

Framework and Approach for the 2014-19 ACT electricity network determination

Response to the Australian Energy Regulator's
Preliminary Positions paper

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ActewAGL 

for you

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Summary

Classification of services

- The National Electricity Rules (NER) require the Australian Energy Regulator (AER), in classifying services, to act on the basis that there should be no departure from a previous classification unless a different classification is clearly more appropriate.
- ActewAGL Distribution (ActewAGL) agrees with the AER’s preliminary position that network services should continue to be classified as standard control services. We do not agree that connection services (as defined in Chapter 10 of the NER) should be separated from other distribution services and classified as either standard or alternative control services. The current standard control classification in which the cost of connection services (not recovered in capital contributions) is recovered in distribution use of system (DUOS) charges is the most appropriate.
- ActewAGL agrees that *type 5-7 metering services* should continue to be regulated as alternative control services, along with miscellaneous metering services. *Type 1-4 metering services* should remain unregulated.
- ActewAGL does not agree that it is more appropriate for *fee based* and *quoted services* to be classified as alternative control services, given the additional administrative costs associated with regulating these services which account for little revenue. In addition, many of ActewAGL’s current *miscellaneous services* relate to *connection services* (as defined in Chapter 5A of the NER)¹ and can be regulated under the provisions of Chapter 5A; or else relate to metering and should remain, as currently, classified with *type 5–7 metering services* as alternative control services.
- The AER’s preliminary position on the classification of *connection services* raises particular concerns for ActewAGL. Charges for new connections or alterations to connections are properly regulated within the provisions of Chapter 5A of the NER.

Control mechanisms

- The NER set out factors that the AER must consider in determining the control mechanisms to apply to standard and alternative control services. The control mechanism currently applied is one of several factors the AER must consider.

¹ NER 5A.A.1—Definitions

- ActewAGL considers that the AER should require a change in the control mechanism only if the AER can establish that its preferred option is clearly superior to the current mechanism when assessed against the factors set out in the Rules, and there will be a net benefit from the change.
- ActewAGL does not agree with the AER's proposal to change the control mechanism for standard control services from the current average revenue cap to a revenue cap.
- As the AER recognises in both the initial control mechanism discussion paper and the preliminary positions paper, revenue caps have some significant shortcomings, particularly in relation to two factors that the AER considers important—price stability and incentives for efficient pricing. ActewAGL disagrees with the AER's view that these weaknesses are more than offset by some relative strengths of revenue caps. We also consider that the AER's assessment of the current average revenue cap is unbalanced, focusing on theoretical weaknesses but not taking account of actual outcomes and the impacts of other elements of the regulatory framework which shape pricing and investment incentives.
- On balance, there is no case for changing the control mechanism for ActewAGL's standard control services from an average revenue cap to a revenue cap.
- A revenue cap currently applies to ActewAGL's *type 5 – 7 metering services*. The AER's preliminary position is to change the control mechanism to price caps. The AER has provided no guidance on the basis of control—for example how initial prices would be set, how the price path would be set, and whether there would be scope to change individual prices during the period to take account of changes in costs. ActewAGL's preferred approach is to modify the current revenue cap mechanism to directly address the inherent problems with it. Our proposal effectively involves applying a price cap to a basket of metering services, rather than for each individual service, with flexibility to change relative prices during the period in response to changing cost or demand conditions, without significant regulatory cost.
- If the AER adopts its preliminary position to classify certain connection services and fee based and quoted services as alternative control services, despite ActewAGL's strong objections, then ActewAGL seeks further consultation on how the AER's proposed price caps would be applied. We are concerned that the potentially significant costs of applying new price caps to these new service classifications are likely to outweigh any benefits. We also seek consultation on how price caps set by the AER for connection services and related fee-based services can be reconciled with the new requirements in chapter 5A of the NER.

Application of the incentive schemes

- ActewAGL agrees with the AER's preliminary position that for the 2014-19 ACT distribution determination the reliability component of the service target performance incentive scheme (STPIS) should apply to unplanned SAIDI and unplanned SAIFI, with feeders classified as urban or rural short, targets based on the four years of data that ActewAGL will have provided at the time of the final determination, and exclusions as set out in the national STPIS.
- ActewAGL also agrees that the customer service component of the STPIS should apply to telephone answering. We do not intend to propose the application of other customer service parameters.
- ActewAGL is currently developing a proposal in relation to incentive rates for the reliability of supply component and potentially the telephone answering component of the scheme. ActewAGL is also reviewing the revenue at risk under both the reliability component and the customer service component of the scheme, and will present its proposals in the May 2013 regulatory proposal
- ActewAGL agrees with the AER's preliminary position to apply the national efficiency benefit sharing scheme (EBSS) for the 2014-19 ACT distribution determination.
- ActewAGL appreciates that the timing of the AEMC *Power of Choice* review has implications for the demand management and embedded generation connection incentive scheme (DMEGCIS). We accept that the AER may want to consult with ActewAGL on possible changes to the DMEGCIS after the November 2012 release of the AER's Framework and Approach final decision.

Dual function assets

- ActewAGL disclosed to the AER on 30 June 2012 that its ACT distribution network incorporates Dual Function Assets (DFA) with an estimated value of 4.7 per cent of the network's Regulated Asset Base (RAB) as at 1 July 2012. The DFA will support transmission capacity to areas of South East NSW.
- For the current (2009-14) regulatory period, ActewAGL has programmed a significant upgrade of the 132 kV line between Gilmore and Theodore and is currently clarifying the operational and technical need to install revenue grade metering at each of the connection points between its 132kV sub-transmission network and the remainder of the distribution network.
- In ActewAGL's view, ACT consumers should not be required to pay for network costs occasioned by ActewAGL's role as a TNSP as a consequence of the connection of the second supply point to the ACT. Transmission based network costs include costs of new revenue metering and protection assets associated with the requirements of the

network being classified as a transmission network under the NER and any additional requirements of a TNSP over those of a DNSP.

Other matters

- The AER intends to use a suite of assessment tools in its review of ActewAGL's regulatory proposal. While we accept that in principle there may be a useful role for these tools when used as part of an overall assessment of regulatory proposals, we have a number of concerns about the practical application and detailed specification of the models. ActewAGL believes that further consultation is required.
- The AER must ensure that the applicable Regulatory Information Notices (RINs) are finalised sufficiently early to allow ActewAGL to address all the requirements and incorporate the response in its regulatory proposal. In developing its information requirements the AER must take account of the costs of meeting its requests, and weigh these against the likely benefits of the additional information it seeks.
- ActewAGL intends to lodge its revised Cost Allocation Methodology (CAM) in October 2012 to allow sufficient time for AER consideration and approval in advance of the submission of its regulatory proposal.

1. Introduction

ActewAGL Distribution (ActewAGL) welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) *Preliminary Positions, Framework and Approach paper, ActewAGL* (the Preliminary Positions paper) released on 25 June 2012. ActewAGL Distribution, a partnership between ACTEW Distribution Ltd and Jemena Networks (ACT) Pty Ltd, owns and operates the electricity distribution network in the Australian Capital Territory (ACT).

The *Framework and Approach* process is designed to assist Distribution Network Service Providers (DNSPs) by setting out, no later than 19 months prior to the start of the next regulatory period, the control mechanisms that the AER will apply and the AER's intended approach to classification of services, application of incentive schemes, dual function assets, cost allocation and any other matters that it considers relevant. Early guidance on each of these matters is critical as it impacts on the ability of DNSPs to frame their regulatory proposals. Clear guidance is especially important where the AER is proposing fundamental changes to the service classifications and control mechanisms, as it is for ActewAGL.

The major changes proposed by the AER in the Preliminary Positions paper are:

- the current standard control services would be split into several components, with some re-classified as alternative control services, while others would retain the standard control classification;
- the control mechanism for standard control services would change from an average revenue cap to a revenue cap; and
- the control mechanism for alternative control services would change from the current revenue cap to a set of price caps.

In addition, the AER's preliminary position is to apply the national STPIS for the first time in the ACT.

Each of the proposed changes would have significant implications for ActewAGL and its customers. ActewAGL supports some of the AER's preliminary positions and agrees that some of the proposed changes are appropriate and warranted in relation to the requirements of the NER. However we remain concerned that others are not warranted and would result in costs for ActewAGL and its customers which more than offset any potential benefits. ActewAGL also requires further clarification from the AER on several aspects of its preliminary positions.

Read as a whole, this submission supports ActewAGL's proposal that for the 2014-19 regulatory period:

- charges for distribution services related to metering be regulated as alternative control services, using a revenue cap for a standard basket of services;

- charges for other distribution services (essentially DUOS charges) continue to be regulated as a standard control service, using an average revenue cap;
- charges for basic connection services (new connections or alterations to connections for retail customers) be regulated using a model standing offer under Division 1 of Chapter 5A of the NER;
- charges for standard connection services (new connections or alterations to connections for particular classes of connection applicants) be regulated using a model standing offer under Division 2 of Chapter 5A of the NER; and
- charges for negotiated connection services be regulated according to Part C of Chapter 5A of the NER.

With the consistent application of Chapter 5A, and after treating miscellaneous charges related to metering as charges for metering services, it is possible that ActewAGL will have few other fee-for-service charges related to distribution services in the next regulatory period. For those that remain, we propose that they continue to be regulated as standard control services. Alternatively, they should not be regulated at all since the revenue recovered from such services is unlikely to warrant the administrative cost of regulation.

Consistent with the connection charge principles, charges for connection services will only apply if a provision for the cost has not already been made through existing distribution use of system charges or other tariff applicable to the connection such as metering charges.²

² NER clause 5A.E.1(c)(6)

2. Classification of services

A distribution determination must include a decision on the classification of the distribution services to be provided by a DNSP during the course of the relevant regulatory control period. Only services within the definition of *distribution services* in chapter 10 of the NER are to be classified under the current process. Classification of distribution services forms part of the distribution determination and operates only for the regulatory control period for which the determination is made. In its determination of the framework and approach, the AER must set out its likely approach to the classification of distribution services in a DNSP's next distribution determination, and its reasons for that approach. If the AER decides against classifying a distribution service, the service is not regulated under the NER.

The classification of services in the distribution determination must be as set out in the determination of the framework and approach unless the AER considers that, in light of a DNSP's regulatory proposal and submissions received, there are good reasons for departing from the classification.

In classifying services that have previously been subject to regulation under the present or earlier legislation, the NER require the AER to act on the basis that (unless a different classification is clearly more appropriate):³

- there should be no departure from a previous classification (if the services have been previously classified), or
- if there has been no previous classification—the classification should be consistent with the previously applicable regulatory approach.

Classification of services for the 2009-14 regulatory period

In the current 2009–14 ACT regulatory determination, ActewAGL has two service classifications and two forms of regulatory control:

- one that applies to DUOS and miscellaneous distribution services; and
- another applying to metering services (for customers consuming less than 160 MWh/year with manually read meters).

ActewAGL currently has no *negotiated distribution services*.

Prices for ActewAGL's DUOS and miscellaneous distribution services are regulated together as standard control services using CPI minus X applied to maximum allowable average revenue.

³ NER, clauses 6.2.1(d) and 6.2.2(d)

ActewAGL's prices for regulated metering services are controlled via a revenue cap, adjusted each year by CPI minus X. Prices for metering services for customers consuming over 160 MWh/year are not subject to regulation, given that these services are fully contestable.

Metering for customers consuming less than 160 MWh/year is contestable if meters are remotely read. Thus, where meter providers provide customers with smart meters (incorporating communications), revenue from such meters would not be regulated.

There are unregulated charges related to the sale of padlocks for meter boxes and for the hire of tiger matting.

The AER's preliminary positions for the 2014-19 regulatory period

The AER's preliminary position for classification of services in the case of ActewAGL is:⁴

- to classify *network services* as direct control services and further, as standard control services;
- to separate *connection services* into four components. All four components are classified as direct control services and further classified as follows:
 - *premises connection assets* as alternative control services;
 - *extensions* as alternative control services;
 - *augmentations* as standard control services; and
 - *incidental services* as alternative control services;
- to classify all *type 5–7 metering services* as direct control services and further, as alternative control services (the AER's likely approach is not to classify *type 1 to 4 metering services*);
- to classify *fee based services* as *direct control* services and further, as alternative control services; and
- to classify *quoted services* as direct control services and further, as alternative control services.

Response to preliminary positions on standard control services

ActewAGL agrees that network services should continue to be classified as standard control services. We propose, however, for reasons outlined below, that *connection services* (as defined in chapter 10 of the NER) should not be separated out and should continue to be regulated as standard control services and their costs recovered in DUOS charges. *Miscellaneous distribution*

⁴ AER 2012, ACT Preliminary Positions paper, p viii

services should also continue to be regulated as standard control services. Their current classification as standard control services under the average revenue cap control mechanism is an effective and relatively low cost form of regulation especially given the relatively small revenue generated. For the 2014-19 regulatory period, ActewAGL expects that some of its miscellaneous services currently regulated as standard control services would be regulated under the standing offer arrangements for basic connection services.

Response to preliminary positions on alternative control services

Metering services

ActewAGL agrees that *type 5-7 metering* services should continue to be regulated as alternative control services, along with miscellaneous metering services and that *type 1-4 metering* services should remain unregulated.

Miscellaneous services to fee-based and quoted services

ActewAGL does not agree that it is clearly more appropriate for *fee based* and *quoted services* to be classified as alternative control services, given the additional administrative costs associated with regulating these services which account for little revenue. This may be more the case for the 2014-19 regulatory period, since the number of such services may significantly reduce for reasons outlined below.

The current inclusion of the revenue from most miscellaneous charges under the average revenue cap (or under the metering alternative control cap in the case of metering related services) while allowing costs to be borne by the beneficiary of the services is a cost effective form of regulation that also provides no incentive to depart from cost reflective charges.

Many of ActewAGL's existing charges for miscellaneous services relate primarily either to metering or to new connections or connection alterations. The latter meet the definition of connection services under Chapter 5A of the NER and are liable to be regulated as part of ActewAGL's *model standing offer* for connection services.⁵ If this were to be the case, it would further boost the case for the remaining miscellaneous distribution charges to be regulated, as at present, as standard control services.

Connection services

The AER initially raised the option of separately classifying some connection services as alternative control services in its December 2011 consultation paper. In establishing its initial

⁵ A *connection service* is defined for the purposes on Chapter 5A of the NER (5A.A.1 Definitions) as meaning either or both of (a) a service relating to a new connection for premises; or (b) a service relating to a connection alteration for premises. A *model standing offer* is defined as a document approved by the AER as a model standing offer to provide basic connection services or as a model standing offer to provide standard connection services.

classification, the AER focussed on whether the costs of the service could be directly attributable to a particular user or group of users. For example, the AER said:

*The costs associated with augmenting the shared network are less attributable to a particular customer and therefore a standard control classification may be more appropriate.*⁶

ActewAGL agrees that the extent to which costs can be directly attributed to particular users is one of the five factors the AER is required under the NER to consider when classifying services as standard or alternative control. In response to the initial consultation paper ActewAGL therefore accepted that:

in principle, it may be appropriate to re-classify as alternative control those components of a connection service where the cost can be clearly attributed to particular users.

However, a decision on the appropriate classification must be based on a full consideration of all the factors required under the NER, not only the extent to which costs can be attributed to particular users. For example, the possible effects of the classification on administration costs must be considered, as must the current arrangements, which according to the NER must be retained unless there is a clearly more appropriate option.

ActewAGL believes that the AER must in making its determination consider how the proposed classification would operate in practice and also establish that the proposal would provide net benefit to customers compared to the current arrangements. The Preliminary Positions paper does not do this. Subsequent consultation with the AER on the issue has achieved little by way of clarification.

ActewAGL is particularly concerned that the AER's preliminary position on connection services:

- introduces unclear and overlapping definitions;
- would require fundamental change to existing practices in the ACT; and
- would require significant step changes for customers and introduce inequities of treatment between existing and future customers.

The situation is further complicated by the release, subsequent to the initial consultation paper, of the AER's *Connection charge guidelines for electricity retail customers* and the new Chapter 5A of the NER, which underpins the guidelines. It is apparent as mentioned earlier, for example, that many of ActewAGL's miscellaneous services that are currently classified as standard control services would fall within the definition of connection services in chapter 5A, as would some miscellaneous charges for metering.

Chapter 5A requires all DNSPs to have a standing offer to provide details of charges for basic connection services, but it is unclear how the charges for basic connection services map into the

⁶ AER 2011, *Consultation Paper, Matters relevant to the framework and approach ACT and NSW DNSPs 2014–2019, Classification of electricity distribution services in the ACT and NSW*, December, p. 15

AER's proposed four categories of connection services to be regulated as distribution service charges.

Under the existing service classification in the ACT, services provided by customer connection assets are included in standard control services provided by ActewAGL and the costs recovered in DUOS charges. Most customers (excluding those connecting directly to the high voltage (HV) network) pay no upfront charges for connection to the network unless they require connection assets in addition to the standard service. ActewAGL includes the value of the customer connection assets it provides in the Regulated Asset Base (RAB).

In the case of extensions to the network for greenfield estates, ActewAGL funds the construction of the extension of the network and reticulation of the new development to a standard overhead configuration. Developers provide a capital contribution for the additional costs of undergrounding the network. Thus the value of the extension and basic overhead reticulation is incorporated in the RAB and recovered in DUOS charges.

The AER's preliminary position on connection services appears to differentiate between the services provided by network assets on the basis of whether they are dedicated to particular customers (*customer connection assets*) or shared by multiple customers (*augmentation*). *Extension* is the third of the four connection categories proposed by the AER which, while described in the preliminary positions paper as a subset of *augmentation*, are dedicated to one or more customers where there is the potential to supply other customers or developments at a later time. The fourth category is *incidental services*. Each of the four connection service categories with the exception of *augmentation* is to be an alternative control service under the AER's proposal, while *augmentation* remains as standard control services.

The AER's connection guidelines set out the methods to be applied for capital contributions for *standard* control services. The AER says in the guidelines that its treatment of standard control services is designed to improve user pays signals and limit cross subsidies:

The AER, in applying a cost-revenue-test to connection services that are standard control services, has sought to improve user-pays signals and limit cross-subsidisation, within the confines of the standard control mechanism.⁷

The connections guidelines say that charges for alternative control services will be specified by the AER in the determination. To date, the AER has provided no guidance on how it would set the prices for connection services that are alternative control services. As a result, ActewAGL remains unsure of how charging for capital contributions would be affected by the AER's proposed classification.

In view of the issues raised here, and the presumption in the NER in favour of the prior classification or classification consistent with the previously applicable regulatory approach

⁷ AER 2012, *Final Decision, Connection charges guidelines, June*, p. 40

unless another approach is more appropriate,⁸ ActewAGL proposes that its connection services remain as standard control services with costs recovered in DUOS to the extent that the costs have not been recovered as a capital contribution regulated under Chapter 5A. In doing so, ActewAGL points to the AER's previous views on this matter.

In its most recent distribution determination, that for Aurora Energy in Tasmania, the AER determined that connection services would be classified as standard control services. Much of the reasoning applied by the AER as part of the Aurora determination applies equally to ActewAGL. As recognised by the AER as relevant in the case of Aurora, ActewAGL holds the only electricity distribution licence in its jurisdiction, in this case, the ACT. The AER further recognised that the jurisdictional arrangements in Tasmania (such as also apply in the ACT) prevent competition for standard connection services and that the incumbent distributor possesses economies of scale and scope that preclude standard connection services being competitively provided through an alternative source.⁹

Matters that the AER considered as relevant in determining whether standard connections should remain as standard control services were:¹⁰

- the classification would not influence the potential for competition: rather this is due to the requirements of jurisdictional legislation;
- there would be no material effect of administrative costs of the AER, DNSP or another party if the services were classified as standard control services. In addition there would be administrative costs in classifying the services as alternative control as the DNSP would be required to submit charges for each standard connection service;
- the current approach of recovering the costs of standard connection services through DUOS charges;
- the nature of connection services is that the customer requesting the service will benefit from the provision of the service, and, as such, the costs are directly attributable to specific customers; and
- in Queensland and South Australia, the costs of standard connection services are recovered through DUOS charges, while in Victoria, standard connection services are classified as alternative control services.

The AER's conclusion was that:¹¹

⁸ NER, clauses 6.2.1(d) and 6.2.2(d)

⁹ AER 2010, *Final Framework and Approach paper, Aurora Energy Pty Ltd, Regulatory control period commencing 1 July 2012*, 29 November, p 48

¹⁰ *Ibid*, p 49

¹¹ *Ibid*

Clause 6.2.2(d) of the NER provides that the AER must act on the basis that there should be no departure from a previous regulatory approach unless another classification is clearly more appropriate. The AER is not inclined to depart from the previous regulatory approach because the AER considers that recovery of the costs of standard connection services through DUOS charges (ie spread across all customers and regulated under a revenue cap) is appropriate, due to the reasons discussed above.

ActewAGL submits that identical considerations apply in respect of ActewAGL and the ACT, and that similar treatment of these services should therefore be determined.

In the case of *connections requiring augmentation* which it defined as:¹²

[C]onnections requir[ing] an augmentation or connection to the network in order to connect the customer. That is, capital works need to be undertaken to provide the connection

the AER similarly determined that they should be classified as standard control services and the costs recovered in DUOS charges.

Additionally, the AER noted that the costs associated with such services cannot always be fully recovered through the customer's supply and usage tariff over the life of the new assets installed to facilitate that connection and that, in these circumstances, customers are required to pay an upfront capital contribution. Further, the AER noted that:¹³

... because capital contributions are 'works', they do not constitute a service, but [rather] a contribution to the costs of the connection service. It follows that capital contributions do not fall within the meaning of a distribution service in chapter 10 of the NER and cannot be the subject of classification in clause 6.2.1 of the NER. As it is not possible for the AER to separately classify capital contributions as services under the NER, the AER may only regulate the actual connection requiring augmentation service.

While the AER noted that capital contributions for connections requiring augmentation are not regulated in Tasmania, this is not the case in the ACT, where charges are set in accordance with the *Electricity Networks Capital Contributions Code*. The AER also noted that the provisions of the (then pending) NECF would contain provisions for customer connections.

¹² *Ibid* pp 49-50

¹³ *Ibid* p 50

3. Control mechanisms

Control mechanisms in the 2009-14 regulatory period

ActewAGL's standard control services, which comprise DUOS services and miscellaneous services, are currently subject to an average revenue cap. The Independent Competition and Regulatory Commission (ICRC) also applied average revenue caps to ActewAGL's network services in the previous two regulatory periods.

The average revenue cap for the 1999-2004 regulatory period was based on forecast load. For the 2004-09 regulatory period the ICRC amended the mechanism so that it used the actual load in the most recent calendar year. The ICRC decided to base the cap on "objective and verifiable data, rather than a forecast, where such data are available".¹⁴ The average revenue cap for the current regulatory period is also based on actual load data for the most recent calendar year.

Basing the cap on actual rather than forecast load removes the need for an annual pricing adjustment for the difference between forecast and actual revenues. It also simplifies the administration of the cap. ActewAGL notes that in the Preliminary Positions paper the AER refers to criticisms of average revenue caps by IPART and the Victorian Office of the Regulator General (ORG).¹⁵ However the papers that the AER refers to are assessing the 1996—2001 Victorian average revenue caps, which were different to the current ACT mechanism as they were based on forecast quantities and incorporated an annual unders and overs adjustment.

As part of the 2004-09 review, the ICRC assessed the relative advantages and disadvantages of average revenue caps and revenue caps, and concluded that on balance the average revenue cap was the preferred option:

*The commission has elected to maintain the use of an average revenue cap in the next regulatory period, as the commission believes it provides an appropriate balance of risk between ActewAGL and customers, and at the same time provides incentives for ActewAGL to reduce costs and provide services in response to customer demand.*¹⁶

The ICRC commented on total revenue caps:

A total revenue cap provides the business with a guaranteed level of income and thus reduces revenue risk. It also provides strong incentives to reduce expenditure. However it discourages businesses from expanding capacity or connecting new customers as the business will incur

¹⁴ ICRC 2003, 2004, *Final Decision – Investigation into prices for electricity distribution services in the ACT*, March, p.97

¹⁵ For example, on p. 47 the AER refers to assessments by IPART and ORG.

¹⁶ ICRC 2003, *Draft Decision – Investigation into prices for electricity distribution services in the ACT*, November, pp. 94-95

additional costs but generate no additional income. It therefore relies on relatively accurate forecasts of customer numbers and demand—where this is not the case the business will face substantial profit risk.¹⁷

ActewAGL believes that these comments regarding the balance of incentives and risks under revenue caps and average revenue caps remain relevant to the AER's current review.

ActewAGL's alternative control services are currently subject to a revenue cap, based on a building block analysis, with maximum allowable revenue escalated each year by CPI minus X. The mechanism was first implemented by the ICRC in 2004. The ICRC said its intention was to apply a light-handed form of regulation, prior to the expected introduction of full contestability for metering services. Full contestability was not introduced, but the mechanism was retained through the 2009-14 regulatory period, as required by the transitional NER. ActewAGL believes that a change to the control mechanism may now be warranted.

The AER's preliminary positions for the 2014-19 regulatory period

The AER's preliminary position is to change the control mechanisms for both standard control and alternative control services.

Standard control services

In April 2012 the AER released an initial discussion paper on control mechanisms for standard control services for the 2014-19 ACT and New South Wales distribution determinations. The AER's preferred position was to change the current control mechanisms for standard control mechanisms in both the ACT and New South Wales and adopt revenue caps.

ActewAGL responded to the discussion paper in May 2012, arguing that the average revenue cap should be retained in the ACT. Our assessment of revenue caps and average revenue caps against the factors required in the NER, as well as the additional factors the AER considers relevant, indicated that there was no clear case for the AER to require a change in mechanism for standard control services.

In the ACT Preliminary Positions paper the AER has retained its initial preference for revenue caps.

Alternative control services

The AER's preliminary position is to apply price cap control mechanisms to each of ActewAGL's alternative control services for the 2014-19 regulatory control period. The AER has not provided a preliminary position on the basis of control. However, the AER says in the preliminary positions

¹⁷ ICRC 2003, *Draft Decision – Investigation into prices for electricity distribution services in the ACT*, November, p 94

paper that it expects that quoted services will have a basis of control that would constitute a formula based approach rather than fixed prices.

Response to AER preliminary positions on control mechanisms for standard control services

ActewAGL does not agree with the AER's preliminary position to change the control mechanism for standard control services in the ACT from the current average revenue cap to a revenue cap. We have several concerns with the AER's assessment approach and conclusions.

The AER's approach

The NER set out factors that the AER must consider when determining the control mechanisms for standard control and alternative control services. The mechanism applying in the current period is one of several factors the AER must consider.

ActewAGL believes that the AER has not put sufficient weight on the NER requirement to take account of the current mechanism. Proper consideration of this factor requires a careful assessment of the likely costs and benefits of changing to a new mechanism. ActewAGL considers that, consistent with good regulatory practice and the AER's approach in previous Framework and Approach decisions, the AER should only require a change in the control mechanism if it can establish that its alternative option is clearly superior to the current option, when assessed against the factors set out in the NER, and there will be a net benefit from the change.

Rather than taking the existing control mechanism as a starting point and asking whether there is a better option, when assessed against the factors set out in the NER, the AER's approach seems to be to develop a case to support its preference for revenue caps.

As the AER recognises, in both the initial control mechanisms discussion paper and the preliminary positions paper, revenue caps have some significant shortcomings, particularly in relation to two factors that the AER considers important—price stability and incentives for efficient pricing. ActewAGL disagrees with the AER's view that these weaknesses are more than offset by some relative strengths of revenue caps. We also consider that the AER's assessment of the relative strengths and weaknesses of the current average revenue cap is unbalanced, and inconsistent with the analysis applied in the New South Wales preliminary positions paper.

For example, in the New South Wales preliminary positions paper the AER has placed considerable weight on actual pricing and revenue outcomes under WAPCs. The AER analyses pricing by Victorian and New South Wales DNSPs, and concludes that even though the WAPC provides theoretical incentives for efficient pricing, actual pricing has not been efficient. This finding on actual pricing is central to the AER's rejection of WAPCs.

In contrast, for the ACT the AER simply says that the theoretical incentives are for inefficient pricing. It does not assess actual pricing. For consistency with the approach in the New South Wales paper, the AER should place significant weight on actual pricing and revenue outcomes in the ACT. When this is done, the AER's case against for moving away from the average revenue cap is significantly weakened.

More detailed comments on issues arising from the preliminary positions paper are provided below. The focus is on new matters raised by the AER in the preliminary positions paper, however our previous comments, set out in the response to the initial control mechanism discussion paper, continue to apply and are re-stated where relevant.

Revenue recovery and volume risk

One of the AER's main concerns with both WAPCs and average revenue caps is that they provide scope for DNSPs to earn revenue above the allowance set in the determination. In the New South Wales preliminary positions paper the AER analyses Victorian DNSPs' actual and allowed revenue to demonstrate that DNSPs can earn revenue in excess of the allowance under WAPCs. The AER's finding that "the Victorian DNSPs recovered revenue substantially above forecast throughout the period, averaging a recovery of 8.28 per cent above forecast annually"¹⁸, seems to be central to the AER's rejection of WAPCs.

The AER does not conduct a similar analysis of actual revenue outcomes in the ACT.

ActewAGL's analysis, summarised below and provided in detail in attachment 1, shows that the AER's concerns about over-recovery of revenue are not supported by the evidence on outcomes under the average revenue cap in the ACT.

Over the past 8 years (the full 2004-09 regulatory period and the first 3 years of the current period) under an average revenue cap ActewAGL's actual revenue has been only \$28.6 million higher than the regulatory allowance. This represents only 3 per cent of the total allowance over the period. Higher than forecast CPI accounted for \$16.1 million of the difference. Higher than forecast load accounted for \$15.1 million of the \$28.6 million difference. Other factors, including changes in load profile from one year to the next caused a \$2.6 million reduction in revenue below the forecast.

In the ACT Preliminary Positions paper the AER clarified its interpretation of the factor "revenue recovery and volume risk". The AER says that this factor relates to:

... whether a control mechanism provides DNSPs with an opportunity to recover efficient costs, while limiting revenue recovery above such costs.¹⁹

¹⁸ AER 2012, *Preliminary Positions, Framework and approach paper, Ausgrid, Endeavour Energy Essential Energy*, June, p. 128.

¹⁹ AER 2012, *Preliminary Positions, Framework and approach paper, ActewAGL*, June, p.42

ActewAGL agrees that DNSPs should be provided with an opportunity to recover efficient costs. However, it does not follow that in achieving this objective the control mechanism should limit revenue recovery above the forecast. To the extent that actual cost drivers differ from the forecast values used to determine the revenue allowance at the start of the regulatory period, DNSPs may not be able to recover efficient costs under a revenue cap. Furthermore, constraints on the extent of annual *unders and overs* adjustments each year²⁰ create a risk that revenue may not be sufficient to cover efficient costs.

The AER's preference for revenue caps on the basis that they provide greater revenue certainty implies that the AER considers it appropriate for consumers, not DNSPs, to bear volume risk. The AER has recognised that shifting volume risk to customers is a "negative feature" of revenue caps. Consumers face price instability under a revenue cap, as prices must adjust annually to ensure exact revenue recovery. ActewAGL considers this to be a potentially significant problem, as discussed below.

On balance, a revenue cap is not superior to the current average revenue cap when assessed against the AER's factor "revenue recovery and volume risk".

Price instability

In the ACT preliminary positions paper the AER notes that AGL has submitted that "excessive price fluctuations of changes to the tariff structure under the revenue cap may be detrimental to consumers". In response the AER says:

Although the AER agrees with this view, it considers that price fluctuations could be mitigated through the form of the overs and unders account, including, potentially, the introduction of tolerance limits to the size of the overs and unders adjustment in any one year.²¹

The AER does not provide details on the tolerance limits it may apply. ActewAGL notes that tolerance limits would be a critical feature of a revenue cap, as they would affect the sharing of risks between consumers and DNSPs.

ActewAGL notes that in Tasmania, where Aurora's standard control services are regulated under a revenue cap, under recovery of revenue has been significant in recent years. In the 2012-17 determination the AER had to make a decision on how to adjust 2012-17 revenue to allow Aurora to recover \$52 million (\$2012/13) which was not recovered during the final two years of the 2007-12 regulatory period.²² The AER noted:

²⁰ The AER refers to possible "tolerance limits" on p. 46 of the ACT Preliminary Positions paper, but it does not elaborate.

²¹ AER 2012, *Preliminary Positions, Framework and approach paper*, ActewAGL, June, p. 46

²² AER 2012, *Tasmanian Distribution Determination, Final Decision*, Attachment 2, p. 7

*The under recovery is significant and, potentially, could have a substantial impact on prices in the forthcoming regulatory period.*²³

In the New South Wales preliminary positions paper the AER says:

In relation to a revenue cap, the AER is concerned with price instability within a regulatory control period caused by the overs and unders account. However, the AER's analysis shows that the magnitude of adjustments in the overs and unders account are minor²⁴

ActewAGL estimates show that if a revenue cap applied in the ACT over the past 8 years (that is, the previous regulatory period and the first 3 years of the current period), significant annual price adjustments would be necessary through the *unders and overs* account. The analysis also shows that prices would be more variable under the revenue cap than under the average revenue cap. Over the 8 year period, ActewAGL estimates that, under the average revenue cap, price changes averaged 7.4 per cent each year. Under the revenue cap, price changes would have averaged 9.3 per cent each year.

Contrary to the AER's view, ActewAGL considers that price instability is likely to be a significant issue under a revenue cap.

Incentives for efficient pricing

In the ACT preliminary positions paper the AER lists what it considers to be pricing incentives under average revenue caps: "reducing the price of price sensitive kWh services"; "reducing the availability of capacity management tariffs"; and "adding capacity to the network before its demand arises."²⁵

The AER does not examine the empirical evidence on pricing under an average revenue cap, nor does it address in detail ActewAGL's point, from the initial submission, that the pricing incentives under average revenue caps need to be considered in the context of the broader regulatory framework. In contrast, The AER does consider empirical evidence on pricing under WAPCs (in the New South Wales paper), and it does recognise the role of the pricing provisions in the NER as a factor mitigating the incentives for inefficient pricing under revenue caps.²⁶

²³ AER 2012, *Tasmanian Distribution Determination, Final Decision*, Attachment 2, p. 9

²⁴ AER 2012, *Preliminary Positions, Framework and approach paper*, Ausgrid, Endeavour Energy Essential Energy, June, p. 47

²⁵ AER 2012, *Preliminary Positions, Framework and approach paper*, ActewAGL, June, p. 44

²⁶ AER 2012, *Preliminary Positions, Framework and approach paper*, ActewAGL, June, p 53

Pricing outcomes under the ACT average revenue cap

In the NSW preliminary positions paper the AER refers to “the inefficient nature of energy based charges that are unrelated to the networks peak period and capacity”²⁷. The AER accepts that Ausgrid’s “restructuring of tariffs away from other energy charges (including flat, inclining block and off-peak/shoulder) towards peak, capacity and fixed charges” indicates “improved efficiency”²⁸.

ActewAGL’s network tariff structure has the features that the AER has identified as desirable. More than 50 per cent of the total load in the ACT is now subject to time-of-use or controlled load (off-peak) charges. For the non-residential sector, 80 per cent of the load is on time-of-use or controlled load tariffs. The application of maximum demand and capacity charges in several commercial tariff options has further strengthened price signals to customers and provided incentives to use the network more efficiently. Between 1999/00 and 2011/12, customers on the low voltage demand network tariff improved their load factor and therefore their utilisation of the network by 12.4 per cent, increasing the average energy consumed relative to the average of their monthly maximum demand from 40.1 per cent to 45.1 per cent. Over the same period, high voltage customers increased their load factor, and therefore their utilisation of the network, from 54.2 per cent to 61.0 per cent, an improvement of 12.6 per cent.

In the New South Wales preliminary positions paper, the AER analyses changes in revenue shares by tariff component for the Victorian and New South Wales DNSPs (other than Ausgrid) and concludes that the efficiency improvements shown by Ausgrid are not evident for the other DNSPs under WAPCs.

Compared with the New South Wales and Victorian DNSPs analysed by the AER, ActewAGL has a relatively high reliance on demand and capacity charges. Demand and capacity charges accounted for 24.3 per cent of ActewAGL’s revenue in 2011/12, compared with 19.5 per cent (2012/13) for Endeavour and Essential and 16.2 per cent in Victoria (2010), as reported by the AER.²⁹ Demand, time-of-use and fixed charges together accounted for 45.1 per cent of ActewAGL’s revenue in 2011/12, compared with 38.9 per cent (for fixed, peak and demand) for the New South Wales DNSPs (2012/13) and 39.2 per cent for the Victorian DNSPs (2010).

The AER’s concerns about inefficient pricing for some DNSPs under WAPCs are not relevant to ActewAGL’s pricing under an average revenue cap.

²⁷ AER 2012, *Preliminary Positions, Framework and approach paper, Ausgrid, Endeavour Energy Essential Energy*, June, p. 124

²⁸ AER 2012, *Preliminary Positions, Framework and approach paper, Ausgrid, Endeavour Energy Essential Energy*, June, p. 124

²⁹ AER 2012, *Preliminary Positions, Framework and approach paper, Ausgrid, Endeavour Energy Essential Energy*, June, pp 124-127

Other elements of the incentive regulation framework

A key reason why actual pricing and investment behaviour does not closely match the theoretical outcomes expected under each control mechanism is that the control mechanism is just one of part of the overall regulatory framework. Other elements including the pricing provisions in the NER, the expenditure factors in the Rule and the incentive mechanisms are also important influences on network pricing and investment.

For example, one of the three types of inefficient behaviour that the AER associates with average revenue caps is “adding capacity to the network before its demand arises.” ActewAGL believes that the AER’s application of the capital expenditure factors in the NER, together with prudent network planning and management practices, ensures that this does not happen. This is supported by the evidence from ActewAGL’s 2009-14 capex program, which the AER has approved as “appropriate and necessary”.³⁰ One of the major components of the program is the construction of two new zone substations, the first to be built in the ACT since 1994.

A further key element of the regulatory framework is the requirement to comply with the pricing principles and the pricing approval process. As the AER has noted in relation to pricing incentives under revenue caps:

*DNSPs do not have a strong underlying incentive to set efficient prices under the revenue cap. However, there are provisions in place under clause 6.18 of the NER requires the AER to consider the efficiency of tariff structures as part of the pricing approval process.*³¹

ActewAGL believes that this comment also applies the average revenue cap.

Incentives for demand side management

The comments above about the need to take account of other elements of the regulatory framework are particularly relevant in relation to incentives for demand side management. For example, the expenditure factors in the NER include the requirement for the AER to have regard to whether the DNSP considered or made provisions for non-network alternatives when assessing proposed expenditure. The AER’s demand management and embedded generation connection incentive scheme (DMEGCIS) is also intended to provide incentives for demand management, and it incorporates a revenue recovery component to take account of potential disincentives under some control mechanisms.

Through the *Power of Choice* review the AEMC is currently examining options for strengthening demand management incentives. A draft decision is expected to be released in September 2012. The AEMC’s final decision may not be released until after the AER has released its Framework

³⁰ AER 2008, *Australian Capital Territory Distribution Determination 2009/10 to 2013/14: Draft Decision*, December, p. xxi

³¹ AER 2012, *Preliminary Positions, Framework and approach paper*, ActewAGL, June, p. 53

and Approach final decision, which will determine the control mechanism to apply for the full 2014-19 regulatory period.

ActewAGL considers it is unreasonable to make a significant change to the control mechanism on the basis of theoretical shortcomings in relation to demand management incentives, particularly when there is no evidence of a problem, and other elements of the regulatory framework which are likely to have a more direct impact on demand management are currently under review by the AEMC and subject to potential change.

ActewAGL also notes that the AER says in the Preliminary Positions paper:

ActewAGL Distribution submitted that average revenue caps provide ‘very low’ incentives to undertake demand side management.³²

This is not correct. On the referenced page of its initial submission ActewAGL said that it disagrees with the AER’s comment that incentives are very low under average revenue caps.

Administration costs

In the ACT Preliminary Positions paper the AER says that it disagrees with ActewAGL’s initial submission that administration costs would be higher under a revenue cap than the current average revenue cap. ActewAGL maintains its position that there would be additional costs associated with a revenue cap which is based on forecast volumes and requires an annual unders and overs adjustment for differences between forecast and actual volumes.

The application of tolerance limits as part of the unders and overs mechanism would further add to administration costs, for both ActewAGL and the AER. While the AER raises the possibility of such limits, it does not elaborate. However, ActewAGL notes that tolerance limits apply in Queensland, where Ergon and Energex are subject to a three-tier limit. For example, if the under or over recovery in any year is greater than 5 per cent of the revenue requirement for that year, “the DNSP must submit a plan to the AER detailing how it intends to clear the balance of the DUOS unders and overs account”.³³ This type of requirement will result in higher administration costs compared with the average revenue cap.

Consistency across regulatory periods

The AER says in the ACT Preliminary Positions paper that it “proposes to place more weight on other relevant factors”. ActewAGL strongly disagrees with the AER’s approach to the consistency across regulatory periods factor, which is one of the factors listed in the NER. As discussed above, proper consideration of consistency across regulatory periods requires careful assessment of the likely costs and benefits of changing the current mechanism. ActewAGL

³² AER 2012, *Preliminary Positions, Framework and approach paper*, ActewAGL, June, p. 47

³³ AER 2010 *Queensland Distribution Determination, Final Decision*, May, p. 22

believes that the AER has not done this, and as a result it has taken a preliminary position which will result in significant costs ActewAGL and its customers, for no apparent benefit.

Consistency across jurisdictions

The AER says in the ACT Preliminary Positions paper that it “proposes to place more weight on other relevant factors”. ActewAGL believes this is appropriate, given that there is no clearly superior control mechanism.

Response to preliminary position on control mechanisms for alternative control services

The AER’s preliminary position on alternative control services would involve major changes for ActewAGL. Under the AER’s proposal, the current revenue cap for type 5 – 7 metering services would be replaced with a price cap mechanism, and price caps would also be introduced for the 5 new types of alternative control services—premises connection services, extensions, incidental connection services, fee based services and quoted services.

The AER has provided very little detail on the control mechanisms it intends to apply to its proposed alternative control services. The AER says:

The AER proposes to apply a price cap control mechanism to regulate all alternative control services for the next regulatory control period. The AER has not provided a preliminary position on the basis of control at this stage. However, the AER expects that quoted services will have a basis of control that would constitute a formula based approach rather than fixed prices.³⁴

The AER points out that, in accordance with the NER (clause 6.2.6), the basis of control is to be specified in the distribution determination. ActewAGL accepts this, but considers that the AER should provide further guidance, through the Framework and Approach process, on how it intends to apply the proposed price caps. Guidance on the basis of control—for example, how the initial prices will be set, whether and how a CPI–X price path will be set—is particularly important given that the proposed price caps would apply to 5 separate new services which are currently classified as standard control services and subject to an average revenue cap. Decisions on how the initial price caps are to be set will have a significant influence on ActewAGL’s regulatory proposal.

ActewAGL notes that the AER has in previous Framework and Approach decisions provided guidance on its intended basis for control—for example, whether initial prices would be based on a building block approach. In the Victorian Framework and Approach final decision, the AER explained that in some cases it would apply a “top down” approach to determining initial prices, while in others it would adopt a “bottom up” approach:

³⁴ AER 2012, *Preliminary Positions, Framework and approach paper, ActewAGL*, June, p. 42

A bottom up approach would require the DNSPs to submit cost build up information relating to each individual service. A top down approach would utilise historical audited regulatory account information to derive an appropriate escalation mechanism which will apply to existing prices.³⁵

As the AER notes in the Victorian decision, a bottom up approach to price setting is likely to involve higher costs for DNSPs. The costs of establishing and implementing the AER's proposed price caps should be a key consideration for the AER in determining the control mechanism for alternative control services.

The AER has also explained in previous Framework and Approach decisions that quoted services are subject to caps on unit prices, rather than final prices, recognising that the nature and scope of the services will vary widely. Final prices are determined by applying the unit rates to an approved formula. A review of some past AER determinations and annual pricing approvals indicates that the process of setting and reviewing the unit rates to be used in the formulae for quoted services is very complex.

ActewAGL notes that the AER seems to have misinterpreted comments ActewAGL made in response to the initial consultation paper on classification of services. The AER says in the ACT Preliminary Positions paper:

Fee based, quoted and connection services are currently regulated under the average revenue cap as standard control services. Given that the AER's preliminary position is to classify these as alternative control services, it has also proposed a more appropriate control mechanism to best suit each service type. In a submission to the AER, ActewAGL Distribution supported this view, noting that a light handed 'fee for service' approach would be more appropriate than the existing revenue cap. As a consequence, the AER's preliminary position is to apply a price cap to each type of service."³⁶

ActewAGL would like to clarify that its comment on a light handed fee for service relates to regulated metering services only, not to the other services that the AER is now proposing to classify as alternative control services.

Comments on control mechanisms for specific services are provided below.

Control mechanism for type 5 to 7 metering services

ActewAGL is keen to ensure that the metering control mechanism adopted by the AER avoids the problems inherent in the current revenue cap (for example by providing flexibility to respond to changing costs and changing demand for services during the period), but does not involve excessive administration costs or unnecessary complexity.

³⁵ AER 2010, *Framework and approach for Victorian electricity distribution regulation, Final Decision*, May, p. 80

³⁶ AER 2012, *Preliminary Positions, Framework and approach paper, ActewAGL*, June, p. 50

The AER's preliminary position is to apply price caps to ActewAGL Distribution's alternative control metering services. The AER has not provided details on how the caps would be applied – for example, how the initial prices would be set, how the price path would be set, and whether and there would be scope to change individual prices through the period to take account of changes in costs.

ActewAGL's preferred approach is to modify the existing mechanism to directly address the shortcomings of the current revenue cap. The preferred approach effectively involves setting a price cap for a basket of metering services rather than separate price caps for each service. ActewAGL considers that this approach provides flexibility for adjustments to relative prices during the period to respond to changing relative costs and removes the need for detailed assessments of underlying costs and changes in relative costs for each metering service.

Under ActewAGL's preferred approach, the initial schedule of prices would be set as it currently is, through a limited building block approach. An initial revenue cap would be set, based on the most recent set of actual quantities for each service. For the remainder of the period, ActewAGL would have flexibility to change relative prices, provided that the overall constraint of the original quantities times the proposed prices (escalated by CPI) is not breached. By basing the maximum allowed revenue on the fixed set of initial quantities, this approach avoids the problems that have arisen under the current revenue cap, whereby changes in quantities demanded during the period necessitate significant price changes.

Control mechanisms for fee-based and quoted services

ActewAGL's position is that these services should remain classified as standard control services, and therefore continue to be regulated under the average revenue cap.

If the AER adopts its preliminary classification of services and applies separate new control mechanisms for fee based and quoted services, ActewAGL urges the AER to adopt a light-handed approach, recognising the significant costs of implementing price caps based on a detailed *bottom up* approach or a detailed analysis of unit costs. Any benefits from changing the classification and control mechanism are likely to be very small, and outweighed by the costs of applying new price cap mechanisms.

Control mechanisms for connection services

ActewAGL's position is that basic and standard connection services, the cost of which have been recovered in DUOS charges should remain classified as standard control services, and therefore continue to be regulated under the average revenue cap and through the application of Chapter 5A.

If the AER does not accept ActewAGL's position, and retains its preliminary position that price caps should apply, ActewAGL believes that further consultation will be appropriate and necessary before the AER finalises its Framework and Approach decision. For example, the AER has indicated in the Preliminary Positions paper that it intends to apply price caps, rather than a

formula based approach, to connection services. However, the nature of “extensions”, whereby the scope of the service is likely to vary widely, means that a fixed price cap is unlikely to be appropriate.

ActewAGL also seeks consultation with the AER on how the proposed price caps for certain connection services can be reconciled with the requirements in chapter 5A.

4. Application of incentive schemes

Service target performance incentive scheme (STPIS)

AER preliminary positions

The AER's preliminary positions on the STPIS to apply for the 2014-19 ACT distribution determination are as follows:

- *Scheme components*—the reliability of supply and customer service components should apply. The quality of service component should not apply (as it is not applied as part of the national scheme). The guaranteed service level (GSL) component should not apply, given that a jurisdictional scheme is in place.
- *Parameters*—the reliability component of the service target performance incentive scheme (STPIS) should include unplanned SAIDI and unplanned SAIFI (no MAIFI), with feeders classified as urban or rural short. The customer service component should apply to telephone answering only.
- *Revenue at risk*—a maximum value for revenue at risk of ± 0.5 per cent will be attached to the telephone answering parameter. The maximum revenue at risk under the s-factor is ± 5 per cent of a DNSP's revenue for each year of the regulatory control period, but ActewAGL may propose an alternative value.
- *Incentive rates*—the incentive rates for the reliability component are to be calculated in accordance with the methodology set out in the national STPIS, however ActewAGL may propose an alternative method and values. The incentive rate for the telephone answering parameter is set by the national STPIS at minus 0.040.

ActewAGL response

ActewAGL agrees with the AER's preliminary position that only the *reliability of supply* and *customer service* components of the STPIS should apply in the 2014-19 ACT distribution determination. The *GSL* and *quality of supply* components should not apply.

For the *reliability of supply* component, we agree that the parameters should be *unplanned SAIDI* and *unplanned SAIFI*, with feeders classified as *urban or rural short*, targets based on the four years of data that ActewAGL will have provided at the time of the final determination, and exclusions as set out in the national STPIS.

For the *customer service* component, ActewAGL agrees that the only parameter should be *telephone answering*. We do not intend to propose the application of other customer service parameters.

ActewAGL is currently developing a proposal in relation to incentive rates for the *reliability of supply* component and potentially the *telephone answering* component of the scheme. ActewAGL notes that “DNSPs may propose an alternative VCR”³⁷ when proposing incentive rates and that the NER requires that the Commission “must take into account the willingness of the customer or end user to pay for improved performance in the delivery of services” when developing the STPIS.³⁸ In developing its proposal, ActewAGL will consider the results of expert studies into customer willingness to pay undertaken in the ACT by NERA Economic Consulting in 2003 and by the Australian National University in 2011. These studies employed state-of-the-art choice modelling techniques similar to those used by Ofgem³⁹ and the Electricity Authority of New Zealand.⁴⁰ ActewAGL will provide details of this research and the calculation of proposed incentive rates in the May 2013 regulatory proposal.

ActewAGL is also reviewing the revenue at risk under both the reliability component and the customer service component of the scheme, and will present its proposal in the May 2013 regulatory proposal.

Efficiency benefit sharing scheme (EBSS)

The AER’s ACT and New South Wales EBSS, released in February 2008, has applied to ActewAGL throughout the 2009-14 regulatory period. Under this scheme, financial rewards and penalties will apply from the start of the 2014-19 regulatory period.

The AER’s preliminary position is to apply the national EBSS to ActewAGL for the 2014-19 regulatory period.

ActewAGL agrees with the AER’s preliminary position that the national EBSS should apply in the ACT for the 2014-19 regulatory period.

DMEGCIS

The ACT and New South Wales Demand Management Incentive Scheme (DMIS), as set out in the AER’s November 2008 guideline, applies to ActewAGL for the 2009-14 regulatory period. Rule changes by the AEMC in December 2011 meant that some changes are required, to clarify the scope and application of the scheme. In a review process running in parallel with the Framework and Approach process, the AER has proposed some changes, including a name change to the

³⁷ AER 2012, *Preliminary Positions, Framework and approach paper*, ActewAGL, June, p. 64.

³⁸ NER Clause 6.6.2(b)(3)(vi)

³⁹ For example, Accent 2008, *Expectations of DNOs and willingness to pay for improvements in service*, Report prepared for OFGEM, July.

⁴⁰ Electricity Authority 2012, *Investigation into the value of lost load in New Zealand – Summary of findings*, available at: <http://www.ea.govt.nz/our-work/programmes/transmission-work/investigation-of-the-lost-load/>

demand management and embedded generation connection incentive scheme (DMEGCIS). ActewAGL has responded that it considers the AER's proposed changes are necessary and appropriate. In the consultation on the proposed DMEGCIS the AER has also indicated that further changes may be necessary, pending the outcome of the AEMC's *Power of Choice* review.

ActewAGL appreciates that the timing of the AEMC *Power of Choice* review has implications for the DMEGCIS. The final Framework and Approach paper is likely to be released before the final AEMC report is released. Any Rule changes arising from the AEMC's recommendations would likely not be finalized before the ACT and New South Wales regulatory proposals are due in May 2013.

ActewAGL understands that the AER may wish to consult with the ACT and New South Wales DNSPs on possible changes to the DMEGCIS after November 2012. We suggest that it would be helpful if the AER could, in the November Framework and Approach final decision, provide an indication of potential changes, based on the AEMC draft findings, which are scheduled to be released in September 2012.

5. Other matters

Dual function assets

ActewAGL owns, controls and operates 132 kV lines and associated network assets in its ACT electricity network that meet the definition of dual function assets in clause 6.24.2 of the NER. The assets acquired this status during the current regulatory period as a result of the commissioning of the second point of supply to the ACT at the recently completed TransGrid 330kV/132kV substation at Williamsdale following construction by ActewAGL of a 132 kV double circuit line between Williamsdale and ActewAGL's existing 132 kV network near Theodore.

In accordance with the requirements of Rule 6.25(a) of the NER, ActewAGL advised the AER by 30 June 2012 that it calculates the value ascribed to the DFA in its regulatory asset base (RAB) as at 1 July 2012 to be \$45.46 million.

For the purpose of the AER's consideration of this matter, ActewAGL advises that, for a period of several months in the near future while TransGrid upgrades its Canberra to Williamsdale line, ActewAGL's 132 kV network will provide replacement transmission capacity to Cooma from the TransGrid Canberra substation. On completion of this upgrade, the network will resume its continuing role operating in parallel to and in support of the upgraded TransGrid line. Studies show that, in normal operating conditions, power is expected flow from both bulk supply points (Canberra and Williamsdale substations) into the ActewAGL network. Only during infrequent outages of TransGrid's 330 kV Canberra to Williamsdale line will the ActewAGL network be used as the throughput path for power flowing from the Canberra Substation to Williamsdale Substation into NSW. Even so, it will continually provide a back up transmission service and avoid the need for additional investment in TransGrid's Canberra to Williamsdale 330 kV transmission service.

ActewAGL has programmed a significant project in the current (2009-14) regulatory period to upgrade the 132kV line between Gilmore and Theodore. This work is transmission asset related and currently in planning approval phase. In addition, ActewAGL is currently clarifying the operational and technical need to install revenue grade metering at each of the connection points between its 132kV sub-transmission network and the remainder of the distribution network. This requirement occurs as a result of the DFA being classified as transmission assets under chapter 3 of the NER, and the consequent requirement to register as a TNSP.

The criterion in the NER for determining how DFA should be regulated is:⁴¹

... whether the value of [the DNSP's] dual function assets which provide transmission standard control services comprise such a material proportion of [the DNSP's] regulatory

⁴¹ NER clause 6.25(b)

asset base that pricing in respect of those services should be regulated under Part J of Chapter 6A.

Among the matters the AER must consider is:⁴²

... whether regulating the pricing of the transmission standard control services ... will result in materially different prices for Distribution Customers

In ActewAGL's view, ACT consumers should not be required to pay for network costs occasioned by ActewAGL's role as a TNSP as a consequence of the connection of the second supply point to the ACT. These transmission based network costs include costs of new revenue metering and protection assets associated with the requirements of the network being classified as a transmission network under Chapter 3 of the NER and any additional requirements of a TNSP over those of a DNSP. The DFA will support transmission capacity to areas of South East NSW.

Cost allocation

The AER approved ActewAGL's existing Cost Allocation Method (CAM) on 31 March 2008 under the transitional Rules that apply to the 2009-14 regulatory period. In its final determination for the 2009-14 period, the AER concludes that ActewAGL's existing CAM does not comply with the AER cost allocation guidelines and therefore will need to be resubmitted for the forthcoming 2014-19 period.

ActewAGL intends to lodge its revised CAM in October, sufficiently in advance of the submission of its regulatory proposal to allow time for AER consideration and approval.

Assessment tools

In the Preliminary Positions paper, the AER says that it intends to use a suite of assessment tools in its review of ActewAGL's regulatory proposal. The AER describes two such assessment tools—the replacement expenditure model and the augmentation expenditure model. While we accept that in principle there may be a useful role for these tools when used as part of an overall assessment of regulatory proposals, we have a number of concerns about the practical application and detailed specification of the models. We have participated in initial workshops with the AER and had the opportunity to examine the models and believe that further consultation is required.

The AER has also indicated that, to collect information it needs to apply the models, it intends to issue regulatory proposal Regulatory Information Notices (RINs) "prior to the receipt of the regulatory proposal." ActewAGL believes that the AER must ensure that the RINs are finalised sufficiently early to allow ActewAGL Distribution to address all the requirements and incorporate the response in its regulatory proposal. We also re-iterate our point, made in previous responses

⁴² NER clause 6.25(c)

to draft RINs, that in developing its information requirements the AER must take account of the costs of meeting its requests, and weigh these against the likely benefits of the additional information it seeks.

Attachment 1: Revenue under ActewAGL's average revenue cap

Table 1: Elements of variation of actual revenue from regulated revenue requirement

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	Total
CPI (per cent)									
Forecast	1.70	1.80	2.60	3.00	2.50	2.47	2.47	2.47	
Actual	2.77	2.34	2.67	3.54	2.33	4.35	1.82	2.85	
Load (GWh)									
Forecast	2,615.30	2,654.50	2,693.80	2,733.00	2,772.20	2,932.86	2,916.01	2,907.58	22,225.3
Actual	2,641.63	2,777.95	2,819.82	2,830.05	2,872.92	2,895.88	2,910.93	2,889.16	22,638.3
Revenue (\$ m)									
Forecast cap*	95.07	98.22	102.26	106.86	111.11	139.97	148.31	157.60	959.39
Actual	98.72	102.91	108.95	119.30	121.36	141.32	149.27	158.07	999.91
Pass throughs	0.00	0.00	0.00	5.57	4.15	0.00	0.00	2.18	11.90
Actual less pass throughs	98.72	102.91	108.95	113.73	117.21	141.32	149.27	155.90	988.00
Difference: Actual less forecast									
(\$ m)	3.66	4.69	6.70	6.87	6.10	1.35	0.96	-1.70	28.62
(per cent)	3.8	4.8	6.5	6.4	5.5	1.0	0.6	-1.1	3.0
Difference due to CPI									
(\$ m)	1.07	1.65	1.78	2.43	2.33	2.57	1.77	2.46	16.06
(per cent)	1.1	1.7	1.7	2.3	2.1	1.8	1.2	1.6	1.7
Difference due to load									
(\$ m)	0.96	4.57	4.78	3.79	4.04	-1.77	-0.26	-1.00	15.12
(per cent)	1.0	4.7	4.7	3.6	3.6	-1.3	-0.2	-0.6	1.6
Difference due to other factors									
(\$ m)	1.63	-1.52	0.14	0.64	-0.27	0.54	-0.55	-3.16	-2.56
(per cent)	1.7	-1.6	0.1	0.6	-0.2	0.4	-0.4	-2.0	-0.3

* Forecast cap = MAAR x Forecast Load x Forecast CPI