

Framework and Approach Paper

Response
to
AER Preliminary Positions

August 2010

CONTACT

This document is the responsibility of the Commercial Management Group within the Network Division of Aurora Energy Pty Ltd (ABN 85 082 464 622). Please contact the indicated owner of the document with any queries or suggestions.

REVIEW DATE

This document will not undertake any review post its submission to the Australian Energy Regulator

RESPONSIBILITIES

DOCUMENT OWNER

*Mr Leigh Mayne
Aurora Energy Pty Ltd
177 Main Road
Moonah TAS 7009
Phone: (03) 6271 6544
email: leigh.mayne@auroraenergy.com.au*

IMPLEMENTATION

Commercial Management – Commercial Team

DOCUMENT MANAGEMENT

Commercial Management – Commercial Team

DISCLAIMER

This document is for generating internal and external information belonging to Aurora Energy acting in its capacity as a Distribution Network Service Provider in the state of Tasmania only and it may or may not contain all available information on the subject matter this document purports to address

To the maximum extent permitted by law, Aurora Energy makes no representation or warranty (express or implied) as to the accuracy, reliability, or completeness of the information contained in this document, or its suitability for any intended purpose. Aurora Energy (which, for the purposes of this disclaimer, includes all of its related bodies corporate, its officers, employees, contractors, agents and consultants, and those of its bodies corporate) shall have no liability for any loss or damage (be it direct or indirect, including liability by reason of negligence or negligent misstatement) for any statements, opinions, information or matter (expressed or implied) arising out of, contained in, or derived from, or for any omissions from, the information in this document.

AURORA ENERGY PTY LTD

Response to AER Framework & Approach Preliminary Positions

Version History

Version No	Date of Revision	Authorised By	Details of Amendment
1.0	July 2010	Network Regulation Manager	Initial Version
1.1	August 2010	Group Manager – Commercial Management	Final Version
2.0	August 2010	General Manager - Network	Approved for submission

Amendments to each version of this document will be tracked through Aurora's document management system.

CONTENTS

1. Overview.....	1
2. Summary Position	2
2.1. Classification of Services	2
2.2. Control Mechanisms	3
2.3. Efficiency Benefit Sharing Scheme	3
2.4. Service Target Performance Incentive Scheme	4
2.5. Demand Management Incentive Scheme	4
3. Classification of Services	5
3.1. Standard Network Services	5
3.2. Non-Standard Network Services	7
3.3. Metering Services	7
3.3.1. Type 1-4 Metering Services	8
3.3.2. Type 5, 6 & 7 Metering Services	9
3.3.3. PAYG Metering Services	11
3.4. Public Lighting Services	13
3.5. Fee Based Services.....	14
3.6. Connection Services	16
3.6.1. Standard Connection Services.....	16
3.6.2. Connection Services requiring Augmentation.....	17
3.7. Aurora’s Response to the AER’s Preliminary Position on Service Classification	18
4. Control Mechanisms	20
4.1. Standard Control Services.....	21
4.2. Alternative Control Services	22
4.3. Aurora’s Response to the AER’s Preliminary Position on Control Mechanisms	24
5. Service Target Performance Incentive Scheme.....	25
5.1. Revenue at Risk	27
5.2. Reliability of Supply Component	28
5.3. Performance Targets	28
5.4. Value of Customer Reliability VCR	29
5.5. Exclusions	29
5.5.1. Major Event Day	29

5.6.	GSL Scheme	30
5.7.	Telephone Answering Parameter	30
6.	Efficiency Benefit Sharing Scheme	31
6.1.	Aurora Position	32
7.	Demand Management Incentive Scheme	33

1. Overview

Aurora Energy Pty Ltd (Aurora) is a Tasmanian Government owned electricity distribution, generation and retail company. It was formed in July 1998 pursuant to the Electricity Companies Act 1997 and incorporated under the Corporations Law. It has two shareholders, the Minister for Energy and the Treasurer.

As the monopoly provider of distribution services within the Tasmanian jurisdiction, Aurora is required to hold a distribution licence in accordance with the Electricity Supply Industry Act 1995 (ESI Act). This licence was issued in December 1998 and authorises Aurora to distribute electricity on mainland Tasmania subject to certain conditions and regulatory controls.

The Office of the Tasmanian Economic Regulator (OTTER) currently undertakes the regulation of distribution services within the Tasmanian jurisdiction. A key component of this jurisdictional regulation is the review and monitoring of the economic framework that will apply to the regulated businesses within the jurisdiction.

The Australian Energy Regulator (AER) will in future undertake the regulation of this economic framework in accordance with the provisions of the National Electricity Law (NEL) and the National Electricity Rules (NER).

Under this economic framework the AER is required to investigate the prices for the provision of distribution services in accordance with Chapter 6 of the NER. This Pricing Investigation commences with the release of the AER's preliminary positions regarding the Framework and Approach that will be adopted for the investigation. The investigation culminates in the release of a Pricing Determination that outlines the maximum allowable revenues, or prices, that Aurora may earn for the provision of regulated distribution services for the Regulatory Control Period.

The AER released its preliminary positions on classification, form of control, approach to cost allocation and application of schemes and other matters that would apply to Aurora in June 2010 and sought comment on these preliminary positions, with submissions due to the AER by 9 August 2010.

Aurora's response to these preliminary positions is summarised below and discussed in detail in the remainder of this submission.

2. Summary Position

Aurora welcomes the opportunity to engage with the AER on its preliminary positions regarding the Framework and Approach that will apply to Aurora and provides the following comments on the AER's preliminary positions.

2.1. Classification of Services

The AER's preliminary position is to classify:

- Certain declared distribution network services as standard control services, with all of these services being grouped as network services.
- Connection services (excluding customer contributions) as standard control services.
- Certain metering services, public lighting services and special distribution services as alternative control services, with the services grouped in the following way:
 - metering services;
 - public lighting services; and
 - fee based services.

Aurora agrees with the AER's proposed classification of declared distribution network services and connection services as standard control services.

Aurora agrees with the AER's proposed classification of metering services as alternative control services.

Aurora has held reservations concerning the possible classification of public lighting services, believing that the current treatment as unregulated remained appropriate for provision of all public lighting services. Based upon its own analysis and that of the AER, Aurora now accepts that the proposed choice of classification is the most appropriate form of classification and that public lighting services should be classified as a direct control services.

Aurora agrees with the AER's proposed classification of all fee based services as alternative control services.

The AER proposes not to classify the following distribution services:

- pay-as-you-go (PAYG) metering services; and
- non-standard or quoted services.

Whilst Aurora principally agrees with the AER's decision not to classify the provision of PAYG metering services; Aurora believes this decision should be limited to only those PAYG metering services that are provided by Aurora Retail.

Aurora agrees with the AER's decision not to classify the provision of non-standard services.

2.2. Control Mechanisms

The AER's preliminary position is to apply a revenue cap form of control to standard control services and connection services.

Aurora agrees with the AER's proposed control mechanism for standard control services and welcomes the retention of the mechanism that was previously applied by OTTER in past Aurora pricing determinations.

The AER's preliminary position is to apply a price cap form of control to those services the AER propose to classify as alternative control services. In particular the AER proposes to:

- retain the current control mechanism for metering services and the reference set of special services;
- incorporate other special services into the price cap form of control for the reference set of special services; and
- establish a price cap form of control for public lighting services.

Aurora agrees with the AER's proposed control mechanism for the reference set of special services and welcomes the retention of the mechanism that was previously applied by OTTER in the last Aurora pricing determination.

Aurora also agrees with the AER's proposal to incorporate all other special services into the reference set of special services. Aurora's current methodology for the calculation of these charges is consistent with a price cap and Aurora looks forward to working with the AER on the establishment of an appropriate mechanism for these 'additional' services.

Aurora agrees that the AER's proposed price cap control mechanism for public lighting services is appropriate.

2.3. Efficiency Benefit Sharing Scheme

The AER propose to apply the AER's efficiency benefit sharing scheme (EBSS) to Aurora in the forthcoming Regulatory Control Period. The AER also proposes that direct financial impact from the scheme will not apply until the Regulatory Control Period commencing in 2017.

OTTER considered the implementation of an efficiency benefit scheme during the 2008 – 2012 pricing investigation and determined that such a scheme was not appropriate to the Tasmanian jurisdiction.

Aurora agrees with the AER's proposal for the introduction of an EBSS to Aurora and looks forward to further discussion with the AER on the workings of the proposed EBSS.

2.4. Service Target Performance Incentive Scheme

The AER propose to apply a service target performance incentive scheme (STPIS) to Aurora and to utilise the network segments developed by OTTER as part of that scheme. The AER also propose that the OTTER guaranteed service level (GSL) scheme would remain in force, as OTTER have not indicated an intention to repeal the current jurisdictional GSL scheme.

In its 2007 Determination OTTER concluded not to apply a 'standard' S-Factor scheme in the Tasmanian jurisdiction and instead incorporated its service performance incentives within the application of the OTTER GSL scheme and the 2007 Pricing Determination.

Aurora is concerned that the application of the AER STPIS, in conjunction with the OTTER GSL scheme will result in an unwarranted impost on Aurora and that the workings of both schemes may in fact impose conflicting drivers on Aurora regarding the implementation of reliability outcomes.

While Aurora does not agree the STPIS is necessary to deliver a supply in accordance with the TEC, Aurora supports the AER's intentions to apply the STPIS using the five Category Classifications defined in the TEC.

Aurora therefore wishes to further discuss the workings of the AER's proposed STPIS and may propose an alternative scheme as part of its regulatory proposal to the AER in May 2011.

2.5. Demand Management Incentive Scheme

The AER proposes to apply a demand management incentive scheme (DMIS) to Aurora in the form of a demand management innovation allowance (DMIA). The AER further propose that the DMIA will be set at \$400,000 per annum.

Aurora supports the introduction of a DMIS within the Tasmanian jurisdiction. However investment in innovation is not a scale issue and Aurora believes that an annual DMIA of \$1,000,000 would be more appropriate.

Aurora looks forward to working with the AER on the implementation of the DMIS.

3. Classification of Services

This chapter sets out Aurora's response to the AER's proposed approach to the classification of the distribution services that are provided by Aurora. The AER can choose to classify the provision of distribution services as either direct control services or negotiated services. The AER must further define direct control services as either standard or alternative control services. Those services that the AER does not classify are unregulated.

In Aurora's case the AER has chosen to classify the majority of the distribution services provided by Aurora as direct control.

In accordance with the NER, the AER must, in classifying a distribution service, have regard to:

- the form of regulation factors; and
- the form of regulation (if any) previously applicable to the relevant service or services and, in particular, any previous classification under the present system of classification or under the previous regulatory system (as the case requires); and
- the desirability of consistency in the form of regulation for similar services (both within and beyond the relevant jurisdiction); and
- any other relevant factor.

3.1. Standard Network Services

The AER, having regard for the requirements of Clause 6.2.1 of the NER, considers that network services should be classified as direct control services. The AER further considers that there is no basis to move away from the presumption that standard network services should be classified as standard control services.

Aurora concurs with the assessment of the AER and agrees with the classification of standard network services as direct control, standard control services.

Aurora's legislated monopoly to undertake network services is derived from:

- Section 17 of the ESI Act, which requires that a person must not carry on operations in the electricity supply industry including in relation to distributing electricity unless the person holds a licence;

- Clause 1.1 of Aurora's electricity distribution licence, which grants Aurora a licence to distribute electricity over the authorised distribution network set out in Schedule 1 – Part 1 of its licence; and
- Section 109(1) of the ESI Act prevents any unauthorised persons from interfering with Aurora's electricity infrastructure or electrical installations.

As it is the only entity empowered to distribute electricity over the authorised distribution network and the only party authorised to perform work on the network, only Aurora can provide network services in relation to the network area.

Accordingly, network services should be classified as direct control services because:

- there are very high barriers to entry for any other party providing network services to users on Aurora's network. The licensing requirements mean that Aurora is the only party that can provide network services using Aurora's assets within the distribution area;
- there is little likelihood of another party building a different network to service the same area as Aurora;
- it is very difficult to isolate the incremental or stand alone costs for individual users of network services, because these services are provided by a shared network with indivisible usage; and
- while there are large customers using the network, these customers have limited ability to exert substantial market power in negotiation of network services because:
 - no single customer contributes a significant proportion of the costs of the shared network in revenue; and
 - the possibilities for a customer to by-pass the network or seek substitutes for the supply of electricity are limited.

The AER proposal to classify network services as direct control services is consistent with:

- OTTER's current regulation of these services; and
- the classification of this type of service in other jurisdictions.

Aurora agrees that these services should be further classified as standard control services because:

- there is neither actual, nor potential for the development of, competition for the supply of network services on Aurora's network;

- this is consistent with OTTER's current treatment of Aurora's network services, and with the classification of these services in NEM jurisdictions;
- the costs of providing network services are not directly attributable to individual customers, and involve allocations of shared and overhead costs; and
- none of the other classification criteria are relevant for the purposes of this assessment.

3.2. Non-Standard Network Services

The AER considers that non-standard network services should be unregulated.

Aurora concurs with the assessment of the AER and agrees that non-standard network services should be unregulated.

Aurora provides a range of services to customers that are either in excess of, or alternate to, those provided as part of the standard network service. The nature and scope of these services are specific to individual customer's needs, and therefore the cost of providing the services cannot be estimated without first understanding the customer's requirements. This means Aurora must set individual prices for these services after they have been requested. It would not be appropriate to set a generic fixed total fee in advance for the provision of these types of services.

As the provision of these services by Aurora is 'in excess' of any service that is delivered with the standard network service and are specific to each customer, the customer is in the best position to ascertain if the standard network service would provide the required level of service. If the customer believes the standard network service is inappropriate, they will need to make an assessment of the best mechanism that will deliver the required level of service. This assessment may in fact result in a service provision that is not delivered by Aurora.

The AER's proposal to not classify non-standard network services is also consistent with the past practice of OTTER.

3.3. Metering Services

The AER considers that metering services should be classified as direct control services. The AER further considers that there is no basis to move away from the presumption that standard metering services should be classified as alternative control services.

Aurora concurs with the assessment of the AER and agrees with the classification of standard metering services as direct control, alternative control services.

The AER considers that all PAYG should be unregulated.

Aurora is concerned that the AER's proposal to not regulate the provision of all PAYG metering services may in fact capture a number of meters that Aurora considers should be treated as standard metering services. Aurora does however concur that PAYG metering services provided by Aurora Retail should not be regulated as they are not provided by Aurora acting in its capacity as a DNSP.

The provision of metering services within the Tasmanian jurisdiction can be divided into three distinct categories, being the provision of:

- type 1-4 metering services;
- type 5, 6 and 7 metering services; and
- PAYG metering services by Aurora Retail.

These are discussed in detail below.

3.3.1. Type 1-4 Metering Services

The introduction of retail competition within the Tasmanian jurisdiction has meant that all type 1-4 metering services (as defined by the NER) are now only provided to contestable customers. This has meant that, in accordance with the NER, Aurora is not the responsible person for the provision of these services and they may be sourced from any accredited metering services provider.

Whilst it is true that Aurora may, and does, provide type 1-4 metering services to a number of customers and retailers; the provision of these services is fully competitive and the customer or retailer may choose any accredited provider for this service.

Aurora agrees that these services should not be regulated because:

- there is full competition for the supply of type 1-4 metering services;
- this is consistent with OTTER's current treatment of Aurora's type 1-4 metering services, and with the classification of these services in NEM jurisdictions; and
- the costs of providing type 1-4 metering services are directly attributable to individual customers.

3.3.2. Type 5, 6 & 7 Metering Services

In accordance with Clause 7.2.3(a)(2) of the NER, the local network service provider is responsible for the provision of type 5, 6 and 7 metering services. This provision confirms that Aurora is therefore the only entity able to provide type 5, 6 or 7 metering services within the Tasmanian jurisdiction.

This means that, in a practical sense, Aurora does not negotiate with customers or retailers in the provision of these services. It also means that there is no real competitive or substitution possibilities for metering services given that Aurora has a monopoly to provide these services.

Type 5, 6 or 7 metering services are provided by Aurora on a standard basis to all customers. These services can therefore be termed standard metering services.

In reference to the form of regulation factors, standard metering services should be classified as direct control services based on the existence of:

- high barriers to a new entrant competing with Aurora to provide ancillary metering services within its existing supply area given the existing position of Aurora as the Metering Provider;
- network externalities given that Aurora can use factors of production that relate to its shared network to provide metering services. Specifically, Aurora can use the same assets, labour and materials to provide metering services and network services;
- no material opportunities for customers to exert countervailing market power in relation to ancillary metering services given that:
 - customers do not always initiate the service – different metering services can be initiated by a retailer, a DNSP or a customer; and
 - these services are sought infrequently by customers, are individually relatively low cost to provide and customers do not generally purchase more than one service at a time or aggregate their purchases with other customers.

There are also significant asymmetries between Aurora's knowledge of its costs, services, infrastructure and market in the supply of metering services and that of its customers. This is because Aurora is the monopoly supplier and customers tend to seek these services relatively infrequently.

The AER's proposal to classify metering services as direct control services is consistent with:

- OTTER's current treatment of Aurora's metering services as regulated services. These services are classified as metering services and are subject to a revenue cap control mechanism; and
- other NEM jurisdictions where standard metering services are treated as regulated services.

In their previous determinations OTTER have always chosen to classify metering services as direct control services.

The AER proposal to classify standard metering services as direct control services is consistent with:

- OTTER's current regulation of these services; and
- the classification of this type of service in other jurisdictions.

The provision of standard metering services as a direct control services will also require a further classification into either standard or alternative control services.

In the information paper previously provided to the AER, Aurora contended that standard metering services should be classified as standard control services for the following reasons:

- there is neither competition nor the potential for the development of competition for these services. The ESI Act and the NER would need to be amended in order for any other party than Aurora to provide these services in relation to Aurora's assets;
- the classification of Aurora's standard metering services as a standard control service would not impede a new entrant from providing these services in competition with Aurora. This is because without legislative amendments, no other person can provide metering services on Aurora's network;
- classifying standard metering services as standard control services will involve no significant change in administrative costs for Aurora and the AER. The treatment is consistent with OTTER's current treatment of Aurora's standard metering services as regulated distribution services;
- a review of the interstate treatment of metering services indicates that standard metering services are classified in a similar way in other jurisdictions; and

- although the costs of providing metering services are in the main directly attributable to customers, and involve limited allocations of shared and overhead costs, this is not considered to outweigh the assessment against the other criteria. This is especially the case given that Aurora is the only party that can currently provide these services and that changes would need to be made to legislation and the NER in order to enable competition.

Whilst both Aurora and the AER agree that standard metering services should be classified as direct control services there is some contention as to whether these services should be further classified as either standard or alternative control services.

It is important that the previous classification of standard metering services by OTTER is therefore considered to ascertain if a consistent approach has been adopted.

OTTER have always treated the classification of Aurora's metering services in a manner different to other distribution services. In their 2003 Determination OTTER chose to treat the provision of metering services as an alternative control service and set a revenue cap for the provision of standard metering services. Again, in their 2007 Determination OTTER chose to treat the provision of metering services as an alternative control service and set a price cap on the provision of these services.

During the previous determinations OTTER has consistently applied the utilisation of an individual price cap for the type of metering service provided. In the 2003 Determination OTTER arrived at the maximum allowable revenue for metering service by multiplying the number of meters in each category by a fixed price per service. In their 2007 Determination OTTER further refined this methodology to remove the revenue cap component of the calculation and simply set a price cap for the provision of each category of standard metering services.

It is apparent that OTTER's intention for the provision of metering services was to treat them as an alternative control service and set a price cap for the provision of the service. Aurora therefore agrees with the AER position to treat standard metering services as alternative control services.

3.3.3. PAYG Metering Services

Pay as you go metering is a product provided by Aurora in its capacity as a licensed retailer (Aurora Retail), whereby customers do not receive an electricity account but instead utilise a recharge card to update the credit facility within the metering equipment. Aurora currently has just over 40,000 of its customers using this facility.

The provision of metering services for the PAYG product can be split into two distinct types:

- those where the metering service is provided by Aurora Retail; and
- those where the metering service is provided by Aurora in its capacity as a licensed network service provider (Aurora Network).

Where Aurora Retail provides the metering service, the meter encompasses the entire product including the recording of energy consumption and the card reading facility and credit management. Where Aurora Network provides the metering service, the meter records energy consumption and a separate Payguard unit is provided by Aurora Retail to accommodate the card reading facility and credit management.

It is planned that all PAYG customers will have a standard electronic meter installed by Aurora Network and a Payguard unit installed by Aurora Retail, or another licensed retailer should contestability extend to all customers.

The adoption of this technology ensures that Aurora (as DNSP) meets the obligations within the NER to provide type 5, 6 or 7 metering services. The meter will not be removed should a customer choose to move away from the PAYG product as currently occurs with the Aurora Retail provided meter. Existing Aurora Retail PAYG meters that fail or do not meet compliance are to be replaced with a standard meter and Payguard unit.

The AER's proposal is to not regulate all PAYG metering services. Aurora contends that the PAYG metering services provided by Aurora (as DNSP) are in fact standard metering services (a standard meter is provided that is not linked to the PAYG product) and that the metering services provided are a direct control service in accordance with the proposed classifications for standard metering services. Aurora agrees with the AER that all PAYG metering provided by Aurora Retail should not be regulated as it is not a standard metering service and is not provided by Aurora in its capacity as a DNSP.

Aurora therefore proposes that the AER classify those meters provided by Aurora Network that provide the retail PAYG product via a standard meter and a retailer provided Payguard unit as direct control, alternative control and that those meters that are provided by Aurora Retail as a complete unit are not regulated.

3.4. Public Lighting Services

The AER considers that it is appropriate to depart from the current unregulated approach to public lighting services in Tasmania. The AER's preliminary position is therefore to classify public lighting services as direct control services and further classify them as alternative control services.

Aurora concurs with the assessment of the AER and agrees with the classification of public lighting services as direct control, alternative control services.

While Aurora does not have a legislated monopoly to undertake the repair, replacement and maintenance of public lighting in general, it is obliged under Section 8.2.3 of the TEC to repair or replace an item of public lighting within 7 business days of being notified by any person that such repair or replacement is necessary, unless the public lighting provider has contractual or other arrangements with another party.

In reference to the form of regulation factors, all of the public lighting services should be classified as direct control services based on the existence of:

- high barriers to entry in relation to the repair, replacement and maintenance of public lighting and the alteration and relocation of existing public lighting assets. Aurora owns these assets and there is a legislative prohibition on unauthorised persons interfering with Aurora's network;
- high barriers to entry for services provided on third party assets by virtue of externalities from Aurora's provision of other services. In particular, Aurora can use the same assets, labour and materials to provide public lighting services on its own public lighting assets as for those owned by third parties; and
- no real competitive or substitution possibilities for these public lighting services given that the market for the provision of public lighting services in Tasmania is underdeveloped.

While classifying public lighting services as direct control services is not consistent with the current treatment of these services by OTTER, the definition of these services as distribution services under the NER means that these services are subject to regulation by the AER.

The classification of public lighting services as direct control services is consistent with the AER's classification of these services in Queensland and the AER's classification of repair, replacement and maintenance of public lighting and the alteration and relocation of existing public lighting assets in Victoria.

Aurora agrees that public lighting services should be further classified as alternative control services because:

- the classification of these services as alternative control services would not, of itself, impede a new entrant from providing these services in competition with Aurora in the future;
- this proposed classification would be in line with the way in which these services are classified in NEM jurisdictions; and
- the costs of providing the service can be directly attributed to individual customers.

3.5. Fee Based Services

Aurora provides a range of services on a fixed fee basis to retailers and customers. These services are generally homogenous in nature and scope and therefore a fixed fee can be set in advance for the provision of these services.

These services were considered by OTTER in its Special Services Pricing Determination and were separated into two types of service:

- standard special services (also known as the “reference set”); and
- miscellaneous special services (also known as “other distribution special services”).

The AER considers that the reference set of fee based services should be classified as direct control services and, in turn, as alternative control services. The AER also considers that other distribution special services that fall outside of the reference set of services should also be classified as direct control services, and in turn, as alternative control services.

Aurora concurs with the assessment of the AER regarding the reference set of fee based services and agrees with the classification of these services as direct control, alternative control services. Aurora also concurs with the assessment of the AER regarding other distribution special services and agrees with the classification of these services as direct control, alternative control services.

With reference to the form of regulation factors, fee based services should be classified as direct control services based on the existence of:

- high barriers to a new entrant competing with Aurora to provide fee based services on Aurora’s assets within its existing supply area given the licensing requirements and the existing provisions of the Act;

- network externalities given that Aurora can use factors of production that relate to its shared network to provide fee based services on its own assets. Specifically, Aurora can use the same assets, labour and materials to provide fee based services and network services;
- no real opportunities for customers to exert countervailing market power because, even though customers can define the nature of the service that is required, the service will still be delivered by Aurora using its assets and will be in relation to its distribution network. This means that only Aurora can provide these services and therefore, in a practical sense, it does not negotiate with customers in the provision of fee based services; and
- no real competitive or substitution possibilities for fee based services given that it is an offence for any other party than Aurora to interfere with Aurora's distribution network.

There are also significant asymmetries between Aurora's knowledge of its costs, services, infrastructure and market in the supply of quoted services and that of its customers. This is because Aurora is the monopoly supplier and customers tend to seek these services relatively infrequently.

The proposal to classify fee based services as direct control services is consistent with:

- OTTER's current treatment of Aurora's fee based services as regulated services. These services are classified as special services; and
- other NEM jurisdictions where fee based services are treated as regulated services.

Aurora agrees that these services should be further classified as alternative control services because:

- these services are currently classified as special services with OTTER approving prices on an annual basis. This would suggest that classifying these services as alternative control services would be consistent with the previous regulatory treatment;
- the classification of these services as alternative control services would not, of itself, impede a new entrant from providing these services in competition with Aurora in the future;
- classifying fee based services as anything other than alternative control services would involve a change in administrative costs for Aurora as it would alter the way in which these services are currently provided;

- this proposed classification would be in line with the way in which these services are classified in NEM jurisdictions; and
- the nature of fee based services is that they do not involve building new assets and the costs of providing the service can be directly attributed to individual customers.

3.6. Connection Services

3.6.1. Standard Connection Services

Having regard for the requirements of clause 6.2.1 of the NER, the AER considers that standard connection services should be classified as direct control services and further classified as standard control services.

Aurora concurs with the assessment of the AER and agrees with the classification of standard connection services as direct control, standard control services.

Connection services relate to building connection assets at the customer's premises as well as connecting those connection assets to the distribution network. Aurora currently provides standard connection services within the broader offering of 'network services'.

In reference to the form of regulation factors, standard connection services should be classified as direct control services based on the existence of:

- high barriers to a new entrant competing with Aurora to provide connection services to customers from Aurora's network. This is because there is a legislative prohibition on unauthorised persons interfering with Aurora's network;
- network externalities given that Aurora can use factors of production that relate to its shared network to provide connection services. Specifically, Aurora can use the same assets, labour and materials to provide connection and network services; and
- no real opportunities for customers to exert countervailing market power in relation to connection services given that:
 - customers do not always initiate the service – connection services can be initiated by a retailer, a DNSP or a customer; and
 - these services are high volume, individually relatively low cost to provide and are generally not requested more than one service at a time nor can requests readily be aggregated.

This means that, in a practical sense, Aurora does not negotiate with customers and retailers in the provision of these services, and no real competitive or substitution possibilities for connection services given that a licence is required to operate a distribution network.

The AER's proposal to classify standard connection services as direct control services is consistent with:

- OTTER's current treatment of Aurora's connection services as regulated services; and
- the classification of connection services in the other NEM jurisdictions where these services are treated as regulated services.

Aurora agrees that these services should be further classified as standard control services because:

- there is neither actual, nor potential for the development of, competition for the supply of connection services on Aurora's network;
- classifying connection services as standard control services will involve no significant change in administrative costs for Aurora and the AER;
- this is consistent with OTTER's current treatment of Aurora's connection services, and with the classification of these services in NEM jurisdictions; and
- while the costs of connection works could be assigned to customers, this is not considered for equity with past connections to be an appropriate way of dealing with connection costs.

3.6.2. Connection Services requiring Augmentation

Having regard for the requirements of clause 6.2.1 of the NER, the AER considers that connection services requiring augmentation should be classified as direct control services and further classify them as standard control services.

Aurora concurs with the assessment of the AER and agrees with the classification of connection services requiring augmentation as direct control, standard control services.

Connection services requiring augmentation relate to building connection assets at the customer's premises; modifying the existing distribution network or building additional network; and connecting those connection assets to the augmented distribution network. Aurora currently provides these connection services within the broader offering of 'network services'.

As the provision of connection services requiring augmentation requires the provision of:

- standard connection services; and
- in most instances, standard network services.

Accordingly, connection services requiring augmentation should be classified as direct control services because of the same reasons that both standard network services and standard connection services are classified as direct control services.

The AER's proposal to classify connection services requiring augmentation as direct control services is consistent with:

- OTTER's current treatment of Aurora's connection services as regulated services; and
- The classification of connection services in the other NEM jurisdictions where these services are treated as regulated services.

Aurora agrees that these services should be further classified as standard control services because of the reasons given for both standard network services and standard connection services.

3.7. Aurora's Response to the AER's Preliminary Position on Service Classification

The AER has chosen to classify the majority of Aurora's distribution services as direct control services. The AER has indicated that it has had regard for the NEL and the NER when making this classification and has acted on the basis that, unless a different classification is clearly more appropriate:

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

Aurora has reviewed the AER's proposed classification of Aurora's distribution services and is in general agreement with the classifications proposed by the AER. In conclusion Aurora believes that the following classifications should apply to the distribution services it provides:

- standard network services should be classified as direct control services and further classified as standard control services;
- non-standard network services should be unregulated;
- all type 1-4 metering services should be unregulated;

- all type 5, 6 or 7 standard metering services should be classified as direct control services and further classified as alternative control services;
- PAYG metering services provided by Aurora Retail should be unregulated;
- all above standard metering services should be unregulated;
- public lighting services should be classified as direct control services and further classified as alternative control services;
- all fee based services (OTTER special services) should be classified as direct control and further classified as alternative control; and
- all connection services should be classified as direct control services and further classified as standard control services.

Aurora also understands the concerns of the AER in relation to the transition to the new regulatory framework required by Chapter 6 of the NER and also believes that the classifications that have been proposed will provide for a smooth transition and will not result in the imposition of unnecessary costs for the AER, Aurora or the electricity customers within Tasmania.

Table 1 –Proposed Classification of Distribution Services

Service Category	Proposed AER Classification	Proposed Aurora Classification
Standard Network Services	Direct Control Standard Control	Direct Control Standard Control
Non-standard Network Services	Unregulated	Unregulated
Type 1-4 Metering Services	Unregulated	Unregulated
Type 5, 6 or 7 Standard Metering Services	Direct Control Alternative Control	Direct Control Alternative Control
PAYG Metering Services	Unregulated (All Services)	Unregulated (only services provided by Aurora Retail)
Above Standard Metering Services	Unregulated	Unregulated
Public Lighting Services	Direct Control Alternative Control	Direct Control Alternative Control
Fee Based Services (OTTER Special Services)	Direct Control Alternative Control	Direct Control Alternative Control
Connection Services	Direct Control Standard Control	Direct Control Standard Control

4. Control Mechanisms

This chapter sets out Aurora's response to the AER's proposed approach to the control mechanisms that will apply to the direct control services that are provided by Aurora. The AER can choose to apply a number of control mechanisms to direct control services and these are outlined in Clause 6.2.5(b) of the NER. The options available to the AER are:

- a schedule of fixed prices;
- caps on the prices of individual services (for example, a price cap or caps);
- caps on the revenue to be derived from a particular combination of services (for example, a revenue cap);
- a tariff basket price control (for example, a weighted average price cap);
- a revenue yield control (for example, an average revenue cap); and
- a combination of any of the above.

The forms of control mechanism available for standard and alternative control services are the same. The basis for the control mechanism, however, can differ depending on which class of services it is to apply to.

In the case of Aurora the AER has chosen to apply a revenue cap for those services classified as standard control services and a price cap for those services classified as alternative control services.

In deciding on a control mechanism to apply to standard control services, the AER must have regard to the following factors in clause 6.2.5(c) of the NER:

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

The basis of the control mechanism for standard control services must be the prospective CPI-X form or some incentive-based variant of the CPI-X form in accordance with Part C of chapter 6 of the NER.

The factors for alternative control services are the same as those for standard control services in all but one respect. For standard control services the AER must have regard to the need for efficient tariff structures, for alternative control services the AER must instead have regard to the potential for development of competition in the relevant market.

The control mechanism must have a basis specified in the distribution determination. This may, but need not, utilise elements of Part C of chapter 6 of the NER with or without modification.

4.1. Standard Control Services

The AER proposes to apply a revenue cap to the services classified as standard control services with a basis of the CPI-X form.

The AER's preliminary position is based on the following consideration which it has had regard to in accordance with clause 6.2.5(c) of the NER:

- a revenue cap is the current control mechanism for Aurora's distribution network services and connection services and is one of the control mechanisms listed in clause 6.2.5(b) of the NER that can be applied in the forthcoming regulatory period.
- the incentives and risks of this control mechanism are widely recognised. However an appropriate incentive imposed by the incentive schemes and Aurora's history of operating under a revenue cap is considered by the AER to manage these risks and promote positive incentives.
- the AER notes there are provisions in place under clause 6.18 of the NER that require the AER to carefully examine tariff structures for efficiency as part of the pricing proposal process.
- retaining the current form of control for standard control services maintains consistency in the regulation of those services across Tasmania.
- transition to a completely new form of control mechanism will not guarantee a reduction in administrative costs, and may create undesirable administrative costs.

Aurora concurs with the assessment of the AER and agrees with the application of revenue cap for the provision of standard control services.

A revenue cap is an appropriate control mechanism for Aurora's standard control services on the basis of clause 6.2.5(c) of the NER because it:

- is one of the control mechanisms that is allowed under clause 6.2.5(b)(3) of the Rules;
- would not result in inefficient tariff structures. This is because Aurora would have flexibility to determine individual tariffs in order to recover the revenue cap, subject to any specific side-constraints that may be imposed by the AER, including determining the split between fixed and variable tariffs. New tariffs can readily be introduced throughout the regulatory control period as required;
- is consistent with the current control mechanism that is applied to these services, which is a fixed revenue cap; and
- is consistent with the control mechanism that has been used by the AER for standard control services in Queensland and the ACT.

4.2. Alternative Control Services

The AER proposes to apply price cap regulation to the following services classified as alternative control services:

- all type 5, 6 and 7 metering services, excluding PAYG metering and above standard metering services;
- all public lighting services with repair, replacement and maintenance to be fee based services; and alterations, relocations and the provision of new public lighting services to be quoted services;
- extend the application of a price cap to the reference set of special services to incorporate other special services and to be regulated as fee based services.

The AER's preliminary position is based on the following considerations it has had regard to in accordance with clause 6.2.5(d) of the NER:

- a price cap is the current control mechanism for reference set special services and metering services and is one of the control mechanisms listed in 6.2.5(b) of the NER that can be applied in the forthcoming regulatory control period.
- it is considered unlikely that there will be any impact on the development of competition in the market for these services as a result of applying a price cap control mechanism.

- retaining the current form of regulation (price cap) for the reference set of special services and all type 5, 6 and 7 metering services, excluding PAYG metering and above standard metering services maintains consistency in the regulation of those services across Tasmania and over regulatory periods and is consistent with the form of regulation applied in some other NEM jurisdictions.
- the AER has had regard to current regulatory arrangements and have considered that there are appropriate reasons for changing or commencing regulation of public lighting services and other distribution special services in the forthcoming regulatory control period through determining these services are alternative control services and applying a price cap.
- incorporating other distribution special services with the reference set of special services ensures that all special services are regulated by a consistent form of control (price cap).
- retaining the current form of regulation (price cap) for the all type 5, 6 and 7 metering services, excluding PAYG metering and above standard metering services and the incorporation of the reference set of special services, with other distribution special services and will have limited if any additional administrative costs to the AER, Aurora and users or potential users in the forthcoming regulatory control period.

Aurora concurs with the assessment of the AER and agrees with the application of price cap for the provision of alternative control services.

The majority of these services are currently classified as special services and regulated by OTTER under a price cap control mechanism.

It is appropriate that the control mechanism for fee based and quoted services be a price cap, to be applied using caps on:

- unit costs for the quoted service grouping of alternative control services; and
- individual prices for all other alternative control services.

A formula, and a fixed price quotation, is an appropriate control mechanism and form of price control because it:

- is one of the control mechanisms that is allowed under clause 6.2.5(b)(3) of the Rules;
- would not result in inefficient tariff structures. This is because Aurora would have flexibility to determine individual quotations in order to recover the costs of undertaking works requested by customers;

- will not have any material impact on the competition for an alternative control service or impede the potential to develop competition for these services;
- will not impose additional administrative costs on users, Aurora or the AER since the proposed control mechanism is the same as that which currently applies;
- is consistent with the way in which these services are provided in NEM jurisdictions, where utilities wait until the service has been scoped and then provide a quotation for the service; and
- is the only way that the regulatory regime can cope with services where a price simply cannot be provided before the service has been scoped.

4.3. Aurora's Response to the AER's Preliminary Position on Control Mechanisms

The AER has chosen to apply a Revenue cap form of control to standard control services and a price cap form of control to alternative control services.

Aurora has reviewed the AER's proposed forms of control for Aurora's direct control services and is agreement with the forms of control proposed by the AER. In conclusion Aurora believes that the following forms of control should apply to the direct control services it provides:

- standard network services being classified as standard control services should have a revenue cap form of control applied;
- all type 5, 6 or 7 standard metering services being classified as alternative control services should have a price cap form of control applied;
- public lighting services being classified as alternative control services should have a price cap form of control applied whereby:
 - repair, replacement and maintenance of public lighting should be subject to fee based regulation; and
 - the alteration and relocation of existing public lighting assets and the provision of new public lighting be provided on a quoted basis;
- all fee based services (OTTER special services) being classified as alternative control services should have a price cap form of control applied; and
- all new connection services being classified as standard control services should have a revenue cap form of control applied.

Table 2 –Proposed Classification of Direct Control Services

Service Category	Proposed AER Form of Control	Proposed Aurora Form of Control
Standard Network Services	Revenue Cap	Revenue Cap
Type 5, 6 or 7 Standard Metering Services	Price Cap	Price Cap
Public Lighting Services		
Repair, Replacement & Maintenance	Price Cap Fee Based	Price Cap Fee Based
Alteration, Relocation & Provision	Price Cap Quoted Service	Price Cap Quoted Service
Fee Based Services (OTTER Special Services)	Price Cap	Price Cap
Connection Services	Revenue Cap	Revenue Cap

5. Service Target Performance Incentive Scheme

As part of the national framework for the economic regulation of distribution services, the AER is required to develop and publish an incentive scheme to ensure that distributors maintain and improve upon, agreed levels of service. The AER developed a service target performance incentive scheme (STPIS) in accordance with this requirement.

The AER’s distribution determination for Aurora will specify how the STPIS is to be applied to Aurora for that regulatory control period. In its framework and approach paper, the AER must set out its likely approach, together with its reasons for the likely approach, to the application of a STPIS in the determination.

The AER has indicated its intention to apply a STPIS to Aurora as part of the upcoming distribution determination.

The AER’s preliminary position is to apply the supply reliability and customer service components of the STPIS to Aurora. The AER has indicated that it will not apply the STPIS GSL scheme as there is an existing GSL scheme in Tasmania.

The AER has indicated that it will apply the SAIDI and SAIFI reliability performance components of the STPIS. Separate SAIDI and SAIFI targets will be set for network segments in accordance with the existing network segments under the TEC minimum supply reliability standards. Targets will reflect the available data on average performance over the previous five years, with adjustments as necessary under the STPIS. The incentive rate to apply to the critical infrastructure and high density commercial sections of Aurora's network will be the same as for CBD network sections under the STPIS. All other sections will have the standard incentive rate applied to them.

For the reliability of supply component of the STPIS the AER propose to apply the standard revenue of risk of ± 5 per cent. The AER will calculate a Major Event Day (MED) boundary based upon the 2.5 beta method as specified in the STPIS.

For the customer service component the AER proposes to apply the telephone answering customer service parameter. The default level of revenue at risk of -0.04 per cent per unit is proposed to be applied to the call answering parameter.

In forming this position, the AER has had regard to the factors in clause 6.6.2(b)(3) of the NER, and considers that:

- the use of VCR to determine incentive rates and weighting for parameters under the s-factor scheme reflects the willingness of customers to pay for improved performance in the delivery of services by the Victorian DNSPs. The use of VCR in setting incentive rates and weightings also means that any potential benefits to consumers under the STPIS are sufficient to warrant any reward or penalty under the scheme for Aurora.
- the STPIS will operate concurrently with the TEC minimum service standards to which Aurora is required to comply.
- whilst Aurora will be penalised for diminished performance, it will also have the opportunity to gain financially for performance that exceeds the performance targets. Any incentive to reduce costs at the expense of service levels is counterbalanced by the corresponding penalties under the STPIS.
- the STPIS accounts for the past performance of Aurora's distribution network by setting s-factor targets based on Aurora's average performance over the previous five years.

- the STPIS is designed to operate in conjunction with both the DMIS and EBSS. The STPIS balances the potential for the EBSS to provide incentives to inefficiently reduce operating expenditure at the risk of service levels and, in respect of the DMIS, is essentially neutral regarding the level of reliability of network and non network solutions, neither encouraging nor discouraging non network alternatives to augmentation.

The AER has acknowledged in the position paper that Aurora has been focussing on improving supply reliability to distribution customers for the past two regulatory control periods.

Aurora's objectives in managing reliability performance in line with the TEC and STPIS is to use consistent measures that will allow a single reporting system to be used, and thereby reduce the costs associated with a transition to the next regulatory control period.

Aurora remains committed to delivering a reliable network in accordance with the standards defined in the TEC, and believes these standards provide a suitable level of performance that customers are willing to pay for.

Aurora commends the AER for taking these standards into account when drafting the STPIS.

While Aurora does not agree the STPIS is necessary to deliver a supply in accordance with the TEC, Aurora supports the AER's intentions to apply the STPIS using the five Category Classifications defined in the TEC.

5.1. Revenue at Risk

Aurora believes the proposed $\pm 5\%$ revenue at risk is larger than necessary to drive maintained and improved reliability performance. Aurora believes that $\pm 2.5\%$ will provide sufficient incentive for Aurora to improve its service performance.

Under the previous regulatory control period (2003-2007), Aurora had significantly less revenue at risk ($\pm 1.25\%$), and this provided sufficient incentive for Aurora to improve reliability.

Similarly, in the present regulatory control period, the OTTER GSL scheme is designed to provide a \$1 million incentive, and includes a capped liability (set within the 2007 determination). This scheme currently provides sufficient incentive for Aurora to improve and maintain performance; whilst at the same time not imposing significant cost increases on its customers.

5.2. Reliability of Supply Component

Aurora agrees that a STPIS based on the TEC Category classification is the most appropriate to the Tasmanian jurisdiction. These categories were developed jointly by OTTER, the Tasmanian government and Aurora as appropriate measures for the Aurora network and the customers that utilise that network.

Aurora's existing reliability strategy is to address individual communities that do not meet the standards within the TEC. Generally this is a number of small regional areas that belong to the urban and regional centres categories under the TEC. Whilst these areas may have a small impact on the average performance of the distribution network, they in themselves are not receiving an appropriate level of service in accordance with the requirements of the TEC. Whilst the AER proposed STPIS may still provide an incentive to continue this strategy, there are very limited opportunities to achieve average reliability improvements with a focus in these small regional areas, and improvements will need to be made in the more populated areas with already suitable performance.

Aurora is concerned the drive to improve average performance will be at the expense of individual community performance and accepts that this is a compromise that may arise following the introduction of the AER's proposed STPIS.

Aurora also proposes that should the AER STPIS be implemented the calculation of SAIDI and SAIFI using a connected kVA weighting, as opposed to customer (ASIDI and ASIFI), is utilised. This will allow a consistent methodology to be used between OTTER and AER, reducing the additional costs of reporting and associated resources.

5.3. Performance Targets

Aurora agrees with the AER's proposal for setting performance targets under the STPIS. Aurora will have five years historical data available for setting targets, based on the weighted kVA SAIDI and SAIFI currently utilised. Unfortunately MAIFI data is only available for full feeders and is not calculated using the geographical communities described within the TEC due to the cost to implement MAIFI reporting for partial feeders.

5.4. Value of Customer Reliability VCR

In general, Aurora believes the AER's proposal for the Value of Customer Reliability (VCR) does not directly translate to the Tasmanian customer base. The AER has indicated that it considers the value of VCR to be appropriate because they reflect the wishes of customers in the Victorian jurisdiction and in their preliminary positions paper stated:

“The use of VCR to determine rates and weighting for parameters under the s-factor scheme reflects the willingness of customers to pay for improved performance of delivery by the Victorian DNSPs.”

Aurora contends that the Victorian experience is not directly transferable to Tasmania due to differences in the Tasmanian load demographic, economic output and customer density.

Aurora has yet to establish if an alternative value for the VCRs is appropriate and may propose alternative VCRs as part of its regulatory proposal to the AER in May 2011.

5.5. Exclusions

Aurora agrees that it is important to consider the extent to which a DNSP is able to appropriately mitigate against supply interruptions within its network and that certain outages should be excluded from any scheme that penalises or rewards a DNSP for the performance of their network. Aurora therefore generally agrees with the AER's proposed outage exclusions. Aurora does however propose that an additional exclusion is included in any scheme.

There are a number of outages within the Aurora network that Aurora cannot reasonable mitigate against and are predominantly caused by third party contact with the network, such as motor vehicles colliding with poles. Aurora therefore wishes to add outages due to third party causes, as defined in the TEC, to the list of exclusions. The inclusion of this additional exclusion will also maintain consistency across jurisdictions.

5.5.1. Major Event Day

The use of the 2.5 beta methodology is now a well accepted practice within the NEM and Aurora agrees with the use of this method to arrive at MED exclusions. Aurora will have five years of historical data available for the calculation of the MED.

5.6. GSL Scheme

The AER has indicated that it will apply the OTTER GSL scheme to Aurora in preference to the AER GSL scheme in line with the provisions of the STPIS.

Aurora welcomes the AER decision to continue with the application of the OTTER GSL scheme. Aurora is however concerned that the OTTER GSL scheme has certain components of its application contained within OTTER's 2007 determination and these components will not transfer to the AER STPIS. Aurora is further concerned that as the GSL scheme within Tasmania is designed to provide financial incentives to Aurora around reliability performance that these will also be lost within the AER proposed STPIS.

The OTTER GSL scheme also contains mandated exclusions in its application and there are a number of interruptions experienced by customers under this scheme that are excluded under the s-factor within the STPIS.

A prime example of this difference is in respect to outages within the transmission network. Under the STPIS s-factor the majority of transmission related outages are excluded from the STPIS; under the OTTER GSL scheme the vast majority of transmission outages are included in the calculation of GSL liabilities. The design of the power network in Tasmania means that a number of outages that will be excluded under the STPIS s-factor will be included in the GSL scheme.

The 2007 determination contains a benefit sharing mechanism whereby Aurora is required to fund all its GSL liability for single duration outages and can recover a certain component of that liability where more than 34,000 customers experience a qualifying outage. The design of this mechanism is similar in nature to the s-factor under the STPIS. Where performance is better than expected Aurora is rewarded and where performance is worse than expected Aurora is penalised. The AER STPIS does not allow inclusion of the GSL scheme as part of the revenue at risk.

Aurora may propose alternative GSL scheme components for the STPIS as part of its regulatory proposal to the AER in May 2011.

5.7. Telephone Answering Parameter

The AER has indicated its intention to include the telephone answering parameter as part of the STPIS and to apply that component of the s-factor at -0.04% per unit.

Aurora agrees with the AER proposal for the telephone answering parameter.

Aurora may also propose further customer services components of the STPIS as part of its regulatory proposal to the AER in May 2011.

6. Efficiency Benefit Sharing Scheme

As part of the national framework for the economic regulation of distribution services, the AER is required to develop and publish an efficiency benefit sharing scheme for a fair sharing of efficiency gains and losses between DNSPs and customers. The AER developed an efficiency benefit sharing scheme (EBSS) in accordance with this requirement.

The AER's distribution determination for Aurora will specify how the EBSS is to be applied to Aurora for that regulatory control period. In its framework and approach paper, the AER must set out its likely approach, together with its reasons for the likely approach, to the application of an EBSS in the determination.

The AER has indicated its intention to apply an EBSS to Aurora as part of the upcoming distribution determination.

In forming this position, the AER considers that the:

- benefits to Tasmanian consumers derived from the EBSS are sufficient to warrant any financial reward or penalty that Aurora may incur. Because the EBSS is symmetrical, any efficiency losses would also be shared between customer and Aurora, so that the potential for financial penalty is balanced. The symmetry of the scheme also provides balance so that incentives are not skewed in favour of realising efficiencies only during the first years of the regulatory control period. This will also remove the perceived tendency towards strategic deferral of operating expenditure to the final years of the regulatory control period in order to create an artificially high base year for further forecasts.
- EBSS will provide a continuous incentive for Aurora to achieve operating expenditure efficiencies throughout the regulatory control period, as any efficiency gains or losses realised within the regulatory control period are retained for the length of the carryover period, regardless of the year in which the gain or loss is realised.
- EBSS will counter any artificial incentive to capitalise expenditure, by requiring Aurora to report any changes to its capitalisation policy to the AER. The AER will adjust the forecast and outturn operating expenditure figures used to determine the carryover amounts to account for any changes in capitalisation policy.

- exclusion of costs associated with demand side management from consideration under the EBSS will remove any deterrents to the use on non-network alternatives that might otherwise arise under the EBSS.

The AER further noted the:

- concerns raised by OTTER in its 2007 decision regarding the impact that forecasting accuracy and distinguishing between types of expenditure had on the application of an EBSS. However, the AER considered that up-front certainty that a symmetrical scheme will be applied during the regulatory period prior to the lodgement of the regulatory proposal, combined with additional information on Aurora's historical expenditure will assist the AER to make reasonable and accurate forecasts for the purpose of the EBSS.
- AER currently applies an EBSS mechanism to DNSPs in all other regulated state and territory jurisdictions and it is preferable in the interests of consistency to apply an EBSS to Aurora in the Tasmanian jurisdiction.

6.1. Aurora Position

Aurora has previously argued against the introduction of any efficiency scheme and supported OTTER's decision to not mandate any scheme during the current regulatory control period. These concerns were based upon the introduction of an OTTER scheme that would have resulted in the immediate imposition of efficiency penalties that Aurora believed it had had little control over or ability to mitigate.

Whilst the AER's proposed EBSS will apply from the commencement of the next regulatory control period, the financial impacts of the scheme will not commence until 2017. This will allow Aurora to gain an understanding of the operation of the EBSS during the 2012 – 2017 regulatory control period and to make expenditure decisions in the knowledge that those decisions will have revenue impacts in future periods.

Aurora therefore agrees with the AER position in relation to the introduction of an EBSS and looks forward to working with the AER on the introduction of the mechanisms that will underpin Aurora's EBSS.

7. Demand Management Incentive Scheme

A demand management incentive scheme (DMIS) is not a requirement of the NER and the AER has discretion in its application, unlike the STPIS and the EBSS. The AER has however indicated its intention to apply a DMIS to Aurora as part of the upcoming distribution determination.

The AER's proposed DMIS will take the form of a demand management innovation allowance (DMIA) and will be in the form of a fixed allowed for each year of the regulatory control period. The AER is proposing that the DMIA for Aurora will be \$400,000 per annum or \$2 million for the regulatory control period.

Aurora supports the introduction of a DMIS within the Tasmanian jurisdiction and looks forward to working with the AER on its implementation of the scheme for the upcoming regulatory control period.

Aurora recognises the significant advantages in introducing demand management practices, within specifically identified geographic and demographical areas, to manage existing winter peak loads and the recognised future load increases and a greater utilisation of distribution assets.

It is envisaged that over the regulatory control period Aurora will need to focus on feasibility studies and trials to gain greater appreciation of the areas and technology, which would offer optimum outcomes. Towards the latter part of this period Aurora suggests higher implementation costs will be recognised in the introduction of technology for trials and programs that reflect appropriate peak and base demand management.

These studies and trials are not scale related and Aurora will undertake trials that are consistent and comparable with any other Australian electricity distributor and are not therefore related to the size of Aurora's operations. Aurora therefore proposes that the AER consider a DMIA of \$1 million per annum (\$5 million over the regulatory control period) for the Aurora DMIS.