Submission to AER

CCP4 Response to

Preliminary positions on replacement Framework and Approach (F&A)

for

TasNetworks Distribution revenue reset for 2017-2022 regulatory period

Sub Panel CCP4

13/5/2015

1. Introduction

The AER has identified that Consumer Challenge Panel subpanel 4 (CCP4) is to provide a consumer view into its deliberations on the regulatory revenue reset for the period 2017 to 2022 applying to TasNetworks Distribution previously referred to as Aurora Energy.

In its initial response to the AER, CCP4 commented that the Framework and Approach (F&A) on the regulation of TasNetworks Distribution for the period 2017 to 2022 did warrant change and cited a number of aspects that led to this recommendation.

This submission to the AER made by CCP4 is in response to the AER request to comment on its Preliminary position on the replacement F&A applying to TasNetworks Distribution.

The preliminary position on the F&A applying to TasNetworks Distribution for the period 2012 to 2017 proposes that the existing F&A should be replaced with the following issues driving that decision[1]:

- "the classification of public lighting services in light of submissions received from Hobart City Council, Glenorchy City Council, Trans Tasman Energy Group and a request from TasNetworks to review the current classification of these services
- the application of our service target performance incentive scheme in light of a request from TasNetworks to review the revenue at risk applied under the scheme
- the need to include formulae that give effect to the control mechanisms (that is, how price and/or revenues are to be determined during the regulatory control period)
- the need to outline the application of our revised efficiency benefit sharing scheme
- the likely inclusion of a capital expenditure sharing scheme (to incentivise network service providers to undertake efficient capital expenditure)
- the possible inclusion of a small-scale incentive scheme (pilot or test incentive schemes within an environment that limits the sum of money at risk and the length of time of the scheme)
- the application of the Expenditure Forecast Assessment Guidelines (a nationally consistent reporting framework which allows us to compare the relative efficiencies of network service providers, and decide upon efficient expenditure allowances)
- whether depreciation for establishing the network service providers opening regulatory asset base for the 2022–2027 regulatory control period is to be based on actual or forecast depreciation."

CCP4 agrees that these are all aspects that drive the need to revise the existing F&A. CCP4 comments on each aspect in the following sections.

[1] AER, Preliminary position on replacement framework and approach (for consultation for TasNetworks Distribution for the regulatory period commencing 1 July 2017, pages 4 and 5

2. Distribution services classification

CCP4 considers that the AER approach to classifying services under three broad elements (direct control, negotiated and unregulated) reflecting the varying levels of competition is sound and that its approach to the sub-classification of direct control services between standard control and alternative control reflects the ability to allocate services on a user pays basis when this is appropriate. CCP4 also considers that the AER approach is consistent with the National Electricity Rules (NER) with which the AER has to comply.

CCP4 recognises that the vast majority of services delivered by TasNetworks Distribution must be provided as a monopoly provider because the cost to consumers to provide competition (ie duplicate the services) would be prohibitive. This means that the bulk of the services provided by TasNetworks Distribution must be regulated. Therefore the classification of services really revolves around only a few services where there is a degree of competition that can cause TasNetworks Distribution to provide competitive outcomes for consumers.

2.1 Unclassified services

The AER nominates provision of type 1-4 metering services (these services are for meters that are to be read remotely) and the NER allows competition in the provision of these meters. As other meter service providers are able to compete, CCP4 agrees that this service should not be regulated.

The AER nominates pay as you go (PAYG) meters provided by TasNetworks Distribution should not be regulated. CCP4 agrees as others can also provide a PAYG metering service but CCP4 also notes that a number of consumers are currently being served by TasNetworks Distribution owned PAYG meters under a legacy arrangement and might not be aware that they can chose an alternative supplier for this service so there is a risk that TasNetworks Distribution might be collecting monopoly rents for the provision of the service and/or using the ownership of the meters to provide a financial barrier to consumers wanting change. Whilst it agrees that PAYG meter services should not be included in direct control services, CCP4 considers that the AER should require TasNetworks Distribution to demonstrate that its PAYG metering service is competitive.

The AER nominates emergency recoverable works should be excluded from regulated and negotiated services. CCP4 agrees. By definition, the term recoverable services implies that TasNetworks Distribution should be able to get restitution from the causers of the need for the emergency recoverable service. By excluding the service from direct control and negotiated services, this imposes on TasNetworks Distribution a requirement to seek restitution from the causer of the need for the service rather than having electricity consumers pay for such works.

2.2 Negotiated services

The AER has classified new public lighting technology as a negotiated service. The AER considers that such services are those that TasNetworks Distribution does not currently provide or might not even exist at the time of the determination. Equally, most of the assets used for the provision of public lighting are owned by TasNetworks Distribution, implying a degree of monopoly power in relation to implementing changes due to technology change.

CCP4 notes that a negotiated service allows the AER to implement arbitration in relation to negotiated services, which is a lighter handed approach to full regulation. In the case of public lighting technology, CCP4 agrees that this should be a negotiated service as this provides more flexibility in implementing change but with an ability of the consumer to minimise the use of the undoubted monopoly power that TasNetworks Distribution has in relation to public lighting.

Some of the local councils, along with TasNetworks Distribution, have sought for general public lighting to be a negotiated service rather than an alternative control service. In general, CCP4 considers that retaining public lighting as an alternative control service is probably in the interests of consumers as it provides certainty and a limitation on the ability of TasNetworks Distribution to exercise the monopoly power it has in relation to the general activities in relation to public lighting.

CCP4 is seeking better information from local councils as to the reasons behind the apparent preference for general public lighting to be a negotiated service, and whether the change sought is widespread amongst all local councils. CCP4 notes that TasNetworks Distribution is not bound to this F&A classification and may seek a change when it submits its proposal. With this in mind, CCP4 supports the AER position for including general public lighting as an alternative control service within the F&A, pending receiving better information on why change is sought by TasNetworks Distribution and others and the benefits that such change might provide consumers.

2.3 Alternative control services

As noted above in 2.1, there are some metering services that are contestable and excluded from regulation. CCP4 considers that type 5, 6 and 7 metering services should be regulated as they are exclusively provided by TasNetworks Distribution and therefore not subject to competition. As other metering services are excluded from regulation, it is inappropriate for the meter services to be included in the direct control services as not all consumers are served by type 5, 6 and 7 meters[2]. CCP4 agrees that the meter services should be paid for by those using these meters and be included in alternative control services.

CCP4 makes its comments about general public lighting is section 2.2 above

The AER has introduced a new term "ancillary network services" which cover a wide range of services that can be identified as a clear request from a specific consumer and which are non-recurring costs once the work is complete. CCP4 considers that these are best provided on fee or quoted services basis. The AER provides a listing of these in Appendix B of its preliminary position[3] as ancillary services and the AER segregates those which it considers should be alternative control (fee based services) and those which should be on alternative control (quoted services). CCP4 agrees with the AER preliminary position on these services.

In October 2014 there was a request from TasNetworks Distribution to transfer some connection services to alternative control services but this request was withdrawn by TasNetworks Distribution in March 2015. CCP4 sees that the cost-revenue test used to assess the capital contribution a new connection acts to prevent other consumers contributing for the new connection through the standard. Equally, CCP4 notes that the addition of a new connection should increase demand and consumption of electricity thereby spreading the cost of the shared network over a larger base, effectively reducing shared network costs for all consumers. CCP4 agrees with the AER that new connections should be retained as a standard control service.

2.4 Standard control services

Other than the elements of the services provided by TasNetworks Distribution addressed above, CCP4 considers that all other services should be included in the standard control services. This is the vast majority of the services provided by TasNetworks Distribution.

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[2] To do so would require consumers using type 1-4 to contribute to a service that they do not use

[3] Op cit pages 105 and 106

3. Control mechanism

CCP4 agrees with the AER preliminary position, for the reasons detailed by the AER, that standard control services should be regulated under a revenue cap and the alternative control services as a schedule of fixed prices with each price capped.

CCP4 considers that the AER preliminary F&A is consistent with recent determinations made by the AER on distribution network regulation.

4. Incentive schemes

CCP4 is aware of the incentive schemes that have been developed to apply to network performance, opex and capex. The package of incentive schemes was developed over many years and culminated during the AER Better Regulation Program. During the Better Regulation program it was identified that there needed to be consistency between the different incentives as each has the ability to impact outcomes in other schemes. It is therefore essential that the tension between the different schemes is maintained so that together they provide the best outcome for consumers.

CCP4 notes that the AER preliminary position on its F&A reflects maintaining the tension between the schemes and therefore CCP4 supports this part of the preliminary position.

CCP4 also notes that exclusions of elements of each scheme can distort the balance between the schemes and therefore has a view that there should not be any exclusions when measuring the out-turn performance of each scheme.

4.1 Service target performance incentive scheme (STPIS)

The AER notes that the Tasmanian Electricity Code (TEC) imposes a Guaranteed Service Level (GSL) program on TasNetworks Distribution that imposes on TasNetworks Distribution a performance on the interaction with its customers. CCP4 also notes the STPIS also imposes similar GSL performance requirements. CCP4 considers that to impose both the AER and TEC GSL performance is duplicative and agrees with the AER that only the TEC GSL requirements should be imposed on TasNetworks Distribution.

CCP4 notes that TasNetworks Distribution prefers the revenue at risk from the STPIS be limited to +/- 2% whereas the national STPIS has +/- 5% of revenue at risk. As noted above, there is tension between the different incentive schemes and the design of each reflects that this tension is balanced. If the revenue at risk is reduced for the STPIS there would need to be concurrent changes in the other schemes (especially for opex and capex) to reflect this balance. With this in mind, CCP$ supports the AER preliminary position that the STPIS should retain +/- 5% of revenue at risk unless there are changes proposed for the other schemes.

CCP4 notes the AER references to the reviews by AEMC (on reliability measures) and AEMO (on Value of Customer Reliability - VCR). However CCP4 also notes the AER view that its current STPIS design does not necessarily reflect these recent reviews and that these might not be included in the STPIS to be applied to the TasNetworks Distribution reset review. CCP4 considers that it is essential that the most recent information must be used in the STPIS as to utilise data or controls that are outdated could lead to outcomes that are not in the interests of consumers. CCP4 notes that the AER intends to integrate these reviews into its draft determination; CCP4 supports this decision.

CCP4 notes that the settings for reliability (the duration index - SAIDI and the frequency index - SAIFI) will be set at the average of the past five years of network performance. CCP4 considers that this is not appropriate as it does not reflect the benefits from opex and capex that occurs during the regulatory period. CCP4 considers that targets should be based on a rolling average of the previous five yearly performance rather than static targets set at the commencement of each regulatory period. This is consistent with the approach to identifying (and rewarding/penalising) the benefits from the opex incentive scheme.

CCP4 notes that there are exclusions in the calculation of the performance measures to exclude interruptions outside the control of TasNetworks Distribution and to limit an interruption when the outage extends beyond the day of the outage. CCP4 notes that regardless of the cause, consumers will be without supply so the exclusions really to not reflect the actual impacts on consumers. CCP4 accepts that the exclusions proposed for TasNetworks Distribution are common to all distribution networks and accepts that they should be excluded in the case of this reset review of TasNetworks Distribution. However, CCP4 suggests that this issue be addressed at the next review of the STPIS program by the AER.

4.2 Efficiency benefit sharing scheme (EBSS)

CCP4 notes that although TasNetworks Distribution has been exposed to the EBSS in the current period, the EBSS has been refined during the Better Regulation program. Particularly the EBSS is now continuous across regulatory periods, and because there is now an incentive program for capex, the previous approach where non-network solutions for capex were excluded from the EBSS (ie networks received a benefit by implementing non-network solutions as the increase in opex was granted but there was no countervailing reduction in capex) this no longer applies because of the introduction of the capex incentive scheme.

CCP4 supports the use of the new EBSS in this revenue reset as this results in a balance across the incentive schemes that was intended by the introduction of the changes to the Electricity Rules. Accordingly, the new EBSS should be included in the F&A.

4.3 Capital expenditure sharing scheme (CEES)

The introduction of the CESS is required by the revised Electricity Rules applying to networks. The details of the CESS were debated extensively during the Better Regulation program and this included ensuring there was a high degree of balance between the three different schemes so that no one scheme had a greater power than another.

Whilst CCP4 has some concerns about the development of the CESS, CCP4 also considers that these should be raised when reviewing the scheme rather than addressing these piecemeal with each revenue reset. On this basis, CCP4 agrees with the AER that the CESS as developed should apply to the TasNetworks Distribution revenue reset and be included in the F&A.

4.4 Demand management incentive scheme (DMIS)

CCP4 agrees with the AER that demand management should be incentivised as demand management can provide a more efficient outcome for consumers than continually increasing the size of the network to accommodate increases in demand.

CCP4 agrees with the AER that incentivising demand management must also recognise that other incentive schemes (STPIS, EBSS and CESS) have an impact on how a network might better manage demand and that network pricing also has a major role in managing demand.

Equally, CCP4 notes that an incentive to seek better outcomes for consumers by networks managing demand can provide an avenue for networks securing funds that do not or are unlikely to deliver a benefit.

Whilst supporting the application of a DMIS to the F&A, CCP4 considers that any funding provided to TasNetworks Distribution as part of the DMIS must be carefully assessed so that what is proposed provides new research that is applicable to the needs of Tasmanian consumers. CCP4 observes that there has been considerable funding provided over the past 5-10 years for networks to assess better approaches to demand management. Often this research is duplicative (ie has been carried out elsewhere and the results are available) or has only passing reference to the activities of the network undertaking the work or to the consumers providing the funds. With this in mind, CCP4 will be closely examining any proposals made by TasNetworks Distribution to ensure there are identifiable benefits for Tasmanian consumers and that the work has not been carried out elsewhere.

5. Application of the expenditure forecast assessment guidelines

CCP4 supports the application of the expenditure forecast assessment guidelines to TasNetworks Distribution for this next regulatory period.

CCP4 notes that these guidelines are an integral element of ensuring that forecast expenditure is efficient. To exclude TasNetworks Distribution from the application of the guidelines would not be in the interests of consumers.

6. Calculation of depreciation (forecast or actual capital expenditure)

The AER Better Regulation guidelines addressed the issue of the incentive inherent in using forecast or actual depreciation in the roll forward model used in setting the opening Regulatory Asset Base (RAB) for each year.

CCP4 notes that there are impacts for consumers using either approach but recognises the need to balance the power of the incentives (especially that of the CESS) to engender the most efficient outcome for consumers.

During the Better Regulation program, CCP4 noted a preference for using forecast depreciation as this provided a better balance with the power of the incentive from the CESS; the AER observed that under normal conditions it would use the forecast depreciation in lieu of actual depreciation unless there were strong reasons to change from this position.

CCP4 agrees with the AER that, at this stage, forecast depreciation should be used for this revenue reset and included in the F&A.

7. Jurisdictional and legacy issues

CCP4 acknowledges that there has been a request from TasNetworks to align the revenue resets for distribution assets with transmission assets. CCP4 recognises the benefits that such an alignment should bring and that this alignment is still subject to a rule change.

CCP4 accepts that the AER will be bound by any rule change and therefore considers the AER needs to ensure that the F&A reflects that the regulatory period could be either 2 years or 5 years.