposed to decrease in real terms from the 2017–22 regulatory control period, despite the increase in RAB and accelerated depreciation of insulators and instrument transformers.

There are $28.8 million of insulators and instrument transformers that AusNet Services stated have been decommissioned, or will be decommissioned by the end of the 2022–27

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[39]   AusNet Services stated that the proposed 'growth assets' amount reflects the actual depreciated value of these assets as at 1 April 2022. The largest project is the "New 66kV Connection Point at Brunswick Terminal Station" requested by CitiPower and AEMO. This project accounts for just over 70 per cent of the total proposed growth assets.

[40]   The regulatory requirements for the roll-in of the 'growth assets' into the RAB are set out in NER 11.6.21(c). AusNet Services has proposed and the AER has accepted the inclusion of growth assets into the RAB in the previous regulatory control periods, which at the time the assets were labelled as 'group 3 assets.'

regulatory control period. AusNet Services proposed that these assets be fully depreciated by the end of that period.

AusNet Services also proposed that the estimated $442 million of insulators and instrument transformers still in service beyond the 2022–27 regulatory period should be depreciated over a shorter remaining asset life than reflected in the current depreciation schedule, and that future expenditure on these assets be recovered over a shorter standard asset life than currently. These assets are currently included in broader asset classes with relatively long asset lives. AusNet Services proposed to separate out these assets. It submitted that its proposed asset lives are consistent with the expected economic lives of the assets in question. If accepted, the revision to the remaining lives for these assets will add about $35.6 million ($2021–22) to the depreciation amount in each of the next three regulatory control periods (beginning with the 2022–27 regulatory control period), until some assets start to become fully depreciated in 18 years and then require replacement.[41] As a consequence, the RAB will reduce faster until the replacement occurs.

Question
6. Do you agree with AusNet Services' proposal to separate assets with shorter asset lives from broader asset classes?

4.2 Capex

Capital expenditure (capex) refers to the capital expenditure incurred in the provision of AusNet Services' network services. Capex is added to the RAB and so forms part of the capital costs of the building blocks used to determine total required revenue.

Under the NER, we must accept the proposed forecast of total capex if we are satisfied it reasonably reflects the capital expenditure criteria (capex criteria) set out in the NER.[42] The capex criteria relate to the efficient costs incurred by a prudent operator in light of realistic demand forecasts and cost inputs. We must have regard to the capex factors in the NER when making that decision.[43]

4.2.1 How do we assess capital expenditure

Our approach is to compare the service provider's total capex forecast with an alternative estimate that we are satisfied reasonably reflects the capex criteria. Having established our alternative estimate of the total forecast capex, we can test the service provider's proposed total forecast capex. This includes comparing our alternative estimate total with

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[41] The depreciation of new insulators and instrument transformers will also be higher due to the shorter standard asset lives.

[42] NER, cl.6A.6.7(c).

[43] NER, cl.6A.6.7(e).

the service provider's proposal total. If there is a difference between the two, we may need to exercise our judgement as to what is a reasonable margin of difference.

If we are satisfied that the service provider's proposal reasonably reflects the capex criteria, we accept it. If we are not satisfied, the NER require us to put in place a substitute estimate which we are satisfied reasonably reflects the capex criteria taking into account the capex factors.[44] Where we have done this, our substitute estimate is based on our alternative estimate.

We assess forecast capex proposals through a combination of top down and bottom up assessments. Our focus is typically on determining the prudent and efficient level of forecast capex.

We will generally assess forecast capex through assessing:

- the need for the expenditure

- the efficiency of the proposed projects and related expenditure to meet any justified expenditure need.

This is likely to include consideration of the timing, scope, scale and level of expenditure associated with proposed projects.

Where businesses do not provide sufficient economic justification for their proposed expenditure, we will determine what we consider to be the efficient and prudent level of forecast capex. In assessing forecasts and determining what we consider to be efficient and prudent expenditure we may use a variety of analytical techniques to inform our views.

Our assessment approaches for capex and opex differ. We use revealed costs for opex to a greater extent than for capex, because we consider opex is largely recurrent. Past actual expenditure for TNSPs may not be an appropriate starting point for capex given it is largely non-recurrent and hence more 'lumpy', and so past expenditures or work volumes may not be indicative of future volumes. Further, TNSPs will tend to propose smaller volumes of large, high cost projects which we may need to consider on a case-by-case basis.

The assessment techniques that we may adopt to assess AusNet Services' forecasts of total capex are outlined in our expenditure forecast assessment guideline.[45]

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[44]   NER, cl.6A.13.2(b)(4).

[45]   AER, *Expenditure Forecast Electricity Distribution Guideline*, November 2013.

4.2.2 AusNet Services' capex proposal

AusNet Services has proposed forecast capex of $796.2 million ($2021–22) over the forthcoming regulatory period.[46] This represents an average increase of approximately 9 per cent compared to actual and expected expenditure over the current period.[47]

AusNet Services submitted that the increase in forecast capex from actual and expected capex in the current regulatory control period largely reflects:[48]

- higher expenditure to replace major station assets and ground-wire and insulator line assets, based on their condition; and

- higher technology expenditure, including cyber security investment to comply with an anticipated change in regulatory obligations.

AusNet Services' proposed capex forecast is predominantly network capex ($691.8 million or 87 per cent) compared to non-network capex ($104.4 million, or 13 per cent). A majority of AusNet Services' forecast capex ($424.2 million or 53 per cent) is for major station replacement projects.[49]

AusNet Services' approach to forecasting replacement capex is based on an economic assessment framework to determine the preferred replacement option and its economic timing. Major station projects and asset replacement programs are considered economic when the consequence of failure exceeds the cost of replacement.[50]

The major stations capex forecast includes several existing projects and 15 new projects at terminal stations where AusNet Services considers it is economic to replace assets in the next regulatory period. Compared to the current period, more of the new projects involve replacing 500 kV equipment (one in the current period compared to five in the 2022–27 regulatory control period), which AusNet Services submitted is more costly to replace compared to the 220 kV equipment which has been the historical focus of its asset replacement activities.[51]

AusNet Services proposed forecast capex of $83.8 million for ICT expenditure over the next regulatory period. This is $10.3 million or 14 per cent higher than expenditure in the current regulatory period. Except for the Intelligent Network Operations program ($15.9 million), all programs are corporate-wide initiatives that were also proposed in AusNet Services' electricity distribution revenue proposal lodged in January 2020.

Figure 6 shows AusNet Services' proposed capex forecast, compared to historic levels and capex allowances. The profile of forecast capex shows an increase in capex in the

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46   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 70.

47   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 70.

48   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 70.

49   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 70.

50   AusNet Services, *Revenue Proposal 2022–27*, October 2020, pp. 89–93.

51   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 99.

first year of the 2022–27 regulatory control period which is maintained for three years before declining in the final two years of the period. AusNet Services submitted that it had considered the deliverability risks associated with an unsmoothed capex profile caused by the economic timing for several large major station projects, and sought stakeholder views on how the capex forecast should be profiled. This resulted in the deferral of five major station projects and a smoother capex profile than initially planned, which AusNet Services considers addresses deliverability risks associated with the capex program.[52]

Figure 6   Comparison of AusNet Services' past and forecast capex ($million, 2021–22)
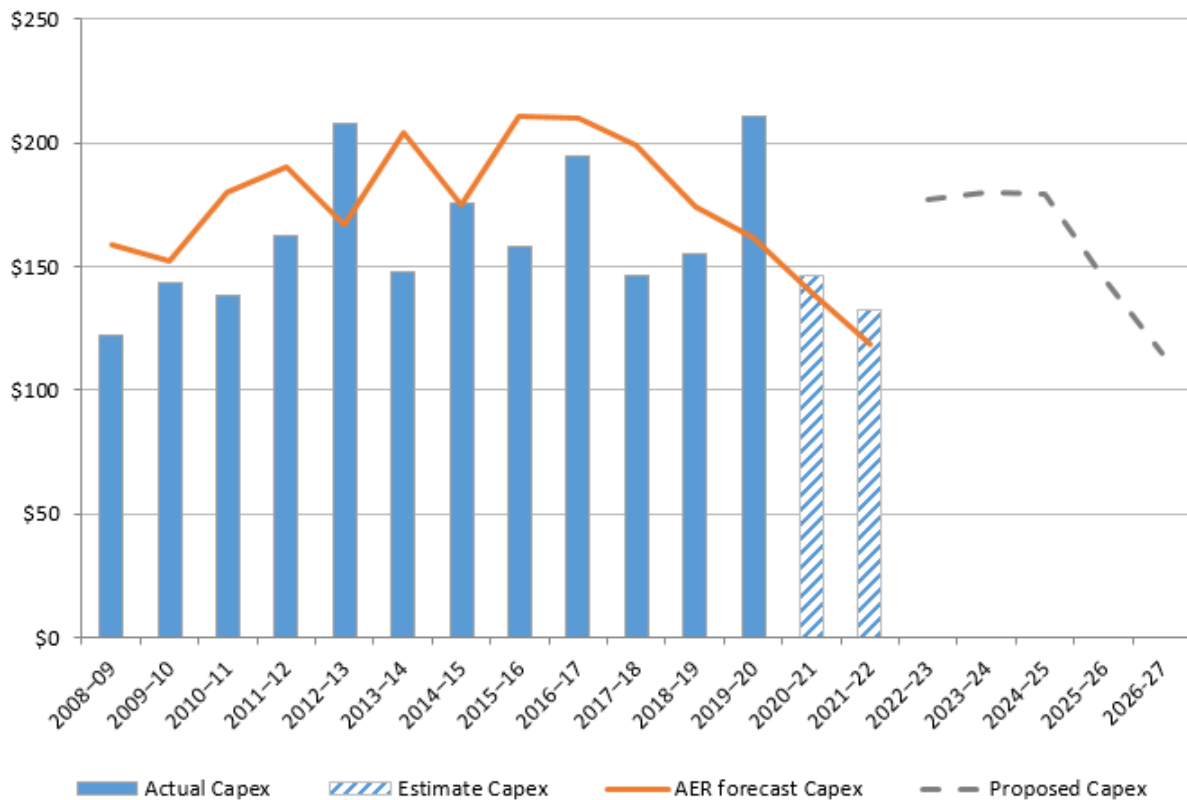
Source: Actual/Estimated: AusNet Services RFM 2017–22 (final decision; 2022–27 Regulatory Proposal; AER forecast/Proposed: AusNet Services PTRM – 2007–12 Final decision; 2017–22 Update 3; 2020–25 Regulatory proposal.

Note: Years are from 1 April to 31 March.

4.2.3 Key drivers of the capital expenditure proposal

The key driver of AusNet Services' capital expenditure forecast is the need to replace assets expected to reach the end of their useful lives over the next regulatory period. AusNet Services has developed investment plans to replace deteriorated assets where the risks to reliability and safety outweigh the cost of replacement.

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[52]   AusNet Services, *Revenue Proposal 2022–27*, October 2020, pp. 128–129.

In Victoria, responsibility for planning and augmenting the transmission system is separated from ownership of the transmission assets. As the transmission network owner, AusNet Services provides shared transmission services to AEMO and connection services to generators, distributors and large industrial customers. Transmission customers, including AEMO, make decisions regarding the augmentation of the transmission system. AusNet Services does not include these augmentation plans or associated costs in its revenue proposal.

Figure 7 shows the breakdown of AusNet Services' proposed capital expenditure by driver category.

Figure 7 Composition of proposed capital expenditure by driver
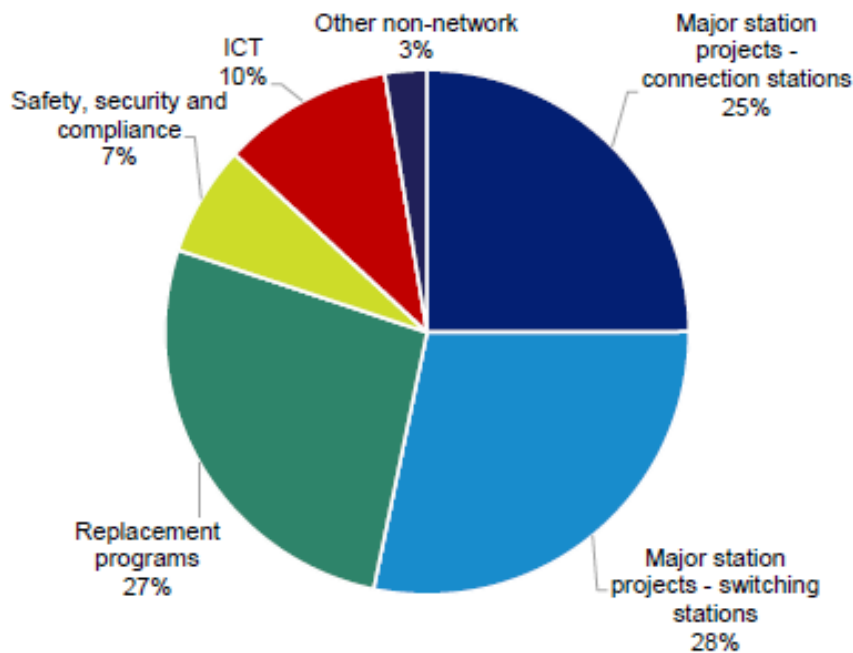
Around 28 per cent of the total capex forecast is for replacement works at switching stations that form the backbone of the Victorian transmission network or support interconnectors. The remaining major stations capex is for asset replacement at terminal stations where distribution networks connect to the transmission network.

Our role is to ensure that AusNet Services' forecast capex for 2022–27 is consistent with the capex criteria; efficiency, prudency and a realistic expectation of the demand forecast and cost inputs required to achieve the capex objectives under the NER.

As part of our assessment of AusNet Services' capex forecast, we are interested in stakeholder views as to how well its proposal—the key drivers of which are summarised above—addresses its key themes of affordability, reliability and sustainability, and the extent to which its capex forecast addresses the concerns of electricity consumers, as

identified in the course of its engagement on its proposal. Stakeholders should also feel free to comment on any aspect of AusNet Services capex proposal.

Questions
7. Do you consider that AusNet Services' smoothing of its capex profile appropriately addresses deliverability concerns and reflects the views of stakeholders?
8. Does AusNet Services' economic assessment framework provide appropriate justification for its proposed capex projects and programs?
9. Do you consider that AusNet Services' forecast capex reasonably reflects the efficient costs of a prudent operator?

4.3 Opex

Operating expenditure (opex) refers to the operating, maintenance and other non-capital expenditure incurred in the provision of network services. It includes labour costs and other non-capital costs that a prudent service provider is likely to require for the efficient operation of its network. Forecast opex is one of the building blocks used to determine AusNet Services' total revenue requirement. Under the NER, we must accept a service providers' forecast of total opex if we are satisfied it reasonably reflects the opex criteria.[53] The opex criteria relate to the efficient costs incurred by a prudent operator in light of realistic expectations of the demand forecast and cost inputs. We must have regard to the opex factors when assessing the distributor's forecast opex.[54]

Under the NER, if we are not satisfied a service providers' opex proposal reasonably reflects the opex criteria, we must not accept it.[55] We must estimate the total required opex that, in our view, reasonably reflects the opex criteria taking into account the opex factors.

4.3.1 How we assess operating expenditure

We have outlined our approach to assessing the service providers' forecasts of total opex in our expenditure forecast assessment guideline.[56]

Our approach is to compare the service provider's total forecast opex with an alternative estimate that we develop and that reasonably reflects the opex criteria.[57] By doing this we form a view on whether we are satisfied that the service provider's proposed total forecast opex reasonably reflects the opex criteria. If we conclude the proposal does not reasonably reflect the opex criteria, we use our estimate as a substitute forecast.

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[53] NER, cl.6A.6.6(c).

[54] NER, cl.6A.6.6(e).

[55] NER, cl.6A.6.6(d).

[56] AER, *Expenditure forecast assessment guideline*, November 2013.

[57] AER, *Expenditure forecast assessment guideline*, November 2013, p. 7.

Our estimate is unlikely to exactly match the service provider's forecast because it may not adopt the same forecasting method. However, if the service provider's inputs and assumptions are reasonable, its method should produce a forecast consistent with our estimate.

If a service provider's total forecast opex is materially different to our estimate and we find there is no satisfactory explanation for this difference, we may form the view that the service provider's forecast does not reasonably reflect the opex criteria. Conversely, if our estimate demonstrates that the service provider's forecast reasonably reflects the expenditure criteria, we will accept the forecast.[58]

AusNet Services stated it adopted the base-step-trend approach to develop a total opex forecast that is prudent and efficient, consistent with AER practice and the expenditure objectives set out in the NER.[59]

4.3.2 Key drivers of the operating expenditure proposal

AusNet Services proposed total opex of $1370.7 million ($2021–22) for the 2022–27 regulatory control period.[60]

A significant portion of AusNet Services' total opex is attributed to easement land tax – a levy applied by the Victorian Government that is included in total opex and recovered through regulated revenues. Easement land tax accounts for 60 per cent of AusNet Services' proposed opex and 65 per cent of AusNet Services' estimated opex in the current regulatory period.

Table 4 shows the easement land tax and remaining opex of AusNet Services' proposed opex, estimated opex and our forecast opex for the current regulatory period. AusNet Services' proposed opex is 12 per cent higher than both estimated and forecast opex.

Table 4 also highlights that whilst AusNet Services incurred higher easement land tax than forecasted in the current regulatory period, it expects to incur significantly lower controllable opex for the same period. However, AusNet Services proposed higher controllable opex by 29 per cent in its opex proposal relative to their estimated opex in the current regulatory period.[61]

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58 NER, cl.6A.6.6(c).

59 AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 133.

60 Including debt raising costs.

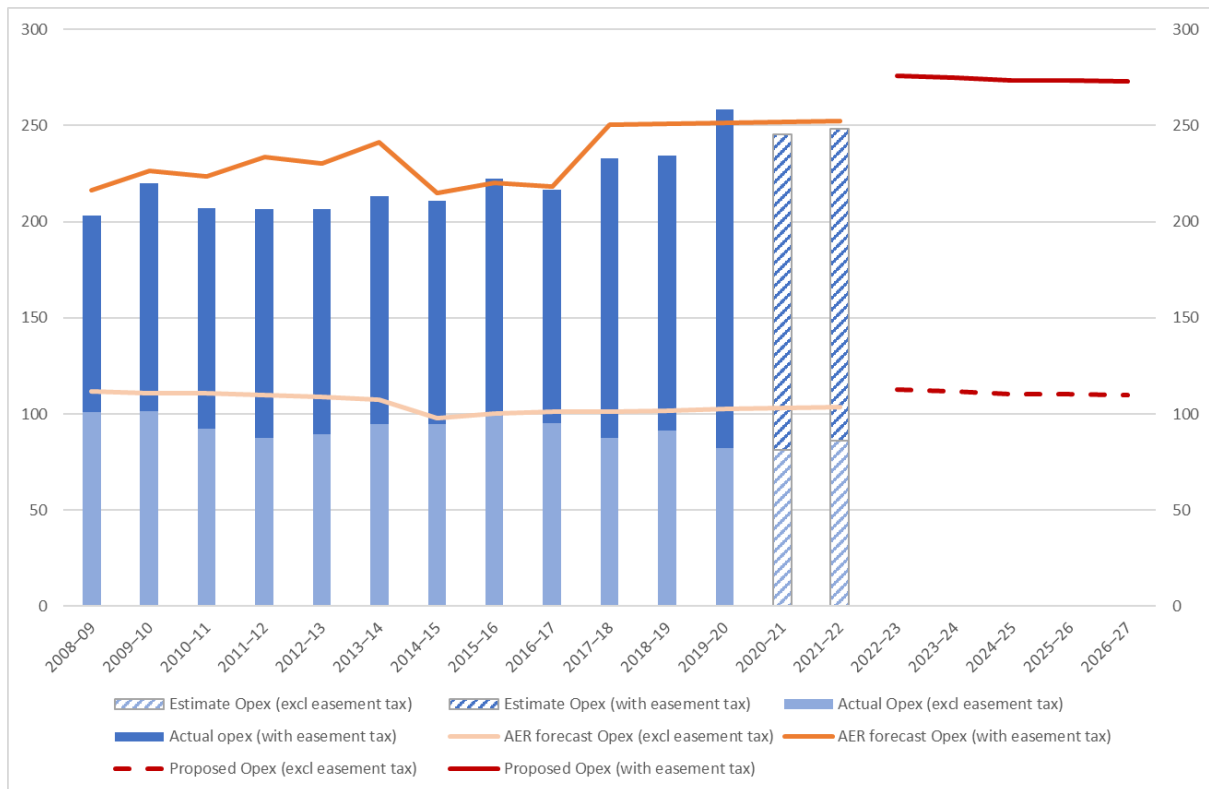61 AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 133.

Table 4   AusNet Services' opex ($million, 2021–22)

	2022–27 opex proposal	Estimated 2018–22[62]	Forecast opex 2018–22
Total opex	1370.7	1219.7 (+12%)	1228.7 (+12%)
Easement land tax	815.9	791.1 (+3%)	727.4 (+12%)
Controllable opex	554.7	428.5 (+29%)	501.2 (+11%)

Source: AusNet Services, *2022–27 Regulatory proposal – Supporting document – opex model*, 29 October 2020; AER analysis.

Figure 8 shows the trend in AusNet Services' total opex over time, both with and without the easement tax. The solid red line illustrates AusNet Services' total proposed opex (including easement tax) and the dotted red line proposed opex (excluding easement tax).

Figure 8   AusNet Services' opex over time ($million, 2021–22)[63]

Source: AusNet Services Economic benchmarking – Regulatory Information Notice response 2006–20; AER final decision PTRM 2008–14; AER final decision 2014–17 PTRM; AER final decision 2018–22 PTRM and opex model; AusNet Services, Regulatory proposal 2022–27, 29 October 2020; AER analysis.

Note: Years are from 1 April to 31 March.

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[62]   Opex for 2017–18, 2018–19 and 2019–20 is actual, opex for 2020–21 and 2021–22 is estimated because actual data is not yet available. Calculation is based on inputs provided in AusNet Services' opex model. 2020–21 and 2021–22 total opex estimates exclude debt raising costs, growth assets and EPA step change opex.

[63]   Including debt raising costs.

AusNet Services has used our base-step-trend approach to forecast opex. This is consistent with our preferred approach to assessing opex, as outlined in our Expenditure Forecast Assessment Guideline. AusNet Services proposed 2021–22 as its base year, as this will provide the most recent year for which actual data will be available for use in its revised regulatory proposal.[64] For its initial regulatory proposal, AusNet Services used the 2020–21 total opex forecast from its 2020–21 approved budget. AusNet Services forecast the easement tax for 2020–21 as a category specific forecast and removed this cost from its base year total opex forecast.[65] The adjusted base opex used by AusNet Services to trend forward was $81.5 million ($2021–22).

AusNet Services approach to forecasting trend is largely consistent with our standard approach:

- **output growth:** AusNet Services forecast no output growth. AusNet Services stated that its opex forecast did not account for system growth as these costs were initially handled outside of the revenue cap because of the division of transmission service network provider functions in Victoria.[66] This is consistent with the AER's approach for categorising output growth in AusNet Services' 2017–22 final revenue determination.

- **price growth:** AusNet Services forecast price growth of $5.0 million ($2021–22)[67] for the 2022–27 regulatory control period based on the average of wage price index (WPI) forecasts from its consultant BIS Oxford and the consultant typically used by the AER, Deloitte Access Economics (DAE).[68] This is consistent with our standard approach. AusNet Services stated they would commission an updated forecast from BIS Oxford prior to submitting its Revised Revenue Proposal, therefore the proposed forecast was simply a placeholder that would be updated in its revised proposal.[69]

- **productivity growth:** AusNet Services forecast productivity growth of 0.31 per cent per annum for the 2022–27 regulatory control period, resulting in a $3.8 million ($2021–22) reduction. AusNet Services explained that the 0.31 per cent reflected the annual productivity growth rate that the transmission industry had been able to achieve over the long term and as such was a reasonable estimate of productivity growth in the upcoming period.[70] This is consistent with our standard approach of using the annual benchmarking report average productivity growth for transmission to forecast productivity growth.

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[64] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, pp. 136–137.

[65] Movement in provisions are also forecast as a category specific forecast but are reported as $0 for the 2020-21 base year. AusNet Services states this cost will be deducted from its base opex in the revised proposal when actuals are available. AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 140.

[66] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 143.

[67] AusNet Services, *Regulatory Proposal 2022–27 – Supporting document – opex model*, October 2020; AER analysis.

[68] DAE WPI forecasts are based on AusNet Services' Distribution 2021–26 draft decision. AusNet Services, *2022–27 Regulatory proposal – Supporting document – TRR 2022–27 Model WPI calculation*, October 2020.

[69] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 143.

[70] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 145.

- AusNet Services proposed five step changes totalling $108.7 million ($2021–22).[71] The key step changes included:

  A. Council rates were expected to rise from $1 million ($2021–22) to $14.3 million ($2021–22) per annum due to a change in the methodology used to value terminal station assets. This resulted in a step change of $71.5 million ($2021–22)[72] and represented a significant portion of AusNet Services' opex proposal. Our assessment will need to verify that the forecasts are prudent and efficient.

  B. AusNet Services proposed to enhance its cyber security program to comply with new regulatory obligations by the next regulatory control period. The cost of these upgrades was forecast at $27.9 million ($2021–22).[73] Our assessment will consider the latest advice from relevant commonwealth bodies and our treatment of similar costs from recent decisions.

- AusNet Services' total opex forecast included three category specific forecasts totalling $842.0 million ($2021–22).[74]

  A. AusNet Services forecast easement land tax of $815.9 million ($2021–22) using a category specific forecast.[75] This contributed close to 60 per cent of AusNet Services' total opex forecast. This is a significant portion of total opex. Where the forecast we include in our final decision on opex differs from the actual tax paid, AusNet Services is required to apply for a cost pass through for the difference. For example, where the actual tax paid is lower than forecast, AusNet Services is required to return the difference to customers.[76]

  B. AusNet Services forecast an increase in opex to operate and maintain its group 3 assets. Group 3 assets (or excluded prescribed assets) are new network augmentations and connections assets constructed at the direction of AEMO or a distribution business. This increased its opex forecast for the 2022–27 regulatory control period by $26.1 million ($2021–22).

AusNet Services forecast debt raising costs of $8.7 million ($2021–22).

Figure 9 shows how each of these components contributed to AusNet Services' total opex forecast.

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[71] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 146.

[72] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 147.

[73] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 149.

[74] AusNet Services, *2022–27 Regulatory Proposal – Supporting document – opex model*, October 2020; AER analysis.

[75] AusNet Services, *Regulatory Proposal 2022–27*, October 2020, p. 154.

[76] NER, cl. 11.6.21. The pass-through arrangements contained in cl. 11.6.21 (a) and (d) of the NER allow any variance between the forecast easement land tax and the actual tax levied to be corrected in the relevant regulatory year's revenue. The annual correction, referred to as an easement tax change event, is not subject to the materiality threshold contained in the NER. The process is to be followed with regards to an application for a negative or positive pass through amount arising from an easement tax change event.

Figure 9   Breakdown of AusNet Services' opex forecast ($million, $2021–22)
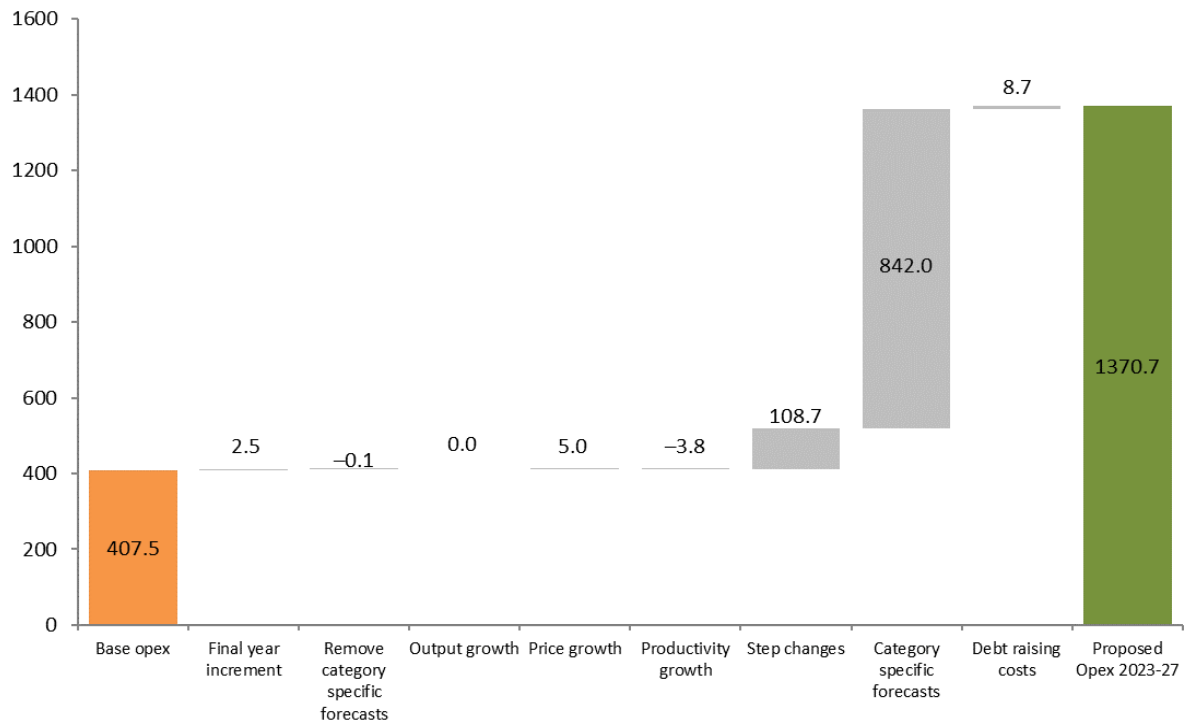
Source: AusNet Services, TRR *2022–27– Supporting document – opex model*, 29 October 2020; AER analysis.

Note: Years are from 1 April to 31 March.

Question
10. Do you consider that AusNet Services' forecast opex reasonably reflects the efficient costs of a prudent operator?

5 Incentive schemes

Incentive schemes are a component of incentive based regulation and complement our approach to assessing efficient costs. The incentive schemes that might apply to transmission businesses are:

- the opex efficiency benefit sharing scheme (EBSS)

- the capital expenditure sharing scheme (CESS)

- the service target performance incentive scheme (STPIS).

Once we determine how network revenues will be calculated networks have an incentive to provide services at the lowest possible cost, because returns are determined by their actual costs of providing services. If networks reduce their costs to below our forecast of efficient costs, the savings are shared with their customers in future regulatory periods through the EBSS and CESS. The STPIS ensures that the network is not simply cutting costs at the expense of service quality.

Our incentive schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. Incentives for opex and capex are balanced with the incentives under the STPIS to maintain or improve service quality. The incentive schemes encourage businesses to make efficient decisions on when and what type of expenditure to incur, and meet service reliability targets.

AusNet Services has proposed the application of our EBSS, CESS and STPIS. These provide important balancing incentives under our revenue determinations to encourage distributors to pursue expenditure efficiencies and demand side alternatives to capex and opex, while maintaining the reliability and overall performance of their networks.

5.1 EBSS

Our 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 tariffs in future regulatory control periods.

Question
11. Do you consider that AusNet Services' forecast EBSS provides an incentive for distributors to pursue efficiency improvements in opex and to fairly share these between distributors and consumers?

5.2 CESS

Our CESS aims to incentivise businesses to undertake efficient capex throughout the regulatory control period by rewarding efficiency gains and penalising efficiency losses (each measured by reference to the difference between forecast and actual capex).

In our final Framework and Approach paper we set out our intention to apply the CESS (as set out in our capex incentives guideline)[77] to AusNet Services in each regulatory year of the 2022−27 regulatory control period.[78]

Question
12. Do you consider that AusNet Services' forecast CESS incentivises AusNet Services to undertake efficient capex throughout the regulatory control period by rewarding efficiency gains and penalising efficiency losses?

5.3 Service target performance incentive scheme

Our STPIS, version 5, provides a financial incentive to TNSPs to maintain and improve service performance. There are three STPIS components that are applicable to AusNet Services:

- service component (SC), which incentivises TNSPs to reduce the frequency of unplanned outages and the time taken to return the network to service

- market impact component (MIC), which incentivises TNSPs to minimise the financial impact of outages on the dispatch of generation

- network capability component (NCC), which incentivises TNSPs to identify transmission network limits and increase their capability by undertaking projects with a capital cost of less than $6 million and which are likely to result in a material benefit.

AusNet Services' revenue proposal accepted the Framework and Approach paper's proposal to apply version 5 of the STPIS for the next regulatory control period.[79]

AusNet Services submitted SC targets, caps, collars and weights.[80] AusNet Services has indicated that for the 'Loss of Supply Event Frequency: number of events greater than y (0.3) system minutes per annum' it expects that a zero event in 2020 will result in a 5-year average, and therefore a target, of zero. It submitted that this will result in no bonus, if it achieves zero events, but incur a penalty, if there are any events. It has submitted that this results in an asymmetric scheme and that it will propose an alternative methodology

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[77] AER, *Capital expenditure incentive guideline for electricity network service providers*, pp. 5–9.

[78] AER, *Final Framework and approach, AusNet Services, regulatory control period commencing 1 April 2022*, April 2020.

[79] AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 169.

[80] AusNet Services, *Revenue Proposal 2022–27*, October 2020, pp. 168–173.

for determining the target in its revised proposal.[81] This issue was not raised by AusNet Services in its submission to the AER's Preliminary Framework and Approach.

We do not consider the STPIS is an asymmetric scheme. One of the key features of the STPIS is that a TNSP can only keep its reward under the STPIS if the service level improvement is retained in subsequent regulatory control periods. If the improvement is not maintained, the TNSP will need to return the earlier reward to the network users. Hence, a TNSP can only earn a reward for service improvement results once. Consumers, however, receive on going benefits from the earlier service level improvements, because the performance targets are increased to that level in the next regulatory control period—for the next five years in the new the regulatory control period.

We will apply version 5 of the STPIS, which provides for us to approve an alternative methodology subject to us being satisfied that the conditions set out in cl. 3.2(i) are met. We are interested in stakeholder views on AusNet Services' indication that it may depart from a target calculated as the 5-year average.

With respect to the MIC, AusNet Services stated that it continues to be of the view that a review of the MIC assessment is required. It submits that the closure of thermal generation and the increase in renewable generation has significantly reduced the opportunities for AusNet Services to schedule outages.[82] We set out our position in response to this issue in our Framework and Approach.[83] We do not consider there is an immediate need to review the MIC. We consider that the incentive is operating appropriately, encouraging network management or investment to address network constraints. Until these constraints are addressed penalties will accrue to the TNSP. Once these constraints are addressed bonuses will be earned by the TNSP. AusNet Services has set out its interpretation of exclusion clauses and sought our view on these exclusions. [84] AusNet Services has indicated that it intends to use a network pass through to manage planned outages on its network.[85] We are interested in stakeholder views on the use of a network pass through to manage planned outages and the interaction with the STPIS.

AusNet Services has not proposed any Network Capability Incentive Parameter Action Plan (NCIPAP) projects to address network limits under the NCC.[86]

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[81]   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 171.

[82]   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 168.

[83]   AER, *Final Framework and approach, AusNet Services, regulatory control period commencing 1 April 2022*, April 2020, pp. 9–10.

[84]   AusNet Services, *Revenue Proposal 2022–27*, October 2020, pp. 174–177.

[85]   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 162.

[86]   AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 177.

Questions

13. What are your views on AusNet Services' indication that it may depart from a STPIS target calculated as the 5-year average?

14. What are your views on AusNet Services' proposed use of a network pass through to manage planned outages and the interaction with the STPIS?

5.4 Demand management incentive mechanism

The Demand Management Innovation Allowance Mechanism (DMIAM) provides transmission network service providers with an allowance to undertake innovative projects related to demand management projects. The projects must meet the objective of having the potential to reduce long term network costs.

In our Framework and Approach we stated that we expect to develop and apply a DMIAM to AusNet Services for the 2022–27 regulatory control period in our final determination. [87]

AusNet Services has indicated that it considers the DMIAM should be applied to it during the forthcoming regulatory control period. [88]

Question

15. Do you consider the DMIAM should be applied to AusNet Services' 2022–27 regulatory control period?

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[87] AER, *Final Framework and approach, AusNet Services, regulatory control period commencing 1 April 2022*, April 2020, p. 7.

[88] AusNet Services, *Revenue Proposal 2022–27*, October 2020, p. 160.

Summary of questions

1. To what extent do you consider AusNet Services has engaged with (as opposed to simply seeking feedback from) consumers to inform the proposal?

2. To what extent have consumers been provided with impartial support to engage with energy sector issues?

3. To what extent do you consider you were able to influence the topics engaged on by AusNet Services?

4. To what extent were you able to access and resource independent research and engagement?

5. To what extent do you consider AusNet Services' proposal ties to your expressed views as a consumer?

6. Do you agree with AusNet Services' proposal to separate assets with shorter asset lives from broader asset classes?

7. Do you consider that AusNet Services' smoothing of its capex profile appropriately addresses deliverability concerns and reflects the views of stakeholders?

8. Does AusNet Services' economic assessment framework provide appropriate justification for its proposed capex projects and programs?

9. Do you consider that AusNet Services' forecast capex reasonably reflects the efficient costs of a prudent operator?

10. Do you consider that AusNet Services' forecast opex reasonably reflects the efficient costs of a prudent operator?

11. Do you consider that AusNet Services' forecast EBSS provides an incentive for distributors to pursue efficiency improvements in opex and to fairly share these between distributors and consumers?

12. Do you consider that AusNet Services' forecast CESS incentivises AusNet Services to undertake efficient capex throughout the regulatory control period by rewarding efficiency gains and penalising efficiency losses?

13. What are your views on AusNet Services' indication that it may depart from a STPIS target calculated as the 5-year average?

14. What are your views on AusNet Services' proposed use of a network pass through to manage planned outages and the interaction with the STPIS?

15. Do you consider the DMIAM should be applied to AusNet Services' 2022–27 regulatory control period?

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CESS	Capital Expenditure Sharing Scheme
CPI	Consumer price index
EBSS	Efficiency Benefit Sharing Scheme
MAR	maximum allowed revenue
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NCIPAP	Network Capability Incentive Parameter Action Plan
opex	operating expenditure
PTRM	Post tax revenue model
RAB	Regulatory asset base
RFM	roll forward model
SL	straight line depreciation method
STPIS	Service Target Performance Incentive Scheme
TNSP	Transmission network service provider