Contact: Leigh Mayne
Phone no.: (03) 6271 6544
Our Ref: NW10285398

Your Ref:

15 May 2008

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Pattas

AER GUIDELINES, SCHEMES AND MODELS

Aurora is pleased to make a submission to the AER's proposed guidelines, schemes and models that were released on 1 April 2008 in relation to the following:

- Proposed Efficiency Benefit Sharing Scheme;
- Proposed Cost Allocation Guidelines;
- Proposed Service Target Performance Incentive Scheme;
- Proposed Roll Forward Model (RFM); and
- Proposed Post-tax Revenue Model.

Aurora would be pleased to discuss any of the issues raised in this submission with the AER. If you have any questions in relation to any of the matters raised, please contact me on the above telephone number.

Yours sincerely

Leigh Mayne
Network Regulation Manager

Aurora Energy Pty Ltd
GPO Box 191
Hobart Tasmania 7001
Network Division
177 Main Road
MOONAH TAS 7009
www.auroraenergy.com.au
ABN 85 082 464 622

Efficiency Benefit Sharing Scheme

Aurora provides the following comments in relation to the AER's proposed Efficiency Benefit Sharing Scheme (EBSS):

- Aurora considers that the AER should clarify the types of matters that the AER will address in its Framework and Approach paper under clause 6.8.1(b)(3) of the National Electricity Rules (Rules).

  Clause 6.8.1(b)(3) of the Rules requires the AER to set out its likely approach to the application of an efficiency benefit sharing scheme to the DNSP.

  Aurora requests that the AER provide an indication of the information that it proposes to include in its Framework and Approach paper and how that information will differ from that included in the Guidelines.

- Aurora considers that the AER should clarify the matters that a DNSP is required to include in its Regulatory Proposal under schedule 6.1.3(3) of the Rules.

  Schedule 6.1.3(3) of the Rules requires a DNSP's building block proposal to contain a description, including relevant explanatory material, of how the DNSP proposes the EBSS should apply for the relevant regulatory control period.

  Aurora requests that the AER provide an indication of the information that a DNSP is required to include in its building block proposal in relation to the EBSS.

- It is not clear to Aurora how the EBSS would accommodate changes in service classifications between regulatory control periods.

  Aurora notes that the EBSS applies to standard control services only. To the extent that services are classified differently between regulatory control periods, it is not clear if carry-over amounts from a previous regulatory control period will remain appropriate, or how any required revenue adjustments (as a result of services re-classifications) will be accommodated in the EBSS.

  Aurora suggest that the Guidelines include a provision that allows for a reassessment of carry-over amounts between regulatory control periods where there has been a change to service classifications.

- It is not clear whether the AER's proposed approach to the determination of forecast operating expenditure (based on expenditure in the second last year of a regulatory control period) is consistent with the requirements specified under clause 6.5.6 of the Rules.

  Clause 6.5.6(c) of the Rules states that the AER must accept a DNSP's operating expenditure forecast, provided the AER is satisfied that the expenditure reasonably reflects:

(1) the efficient costs of achieving the operating expenditure objectives; and

(2) the costs that a prudent operator in the circumstances of the DNSP would require to achieve the operating expenditure objectives; and

(3) a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives.

Aurora requests that the AER clarify its proposed approach to the assessment of a DNSP's forecast operating expenditure and explain if and how that approach is consistent with the requirements under clause 6.5.6(c) of the Rules.

Cost Allocation Guidelines

Aurora notes that clause 6.15.4 of the Rules requires a DNSP to provide its cost allocation method to the AER within 12 months after the commencement of the Rules (ie by January 2009). In Aurora's case this means that it will need to finalise its costs allocation method well before commencing detailed preparations for its Revenue Proposal. Similarly, this requirement means that Aurora will need to establish its distribution service classifications (in order to explain the allocation of costs to services within Aurora) well before it would otherwise be required to.

Aurora considers that this is an unreasonable requirement to place on Aurora and sees little benefit to the AER in receiving Aurora's cost allocation method at such an early stage. Accordingly, Aurora requests that it be exempt from the requirements of the Rules with respect to the provision of its cost allocation method and instead be allowed to provide its cost allocation method at a date more consistent with the provision of its regulatory proposal. Aurora proposes that it be permitted to discuss the details of this arrangement with the AER at a convenient time.

Aurora provides the following comments in relation to questions raised by the AER:

- *Q: Are the working assumptions used to prepare this discussion paper and the proposed guidelines appropriate?*

  Aurora requests that the Guidelines clarify the "cost" elements covered under the Guidelines. For example, Aurora queries what revenues; assets and liabilities will be subject to cost allocation.

- *Q: Is it possible to derive a single set of allocators applicable to all network service providers? If yes, would it be appropriate to do so?*

  Aurora agrees with the AER that "... the provision of relevant, reliable and consistent information within an individual regulated business over time is preferable to obtaining information that is strictly comparable between different regulated businesses at any point in time".

  Aurora is of the view that there are substantial differences between individual DNSPs, including geographic and operational differences, which inhibit the development of meaningful single set of cost allocators at this time.

- *Q: Should the regulated business or the AER select the allocators for shared costs?*

  Aurora agrees with the AER that the regulated business, rather than the AER, should select the specific allocators for shared costs. Aurora agrees that such an approach is preferable since it recognises the unique nature of each business and ensures that costs are allocated to reflect the underlying substance of transactions.

- *Q: Is there merit in the regulated businesses working together to produce a future industry standard for the attribution and allocation of costs?*

  Aurora sees little merit in seeking to produce an industry standard for the attribution and allocation of costs at this time. This reflects Aurora's view that significant differences exist between the operations of individual DNSPs.

  Aurora also believes that both the AER and DNSPs need to assess the impact of the practical application of the Rules and associated Guidelines before any meaningful discussion of an industry standard can proceed.

- *Q: Should cost allocation be allowed using the avoided cost method and, if so, under what circumstances should it be allowed?*

  Aurora notes that the jurisdictional regulator (the Office of the Tasmanian Energy Regulator) has approved the use of the avoided cost method by Aurora during the current regulatory period, and Aurora may seek to apply this method in future regulatory periods.

- *Q: Is it appropriate that the scope of the regulatory audit (as it relates to cost allocation) only assesses whether the costs have been appropriately attributed or allocated, not whether the allocators themselves are most suitable?*

  Aurora suggests that the regulatory audit (as it relates to cost allocation) should only deal with auditing the actual calculation of the allocators (eg to ensure that percentages, numbers associated with the allocator are correct) and the subsequent application of those allocators to costs.

  Aurora considers that the AER will determine the suitability or otherwise of allocators as part of its approval of a DNSP's cost allocation method. The auditor should therefore only ensure that the approved allocators have been appropriately applied.

Service Target Performance Incentive Scheme

Aurora wishes to reiterate its position presented in its original submission that an *S-factor* scheme is not the best approach in general and for Aurora in particular.

Aurora has a general concern that the comments in the STPIS Discussion paper are more lenient than the wording in the accompanying STPIS Guidelines, and discussion in the Discussion paper is not reflected in the Guidelines or the Rules.

Aurora provides the following comments in relation to questions raised by AER:

- *Q: The AER would like views on whether there is sufficient clarity in the proposed scheme, so that DNSPs can plan the actions they need to take to be able to comply with the scheme when it is implemented.*

  Aurora suggests that the proposed Scheme is not sufficiently clear. In particular, neither the Rules nor the Guidelines provide sufficient information as to how the process will actually apply; rather, both documents give vague, "policy-style" statements.

  Aurora notes that clause 6.8.1(b)(2) of the Rules requires the AER to set out its likely approach to the application of service target performance incentive scheme to the DNSP.

  - Aurora requests that the AER provide details of the information that it proposes to include in its Framework and Approach paper and how that information will differ from that included in the Guidelines.

  The Rules (schedule 6.1.3(4)) also require a DNSP to provide information in its building block proposal describing how the DNSP proposes the service target performance incentive scheme should apply for the regulatory control period

  - Aurora requests that the AER provide an indication of the material that a DNSP is expected to include in its proposal in response to this Rule requirement.

- *The AER has indicated that it included telephone answering in the customer service component of the service target performance incentive scheme.*

  Aurora does not support the inclusion of customer service measures proposed under sections 5.1(a) – (c) of the Guidelines in the Scheme. Aurora considers that measures such as telephone answering are a relatively minor component of a DNSP's activities and are not indicative of the level or quality of service that a customer receives. Aurora suggests that the inclusion of such measures in the Scheme be optional and at the discretion of an individual DNSP.

- *The AER would like views on the proposed inclusion of planned interruptions in the reliability measures.*

  Aurora sees merit in the continued reporting of planned interruptions, but proposes that planned interruptions be excluded from reliability reporting measures in the Scheme, on the basis that they are inconsistent with the incentive to maintain a reliable network. Further, Aurora considers that the AER's contention that "...planned interruptions only make up a small percentage of interruptions and therefore their inclusion would not have a big impact on the measure overall" is incorrect. In Aurora's experience, planned interruptions represent a significant proportion of total interruptions (for example, planned interruptions accounted for over 20 per cent of Aurora's total system interruptions in 2006-07).

  In relation to the reliability measures specified in Appendix A of the Guidelines (SAIDI, SAIFI and MAIFI), Aurora notes that it does not have a customer-to-asset link completed. Aurora therefore uses the analogous, "kVA connected" approach to calculating these indicators. Aurora is concerned that this approach is not permitted under the proposed STPIS. Aurora seeks the AER's guidance on this issue.

  Note 3 to the "Reliability Component" of Appendix A of the Guidelines states that "[i]nactive accounts are excluded" from the calculation of SAIDI, SAIFI and MAIFI. Aurora is unclear what these "inactive accounts" are referring to. Aurora is also concerned that this reference seems to imply a retail focus (as opposed to a distribution focus). Aurora suggests the AER clarify the focus of this section.

  Further, note 4 to the "Reliability Component" of Appendix A of the Guidelines states that "[s]ustained interruptions which occur when a recloser locks out after several attempts to reclose should be deleted from MAIFI calculations". Aurora considers this is the appropriate method but notes that management of the process will be difficult due to the limited ability to capture the necessary type of recloser data. Aurora suggests that the AER consider a progressive implementation of this measure.

- *Q: Is the mechanism proposed by the AER to balance the incentive to carry out network augmentation with non-network alternatives under the scheme sufficient? Are there any other mechanisms that the AER should put in place in this regard?*

  It is not clear how a mechanism to balance network augmentation with non-network alternatives would operate in practice. Aurora requests that the AER include details of the proposed operation in the Guidelines.

- *Q. The AER would like views on the proposed approaches for setting incentive rates for the reliability and customer service components of the scheme.*

  Aurora notes that the application of Victorian and South Australian "Willingness to Pay" may not reflect the characteristics of an individual DNSP's customer base, including variations with respect to customer demographics, growth rates and willingness to pay.

  It is not clear to Aurora whether the incentive rates in the Guidelines are set or can be proposed by a DNSP. Aurora suggests that a DNSP be allowed to propose alternative values where it can be demonstrated that these more appropriately reflect the DNSP's individual circumstances.

  Aurora suggests that the AER comment on the relationship between the value of customer reliability and the value of lost load (VoLL). In particular, the AER should provide comment on the significant differential (in dollar terms) between the value of customer reliability identified by the AER and the VoLL.

  Aurora is concerned that the proposed network types specified in the Guidelines (CBD, Urban and Rural) are inconsistent with those currently used in Tasmania. The Tasmanian distribution performance standards currently require Aurora to report network reliability on the basis of discrete communities. Aurora seeks the ability to continue to apply these measures as they have been developed jointly with the state government and the jurisdictional regulator to provide the appropriate balance between reliability costs and network performance.

  Aurora considers that if the Scheme should be introduced in Tasmania then it should be either a low powered Scheme or a paper trial for the initial regulatory period. This reflects Aurora's concern that it has no previous experience with the application of this type of performance incentive scheme.

- *Q. The AER would like views on its proposal to set the overall cap on the s-factor at 3% of revenue.*

  Aurora is uncertain how a 3% cap will interact with the EBSS-style carry forward. Aurora notes that in its previous incentive scheme the cap was set by the jurisdictional regulator at 1.6% maximum of the AARR.

- *Q. The AER would like views on its proposed revenue at risk for the customer service component and an individual parameter within the customer component.*

  Aurora does not believe customer service indicators should form part of the S-factor scheme.

Currently in Tasmania Aurora is required in accordance with its licence obligations to formally report on customer service indicators to the jurisdictional regulator quarterly. Moreover some aspects of customer service are covered in Aurora's customer charter and attract a payment should Aurora fail to meet its obligations under the charter.

- *Q. The AER would like views on the proposed scope of exclusions.*

The AER appears to have misunderstood Aurora's position in relation to exclusions. Aurora did not state that exclusions should be based on absolute severity; rather Aurora stated that the IEEE approach was inappropriate because it used relative severity - in particular, relative to the performance of the network in the previous 5 years which can lead to perverse results.

Aurora suggests that any exclusion regime should be aligned where necessary with existing reporting requirements in Tasmania and draw upon the experience with 2.5 beta in Tasmania.

Aurora is concerned that the proposed midnight to midnight timeframe applied to major event day events may limit the reporting of major event day events where these are split between 2 days. This is particularly true in instances where storms begin in the afternoon of one day and finish in the morning of the following day. Whist the single days (midnight to midnight) may not qualify as a major event day; the combined total for the days affected by the single event, is in almost all cases higher than the major event day threshold.

Aurora also suggests that Appendix D of the Guidelines clarify the frequency of recalculation of the major event day threshold.

- *Q. The AER would like views from stakeholders on the proposed s-bank mechanism.*

Aurora questions the AER decision to restrict the s-bank mechanism to one year. Aurora suggests that there be scope to extend the one year period in situations where side constraints on prices would otherwise be exceeded.

Further, Aurora seeks confirmation whether the DNSP has the discretion to determine whether, and to what value, the s-bank mechanism should be applied.

- *Q. The AER would like views on the proposed mechanism to align the scheme with the EBSS.*

Aurora supports the AER's proposal to align the retention period under the STPIS with that applying under the EBSS.

- *Q. The AER would like views on the proposed timing of the incentive and the impact of requiring all reporting on a calendar year as proposed.*

Section 6.9.4 indicates that Tasmania's regulatory periods are aligned with calendar years - Aurora notes that this is no longer the case.

Aurora is currently required to provide its regulatory reporting on a financial year basis. While it is possible for Aurora to report on a calendar basis, such reporting is likely to entail substantial administrative costs both in terms of the modification of the current data capture process and the potential for dual reporting of information to support jurisdictional requirements and the requirements of the AER.

- *Q. The AER seeks views on the parameters, threshold levels, payment amounts and exclusion criteria in the GSL component of the proposed STPIS.*

The AER states that "...where a jurisdictional GSL scheme is already in place, the GSL component of the AER's scheme will not apply to a DNSP". Aurora notes that it currently operates under a jurisdictional GSL scheme and supports the AER's proposal not to apply an additional GSL requirement.

Notwithstanding the existence of Aurora's current GSL arrangements, Aurora provides the following comments:

- The proposed GSL scheme appears to be uncapped. This represents an unacceptable liability, especially if GSLs are considered to be an operating cost and therefore subject to the EBSS;
- Thresholds for GSLs (set out in section 6.3.1(a) of the Guidelines) are based upon the classification of the feeders to which customers are attached. These definitions are based upon feeder load density, according to Appendix A of the Guidelines. Aurora is unclear whether this means that a customer's GSL threshold will vary up and down with load density on the feeder. In addition, Aurora seeks clarification as to when the feeder load density is to be calculated;
- Section 6.3.2(g)(1) of the Guidelines states that "(a) DNSP must make GSL payments by...applying a credit to the customer's account." Aurora suggests that the AER clarify whether this refers to the customer's account with a retailer. Aurora considers this is the case, since DNSPs will not maintain individual customer accounts; and
- Aurora suggests that the AER clarify the frequency of GSL payments proposed in the Guidelines. The Guidelines are not clear as to whether the payments are to be made annually (ie once a year) or when the trigger event occurs that qualifies a customer for a payment.

Roll-Forward Model

Aurora provides the following comments in relation to the AER's proposed Roll-forward Model (RFM):

- Aurora notes that the roll forward model represents a departure from the current roll-forward methodology applied by the Office of the Tasmanian Energy Regulator. Aurora draws the AER's attention to previous correspondence between the Tasmanian Minister for Energy and the AER concerning the regulatory treatment of additional capital expenditure by Aurora during the current regulatory period (AER correspondence dated 8 January 2008). Aurora requests that the AER specifically address this correspondence in determining Aurora's regulatory asset base for the next regulatory control period. Aurora will discuss this matter further with the AER at a convenient time.
- Aurora seeks clarification of the asset classes permitted to be used in the RFM. In particular, Aurora seeks to confirm whether the DNSP should use the asset classes that were set out in the relevant Determination for the current regulatory period, asset classes nominated by the AER, the actual asset classes used by Aurora during the current regulatory period, or the asset classes that Aurora proposing to apply in the next regulatory control period.
- While Aurora sees little merit in modifying the generic models to incorporate 50 asset classes, Aurora suggests that the number of asset classes should be sufficiently large to accommodate the requirements of individual DNSPs. In the case of Aurora, 30 asset classes is considered reasonable.
- The Guidelines indicate that the RFM and PTRM require assets to be grouped according to common lives.

  Aurora notes that the proposed grouping of assets by common lives is inconsistent with current regulatory practice and does not support the proposal. Rather, Aurora suggests that assets should continue to be group on the basis of function.

Post-tax Revenue Model

- Aurora seeks further information from the AER on how the AER intends to transition Aurora from the current pre-tax calculation of revenue to a post-tax approach.