



Statement of Approach

Priorities and objectives of electricity network service provider performance reports

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Shortened forms

AER	Australian Energy Regulator
AEMO	Australian Energy Market Operator
EBSS	efficiency benefit sharing scheme
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
TEC	Total Environment Centre

1 Introduction

The Australian Energy Regulator (AER) is responsible for the economic regulation of network service providers (NSPs) in the National Electricity Market (NEM) under the National Electricity Law (NEL) and the National Electricity Rules (NER).

As the economic regulator for NSPs in the NEM the AER's role includes annual performance reporting. This reporting function has been transferred from state jurisdictional regulators to the AER. The AER has previously published annual performance reports for transmission NSPs, and now intends to publish such reports for distribution NSPs.

In December 2010, the AER released a discussion paper outlining a proposed set of objectives and priorities for electricity NSP performance reports.¹ The AER received 15 submissions in response to its discussion paper. Issues raised in the submissions have been taken into consideration to develop the final statement of approach. This Statement of Approach outlines the AER's objectives and priorities of electricity NSP performance reports in light of the submissions received.

In developing objectives and priorities, the AER has also considered the National Electricity Objective (NEO) and objectives of the NEL and the NER.

The priorities and objectives, which apply to both electricity transmission and distribution NSP performance reports, can be found at appendix B of this Statement of Approach.

¹ AER, *Discussion paper, Objectives and priorities of electricity network service provider performance reports*, December 2010.

2 Purpose and objective of statement of approach

The statement of approach sets out the AER's response to submissions on the priorities and objectives for electricity NSP performance reports. The AER is responsible for the economic regulation of NSPs in the NEM. Under the NEL and NER, the AER carries out a wide range of economic regulatory functions, which may include performance reporting on NSPs' financial and operational performance. Section 28V of the NEL and clause 8.7.4 of the NER require the AER to determine appropriate priorities and objectives to be addressed through the preparation of NSP performance reports.

The priorities and objectives of NSP performance reports outlined in this paper will be reflected in the AER's future NSP performance reports. The AER considers performance reporting a vital part of its overall functions and powers. Performance reporting is essential to the transparency and accountability necessary to underpin efficiency based regulation. Reporting the performance of regulated entities reduces the asymmetry of information between regulated networks and other stakeholders. Performance reporting may also provide an incentive for regulated businesses to improve their performance.

Reporting on the performance of regulated businesses is part of the regulatory cycle and should be viewed as an input into the regulatory determination process. The reporting and explanation of information that will be used in regulatory determinations will assist in making those processes more transparent and accessible to customers and other market participants.

Regulatory framework

In establishing appropriate priorities and objectives of NSP performance reporting, the AER has considered the relevant provisions of the NEL and NER.

Section 28V of the NEL provides a specific function for the AER to report on service and other performance standards, network profitability and other performance matters considered appropriate by the AER.

Clauses 6.5.6(e)(4), 6.5.7(e)(4), 6A.6.6(e)(4) and 6A.6.7(e)(4) of the NER require the AER to have regard to the benchmark operating and capital expenditure that would be incurred by an efficient NSP over the regulatory control period. Reporting the performances of NSPs against benchmark comparators allows stakeholders to make informed assessments, thereby encouraging greater participation in the regulatory process.

Clauses 6.5.6(c), 6.5.7(c), 6A.6.6(c) and 6A.6.7(c) of the NER require the AER to assess whether the forecast operating and capital expenditure proposed by an NSP reasonably reflects the efficient costs of achieving the operating and capital expenditure objectives. Once a regulatory determination has been made by the AER, it is then necessary to monitor actual outcomes so the AER can better understand the dynamic operations of the NSPs within the regulatory control period. In this case, performance reports can compare actual expenditure against forecast expenditure,

allowing NSPs an opportunity to provide explanations for any differences between the two.

The national electricity objective promotes efficient investment in, operation and use of electricity services and is framed with the long term interests of electricity consumers in mind. Objective measures of efficiency generally are made by comparisons between NSPs, or by comparing a single NSP's performance over time. Performance reports will facilitate such comparisons where actual expenditure and financial performance data is made publicly available. Performance reports will also show outcomes of the incentive schemes applying to the NSPs, such as the service target performance incentive scheme and efficiency benefit sharing scheme (EBSS). The preparation of performance reports by the AER will contribute to achievement of the national electricity objective.

3 Issues raised in submissions

The AER received 15 submissions from stakeholders in response to its discussion paper on the priorities and objectives of performance reports.² Many stakeholders raised concerns with the objectives of transparency, accountability and improving the regulatory framework. Others raised issues related to priorities such as benchmarking and the contents of the reports. All of the issues raised and the AER's conclusions are discussed in sections 3.1 to 3.3.

3.1 Objectives

3.1.1 Transparency

GRID Australia, Country Energy and ActewAGL stated that that the information requested by the AER provides limited insight into the internal decision making and business practices of individual NSPs. They concluded the information will do little to promote transparency.

The AER considers that the objective of transparency is fundamental to the rationale for performance reports. Achieving that objective requires collecting and publishing a range of information about the NSPs. Greater levels of transparency will be achieved where the information is provided in detail, without limiting the usefulness or ability to use and interpret the data. Any information that provides an insight into NSPs' practices will complement reporting of outputs by providing greater explanation of results.

Citipower and Powercor stated that measures to achieve transparency should not be implemented with the intention of facilitating comparisons between NSPs. The AER disagrees, and notes that performance reports will increase the amount of comparable information available to stakeholders and will facilitate comparisons between NSPs. However, the AER is aware comparisons must be between similar data, or note anomalous circumstances to be meaningful. This issue is addressed in more detail in section 3.2.1.

3.1.2 Accountability

ActewAGL queried the effectiveness of comparing forecast and actual capital and operating expenditure to achieve accountability. Citipower and Powercor suggested that NSPs should be given the opportunity to explain to the AER and other stakeholders any reasons for deviations from forecasts. AEMO considered that performance reports should aim to highlight differences between forecast and actual information, and that NSPs should be required to explain any differences.

The AER considers that accountability will be enhanced where stakeholders can easily compare the NSPs' intentions and outturn performance, with respect to capital and operating expenditure. There may be many circumstances that cause an NSP's actual capital and operating expenditure to vary from its forecast amounts. However, unless the variations are quantified, and the NSPs provide explanations of the circumstances that led to the variations, there is little accountability for expenditure outcomes. Such information also increases the transparency of the regulatory regime,

² AER, *Objectives and priorities of electricity network service provider performance reports*, December 2010.

as stakeholders gain insight into the circumstances that impact on expenditure decisions of NSPs.

The AER also notes that clause 8.7.4(c) of the NER requires an NSP must be allowed an opportunity to submit information and make submissions relevant to the subject matter of the proposed report. Through that process, as well as the data collection process, the NSPs will be able to provide information to support the reported data, including explanations for differences between forecast and actual expenditures.

3.1.3 Education

Energex stated in its submission that the objective ‘improvement of the regulatory framework’ lacked definition. Instead it suggested that the framework requires ‘fulfilment and conformity’ rather than ‘improvement’. The AER considers that improvements in the regulatory framework will come about when all stakeholders can contribute to an informed debate on the operation of the NEM, and the regulation of NSPs. Performance reports will have an educational function by addressing the inherent information asymmetry in the NEM. The regulatory framework will be strengthened by educating stakeholders on how NSPs operate, and the factors that influence expenditure and service delivery outcomes. Hence, the rationale underpinning the objective remains the same, the objective is entitled ‘education’ to provide clarity to stakeholders.

Grid Australia submitted that if the report is to contain meaningful information to enhance regulation, the information must be made available to stakeholders in a timely manner to ensure its relevance. The AER supports the aim of providing timely information to stakeholders.

3.1.4 Improving Performance

The Australian Energy Market Operator (AEMO) and Citipower/Powercor considered that simply reporting figures would not encourage NSPs to invest more efficiently in their networks. AEMO also supported the objective of using performance reporting to establish benchmark expenditure and investment levels and inform future determinations. The AER notes AEMO’s support and has maintained the objective of improving performance.

3.2 Priorities

3.2.1 Benchmarking of expenditure information and comparison of performance

A number of NSPs raised concerns with reporting information for the purposes of benchmarking.³ In particular, APA Group suggested that caution should be exercised in using reported information for benchmarking purposes. It noted that such comparisons can only provide a broad indication of whether a particular service provider’s performance lies within a possible range of efficient outcomes. Integral Energy stated that the intended use of performance reports as a means of benchmarking is inappropriate, given the difficulty in comparing a diverse range of NSPs and the inherent limitations of reporting high level information. EnergyAustralia and ETSA Utilities expressed concerns with the prospect of

³ APA Group, Country Energy, ETSA Utilities, Integral Energy, Grid Australia and SP AusNet.

comparison of performance between NSPs. These largely stemmed from the different environments in which NSPs operate, which they considered may not be reflected in the reports. Country Energy was concerned that comparisons would be misleading and an inaccurate representation of performance.

The AER's use of benchmarking in regulatory determinations has been limited to date, reflecting in part the difficulties of developing benchmark measures that take into account the diverse range of circumstances facing NSPs. Examples of benchmarking applied by the AER include ratio analysis, opex regression analysis and the application of a replacement capex model used in the Victorian distribution determination.⁴ The AER is currently considering the role of benchmarking in future determinations as the quality and quantity of information reported increases.

The AER notes that the NER includes benchmarking as one of ten opex/capex factors that it must consider in making regulatory determinations.⁵ Reporting benchmark comparisons, to the extent possible, will better inform stakeholders of the relative performance of NSPs (both in comparison to other NSPs and over time) and can be used by the AER in its determinations. The AER considers that benchmarking is a key priority for electricity NSP performance reports, and that issues with data comparability will need to be dealt with through the development of meaningful benchmarking measures.

The AER is aware of the unique environment in which each NSP operates, and demonstrates its understanding by applying customised targets in areas such as service level targets. At the same time, these targets and benchmarks are then applied strictly and consistently to further the objective of accountability.

3.3 Other issues

3.3.1 Duplication and cost of reporting requirements

A number of NSPs⁶ noted the current reporting arrangements to jurisdictional and other national regulators. They considered that minimising duplication of performance reporting should be an objective of the AER's performance reports, and that data collection and publication should align as closely as is practical across policy needs to minimise regulatory costs.

The AER agrees that duplication of information reporting should be eliminated to the extent possible, given the roles and functions of the AER and the jurisdictional regulators. In many cases the reporting obligations from jurisdictional regulators are being reduced and the AER will have a corresponding increase in economic and retail regulatory functions. The AER will accordingly ensure that its reporting processes are streamlined to minimise duplication.

However, the AER considers that significant costs do not arise from providing information to two or more regulatory agencies, unless the information required is different information on the same topic. In such cases, the AER will work with other

⁴ AER, *Victorian electricity distribution network service providers: Distribution determination 2011–2015*, October 2010.

⁵ NER, Clauses 6.5.6, 6.5.7, 6A.6.6 and 6A.6.7.

⁶ Country Energy, Energex, EnergyAustralia, Ergon Energy, ETSA Utilities, Integral Energy.

regulatory agencies to determine if information requirements can be streamlined to minimise the costs of regulatory reporting. If the requirements of national and state based regulatory arrangements overlap, duplication of information reporting may not be able to be eliminated.

The AER is also required to consider the costs of information reporting, if it intends to gather information by way of a regulatory information instrument. The AER notes that information reporting costs will be incrementally higher for those NSPs not currently subject to information reporting of a comparable standard to the future AER reporting requirements. However, in a national regime significant variations to the standard reporting framework will limit the effectiveness of annual performance reports, in terms of meeting the objectives and priorities of the reports.

The AER also notes that the information gathered is not gathered solely for annual reporting purposes, and while it may be used in a performance report, that will be secondary to the other purposes of fulfilling economic regulatory functions and monitoring compliance with regulatory determinations.

SP AusNet suggested combining Demand Management Incentive Scheme annual reporting with the broader annual regulatory reporting. The AER has adopted this approach in recent information requests and will consider implementing the approach in future regulatory reporting arrangements.

3.3.2 Content and analysis of reports

AEMO suggested that an objective be included which reflects performance reports being used to inform regulatory determination processes. The AER intends to use the information published in annual performance reports to assist in future regulatory determinations. AEMO further suggested that performance reports should include an analysis of drivers underpinning expenditure. The AER considers that such analysis is important to achieving the objectives of transparency and accountability and will include information on expenditure drivers where possible.

Integral Energy stated that when comparing forecast and actual operating expenditure, the AER should compare EBSS reporting, not that included in the regulatory accounts. The AER notes that the approach proposed by Integral Energy has the benefit of focussing attention on elements of operating expenditure that are controlled by the NSP, and such comparisons may provide for better analysis of the NSP's actions.

ActewAGL stated that the detailed review at the time of the price determination provides the correct context for performance assessment, and that the determination itself provides effective incentives for performance. The AER accepts that the regulatory regime, as implemented through regulatory determinations, imposes an incentive framework on NSPs. The AER agrees that the regulatory determination process is an appropriate time to undertake detailed analysis of NSPs' performance and proposals, but it should not be limited to this process. The AER will also undertake such analysis at other times to complement its regular five year reviews. Publicly available annual performance reports will enhance the existing regulatory regime by providing stakeholders with relevant and timely information that can inform their participation in the regulatory determination process. The AER notes that

all information obtained from NSPs will be used to inform regulatory determinations, consistent with its obligations with regard to information gathering.⁷

APA Group suggested that the AER should distinguish between collecting information for compliance and performance outcomes. The AER does not see this distinction as material, although both are stated priorities of performance reports and are fundamental to its objectives.

The Energy and Water Ombudsman of NSW advocated for the relationship between NSPs and their customers being the subject of performance reporting. However, the AER is not required under the NER to collect such information, and jurisdictional regulators and ombudsmen are currently better placed to do so. Separate reporting requirements under this framework will address the relationships of NSPs and customers.

Similarly, Origin Energy notes that retailers have limited influence over (in terms of NSP performance) the accuracy, quality and timeliness of metering data. The AER is not proposing to collect metering data at the moment and, will not be reporting on this information.

Total Environment Centre (TEC) suggested that the AER should report comparisons between forecast and actual demand growth, citing benefits such as transparency in monitoring justifications for increased network capital expenditure. This demand information is consistent with the priorities and objectives. The AER intends to collect forecast and actual demand growth information in the future, given the importance of demand forecasts in driving capital expenditure.

TEC also recommended the AER include greenhouse reporting as part of demand management reporting, however the AER is not required to collect this information under the NER and it is more appropriate for other agencies such as the Greenhouse and Energy Reporting Office of the Department of Climate Change and Energy Efficiency to do so.

Integral Energy considered that explanatory text should be provided by each NSP and included in the performance report. EnergyAustralia submitted that a performance report should clearly state where an NSP considers the information to be misleading or an inaccurate reflection of performance. The AER notes that NSPs will have an opportunity to respond to the draft report, but otherwise the reports will fulfil the objective of transparency by providing stakeholders with a clear indication of the operations of NSPs from which informed judgments can be made.

3.3.3 Availability of historical information

AEMO, TEC and ETSA Utilities noted the need for historical information.

The AER considers that it is appropriate for stakeholders to be well informed of a NSP's historical performance. However, information collected by the AER may differ from information applied by jurisdictional regulators in terms of definitions and derivation. As such, annual reporting information may not be presented consistently. Where possible, the AER will publish historical information. Alternatively, links to

⁷ NEL, Section 28F

previous performance reporting information can be provided to allow stakeholders access to historical information.

A. Submissions received

The following parties provided submissions on the discussion paper:

ActewAGL

Australian Energy Market Operator

APA Group

CitiPower and Powercor

Country Energy (now known as Essential Energy)

Energex

EnergyAustralia (now known as Ausgrid)

Ergon Energy

ETSA Utilities

Energy and Water Ombudsman

Integral Energy (now known as Endeavour Energy)

Grid Australia

Origin Energy

SP AusNet

Total Environment Centre

Copies of these submissions are available on the AER's website at www.aer.gov.au/content/index.phtml?itemId=742799.

B. Priorities and objectives of electricity NSP performance reporting

B.1 Objectives of electricity NSP performance reporting

The AER considers performance reports will enhance the effectiveness of the regulatory regime and reflect the NEL requirements to foster the achievement of the NEO through incentive based regulation. The AER considers this will be achieved through enhancing the transparency and accountability of NSPs, and facilitating performance improvements.

Education

Performance reporting will enable the AER to publish meaningful regulatory information. The information in performance reports will educate stakeholders on the NSPs' performance and the outcomes of regulatory processes. Access to the information will encourage a greater understanding of and participation in future regulatory processes. This should lead to greater effectiveness of the regulatory framework as a whole, and improvements in the regulatory framework over time.

Transparency

Performance reporting promotes transparency. Reporting on the NSPs' expenditure, investment decisions and service levels allows for comparisons to be made between NSPs and over time. This will provide an insight into the NSPs' business practices and decision making. This will lead to better informed stakeholder participation in regulatory processes, and enhance the effectiveness of the regulatory framework.

Performance reporting will also establish benchmark expenditure and investment levels. These benchmarks may be applied by the AER when undertaking future transmission or distribution determinations to identify areas for more detailed review.

Accountability

Performance reporting enhances accountability through outcomes monitoring. Performance reports will allow users to see whether an NSP's actual expenditure is consistent with its forecast expenditure, and to review why differences may have occurred. Performance reports will also review and compare the NSPs' service performance levels. This information will provide all stakeholders with the opportunity to assess the actual performance of the NSPs against the forecast performance levels specified in the NSPs' regulatory proposals.

Improve performance

Performance reporting will enable comparisons between the NSPs' expenditure, revenues and performance, in different regulatory years and jurisdictions. This may encourage NSPs to adopt more efficient processes and promote technologies applied successfully by better performing NSPs. It may also provide NSPs with an incentive to increase service performance while maintaining efficient investment levels.

B.2 Priorities of electricity NSP performance reporting

In order to achieve each of these objectives, the priorities of NSP performance reporting are:

- Report the NSPs' compliance with approved cost allocation methods, and elements of the regulatory determination, including service standards and incentive schemes.
- Report the NSPs' forecast and actual outputs, including measures of network utilisation and asset age, to identify areas of NSP performance that may be reviewed by the AER.
- Report forecast and actual capital and operating expenditure, and identify reasons for differences between forecast and actual expenditures.
- Report benchmark expenditure information to allow comparison of NSP performance over time and between NSPs, including in different jurisdictions.
- Report and compare the NSPs' network operations, including service standard levels and demand management information.
- Report comprehensive, accurate and reliable information, enabling stakeholders to undertake analysis of performance and have confidence in the results of that analysis. Provide information over time to enable trends to be identified and comparisons of changes in performance, outputs and expenditures to be made between NSPs.
- Report the NSPs' profitability, comparing businesses within and across jurisdictions and regulatory control periods.
- Report information that can be utilised for future distribution determinations, including information on cost drivers, expenditure trends, service levels and variations in network performance.

C. NEL and NER requirements

Section 7 of the NEL: National Electricity Objective

The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to-

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

Section 28V of the NEL: Preparation of NSP performance reports

- (1) Subject to this section, the AER may prepare a report on the financial performance or operational performance of 1 or more network service providers in providing electricity network services.

Note-

The AER may only prepare a report under subsection (1) if the preparation of the report will or is likely to contribute to the achievement of the national electricity objective: see section 16.

- (2) A report prepared under this section may-
 - (a) deal with the financial or operational performance of the network service provider in relation to-
 - (i) complying with (as the case requires) distribution service standards or transmission service standards; and
 - (ii) standards relating to the provision of electricity network services to network service users or end users; and
 - (iii) the profitability of network service providers in providing electricity network services; and
 - (b) if the AER considers it appropriate, deal with the performance of the network service provider in relation to other matters or things if that performance is directly related to the performance or exercise by the AER of an AER economic regulatory function or power.

Clause 8.7.4 of the NER: Preparation of NSP performance report

- (a) Before the AER embarks on the preparation of *network service provider performance reports*, the AER must consult with:
 - (1) *network service providers*; and
 - (2) bodies representative of the *network service providers* and *network service users*; and
 - (3) the public generally;

in order to determine appropriate priorities and objectives to be addressed through the preparation of *network service provider performance reports*.

- (b) In the course of preparing a *network service provider performance report*, the *AER*:
- (1) must consult with the *network service provider* or *network service providers* to which the report is to relate; and
 - (2) must consult with the authority responsible for the administration of relevant *jurisdictional electricity legislation* about relevant safety and technical obligations; and
 - (3) may consult with any other persons who have, in the *AER's* opinion, a proper interest in the subject matter of the report; and
 - (4) may consult with the public.
- (c) A *network service provider* to which the report is to relate:
- (1) must be allowed an opportunity, at least 30 business days before publication of the report, to submit information and to make submissions relevant to the subject matter of the proposed report; and
 - (2) must be allowed an opportunity to comment on material of a factual nature to be included in these reports.