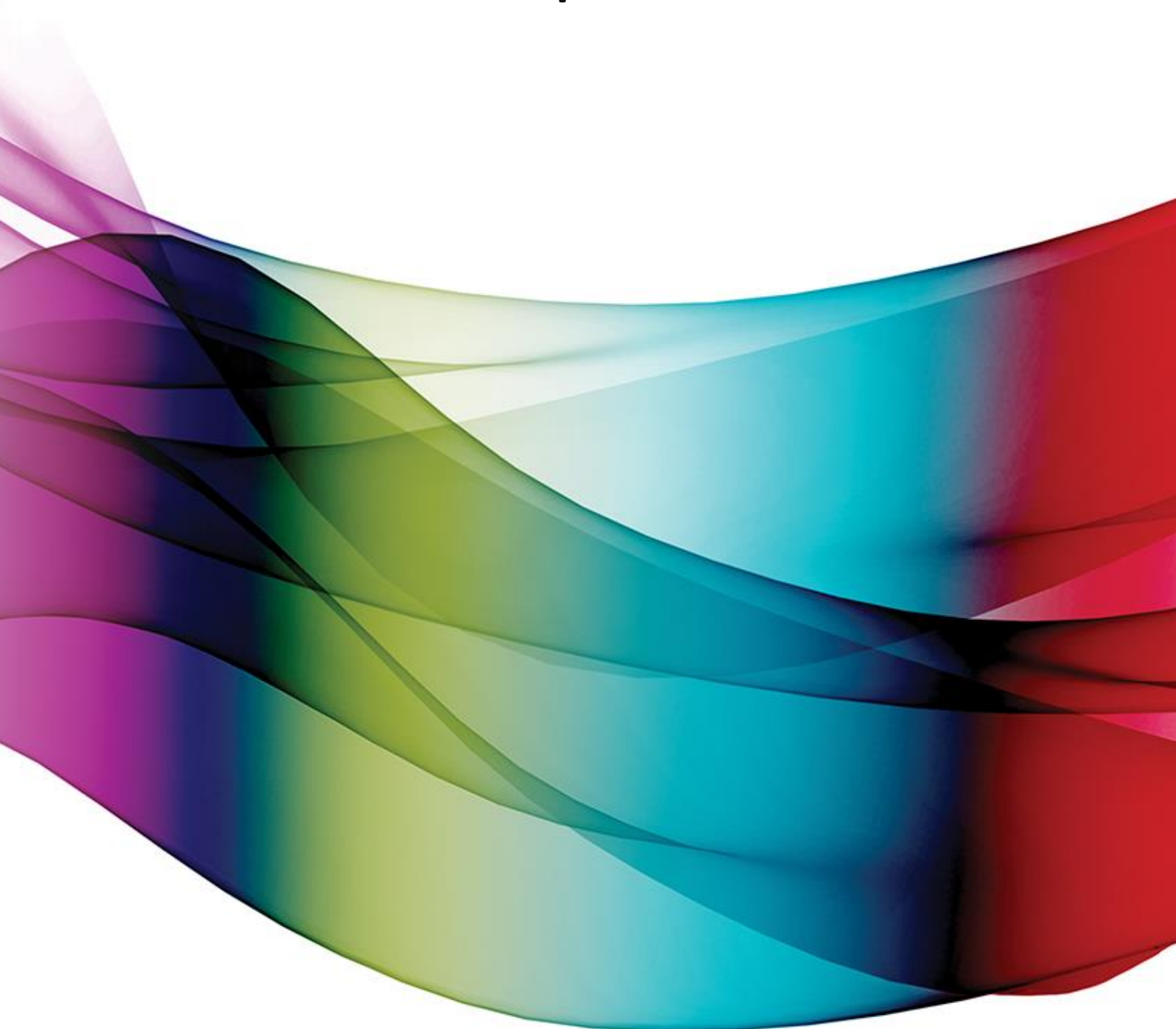



# Framework and Approach 2019-24 Discussion Paper





# *Framework and Approach 2019-24 Discussion Paper*

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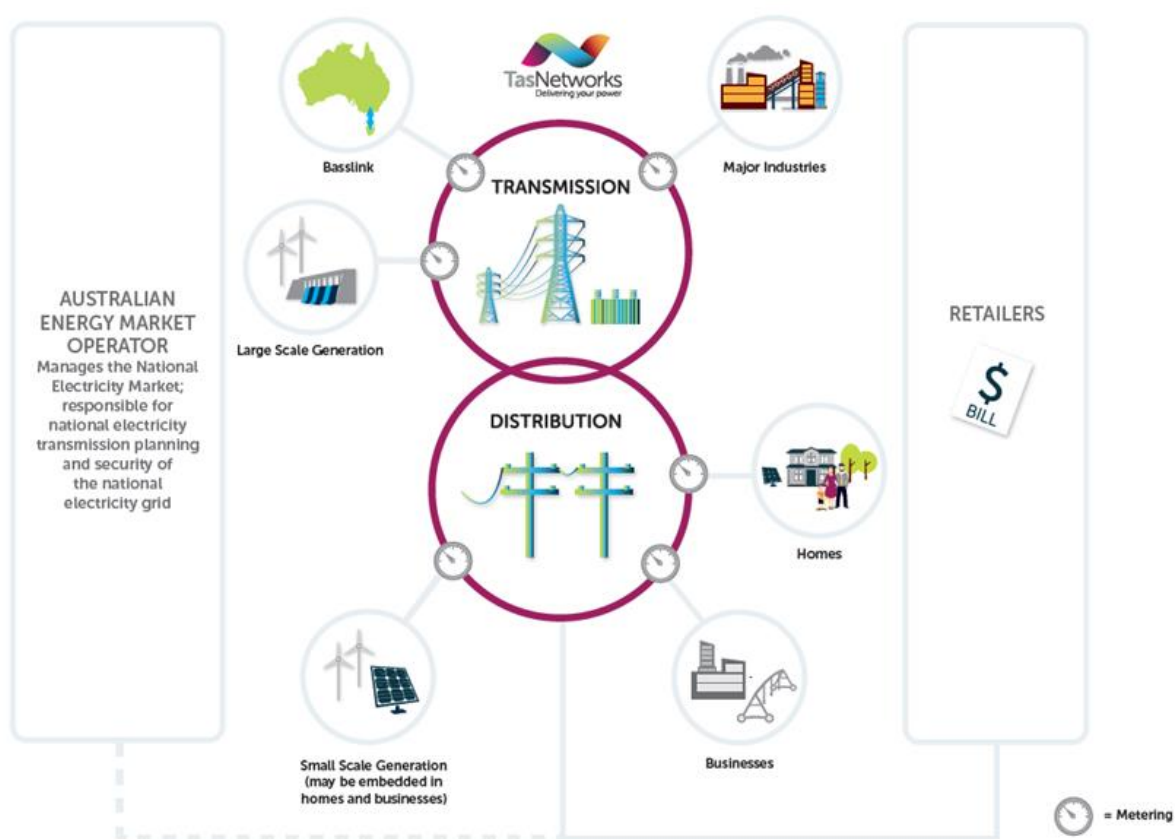
## 1. Introduction

TasNetworks commenced operations on 1 July 2014. We own, operate and maintain the transmission and distribution networks that deliver electricity to more than 280,000 Tasmanian households, businesses and organisations. We are a state-owned corporation with assets valued at over \$3 billion. Our purpose is to create value for our customers, our owners and our community.


For the majority of the network services we provide, the revenue we receive and how these services are priced, is regulated by the Australian Energy Regulator (AER).

**Figure 1: TasNetworks' role in the electricity supply chain**

TasNetworks provides a variety of electricity network services for the transmission and distribution of electricity in Tasmania.



There are a significant number of activities involved in building, renewing, operating and maintaining our networks in a reliable and safe manner. We construct new assets to connect new customers, replace assets that are at the end of their useful lives and maintain and operate our existing assets. We recover the costs of this work from our customers through transmission network charges and distribution network tariffs, charged via electricity retailers.



Transmission network charges can be substantial for customers that connect directly to our transmission network, such as major industrial customers. For customers connected to the distribution network, network charges (distribution and transmission) make up slightly over half of a typical electricity customer's bill received from retailers.

## 1.1. Why does the AER set revenue and prices?

We own and operate a large monopoly transmission and distribution business that supplies electricity to customers all over the mainland of Tasmania. We provide connections to our network to industrial, business and residential customers.

The AER regulates revenue and pricing frameworks for electricity network businesses in Australia, to make sure we only recover efficient costs for providing our services. The AER also puts in place incentive frameworks, to give us financial incentives to maintain or improve service delivery at the lowest sustainable cost.

## 1.2. What is the Framework and Approach?

The National Electricity Law and the National Electricity Rules (**the Rules**) describes the process by which the AER sets our revenues and approves our pricing approach.

These Rules provide the AER with a number of options for how they may set the revenue and prices for different network services. Once the AER has determined its preferred approach, this is published in its 'Framework and Approach' document.


The Framework and Approach is the first stage in the regulatory process to determine the regulated revenue we will be able to recover from customers for the regulatory period beginning in 2019. It sets the foundation for the whole regulatory process.

The Framework and Approach determines:

- ☐ which of our services the AER will regulate;
- ☐ how these services will be regulated; and
- ☐ the form of control (in terms of pricing arrangements) that will be applied.

It also determines the nature of the incentive plans and how these will interact with the way we operate our business for the five year period.

Under the Rules, TasNetworks, as a network service provider, may lodge a request to amend the current Framework and Approach. We are preparing to lodge our proposals for change in October 2016 and this paper outlines our initial thinking. We believe that it is important that our customers have their say on this initial stage of the regulatory process, as that customer feedback helps shape our thinking and our plans.



There will also be further opportunities for customers to engage on these issues as the AER will consult on its draft Framework and Approach in April 2017 before its proposed approach is published by the end of July 2017.

### 1.3. Submission and more information

We are interested in hearing your views by Friday 14 October 2016 on our proposed approach described in this document and especially your responses in relation to the questions highlighted throughout this document.

You can submit your views at:

[revenue.resets@tasnetworks.com.au](mailto:revenue.resets@tasnetworks.com.au)

Or, you can find out more via:

[www.tasnetworks.com.au/customer-engagement](http://www.tasnetworks.com.au/customer-engagement)

or you can contact us through our Customer Service Centre: 1300 361 811

### 1.4. What is the regulatory period that the Framework and Approach will apply to?

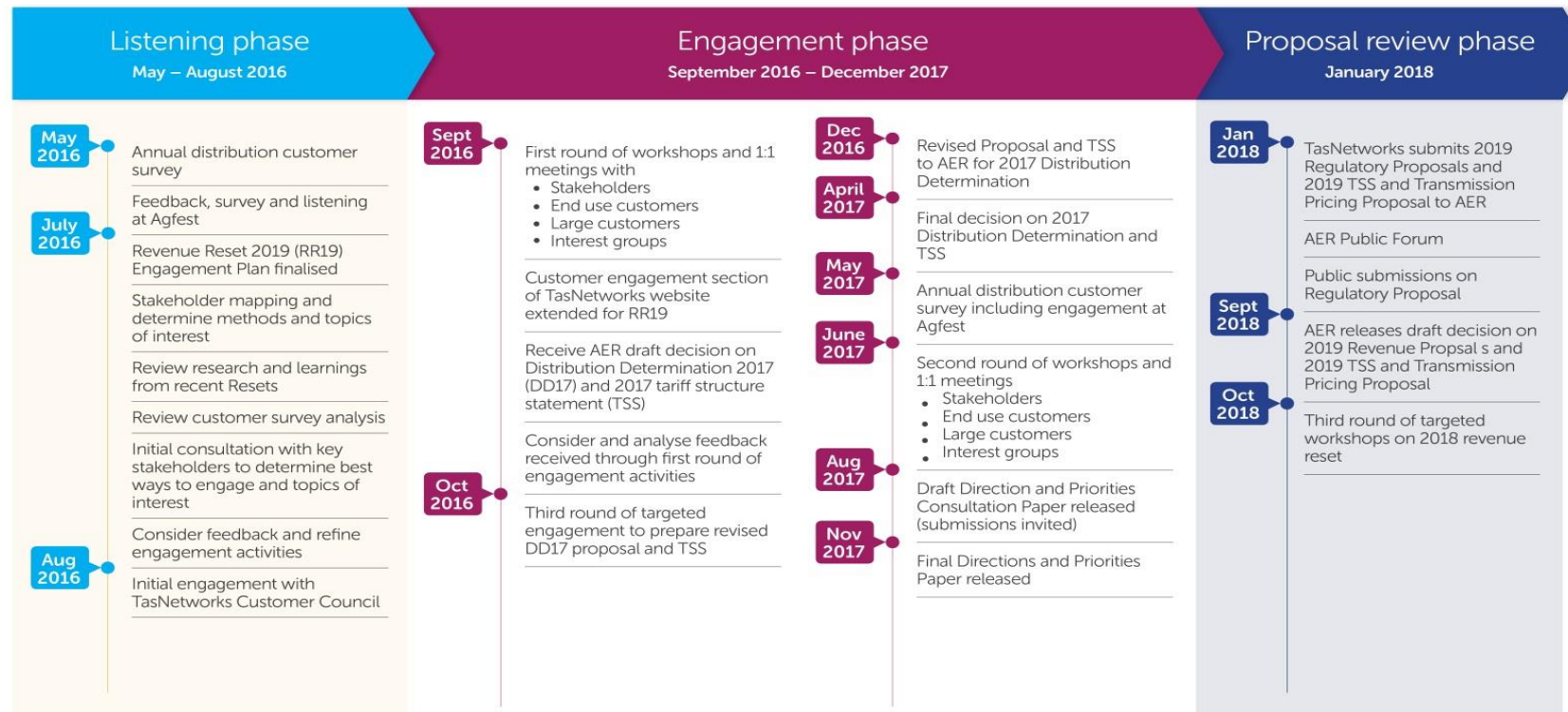
TasNetworks provides transmission and distribution network services, and presently each have different regulatory periods. Under the Rules, the arrangements for regulating and pricing transmission and distribution services are slightly different.

Our customers have expressed a strong preference for engaging with us to consider all our network services, revenues and prices as part of one process. As a result, we are aligning our distribution and transmission regulatory periods. This means our next regulatory period for our distribution business will be for a two year period: the 2017-18 and 2018-19 financial years. From July 2019 the transmission and distribution regulatory periods will be aligned.

At the end of September 2016, the AER will release its draft decision on our 2017–19 regulatory proposal for our distribution business. We have valued the level of input and customer participation so far, and encourage all interested customers to engage with us and the AER following the release of the draft decision (to be released late September 2016).

Throughout the remainder of 2016 and 2017, we will be preparing its draft proposal for next regulatory period starting in 2019. The Framework and Approach paper is the first step in this regulatory process. An infographic is provided on the following page, which highlights the on-going consultation we plan leading up to the submission of our Regulatory proposal in 2018.

## 2019 Revenue Reset Engagement timeline



### Key engagement topics/requirements

- TasNetworks' Business Strategy 2025
- Forecast expenditure programs
- Connections and Metering
- Pricing Strategy and Methodology
- Tariff Reform
- Regulatory Framework including incentive schemes
- New technologies and the future network
- Customer's preferences on service, price and reliability



## 2. Overview of this paper

This paper sets out the range of issues covered by the Framework and Approach for both transmission and distribution revenue and price setting, and poses questions we would like to hear your views on.

Where the regulatory and customer treatments are the same, or similar we have combined consideration of transmission and distribution issues otherwise they are discussed separately.

This document provides an overview of and questions relating to the:

- ☐ length of the regulatory control period;
- ☐ classification of transmission services;
- ☐ classification of distribution services;
- ☐ form of control;
- ☐ incentive schemes overview;
- ☐ incentive schemes - transmission; and
- ☐ incentive schemes – distribution.


## 3. Regulatory Control Period

### 3.1. Length of regulatory period

The regulatory control period is the length of time that the AER will set pre-defined arrangements for our revenue and pricing frameworks. For our 2017 - 19 distribution determination we sought permission for a two year regulatory period in order to align our transmission and distribution regulatory control periods. This was a special case that resulted from the merger of the business in 2014.

Generally, regulatory determinations are for much longer periods: the Rules required a minimum of five years, although longer periods may be accepted. The length of a period is trade off across a range of variables, including a reasonable planning horizon, the costs of a reset process, and a clear revenue and pricing period that provides customers with some certainty and allows businesses time to respond to longer-term incentives.

As part of our Framework and Approach proposal, we have the opportunity to propose what we consider is the appropriate regulatory period.



### 3.2. What is the AER's current approach?

While the Rules allows for transmission and distribution regulatory periods longer than five years, common practice has been for the AER to apply a five year regulatory period for most transmission and distribution networks. This is seen to strike the right balance between pricing and revenue certainty, and flexibility for networks to adapt to changing circumstances.

### 3.3. What regulatory period should apply?

We intend to propose a five year period for our 2019 regulatory reset. This means that the regulatory proposal we will be submitting will apply for the 2019-24 period.

We believe that this provides benefits for our customers by balancing certainty and flexibility. This allows us to plan our investment and operations, and to provide price certainty over this period. The five year period also ensures that we are not locked in to a revenue or pricing path that may not match changes in external factors such as the economy or technological change.

**Q1.** We are interested in your views as to what should be the length of the upcoming regulatory period to apply from 2019? Do you think that five years is an appropriate regulatory period?

## 4. Classification of Transmission Services

The AER can define transmission services as either prescribed, negotiated or unregulated. Prescribed transmission services are generally those services that are included within the charges that all users pay for the network; they are shared across multiple users and provide a standard level of service.

Negotiated transmission services are generally services provided when another party negotiates directly with us for a dedicated service, with a dispute resolution framework to support any negotiating issues. This is normally applicable to large customers and generators.

Unregulated transmission services are not regulated under the economic regulation framework.

Unlike the Framework and Approach for our distribution business, the Rules require that we propose those services we want to be prescribed services within our revenue proposal in January 2018. Our customers will therefore have the opportunity to provide feedback further on in our regulatory process.



## 5. Classification of distribution services

### 5.1 Why does the AER classify our services into different groups?

The AER has a number of options available as to how it can classify our distribution services. Most of our regulated revenue comes through what are known as Direct Control Services. This is when the AER sets a revenue stream or a price for a service based upon what it assessed to be efficient costs. Direct Control Services can take one of two types:

- ☐ **Standard Control Services** - services in which the cost is spread across multiple customers using the shared network. The AER's recent practice has been to use a revenue cap and tariff structure statement to set the efficient revenue and pricing frameworks for providing these services.
- ☐ **An Alternative Control Service** - in effect a fee-for-service in which the benefit from that service can be attributed to a single customer. The price for Alternative Control Services is generally set by a price cap or formula approved by the AER.

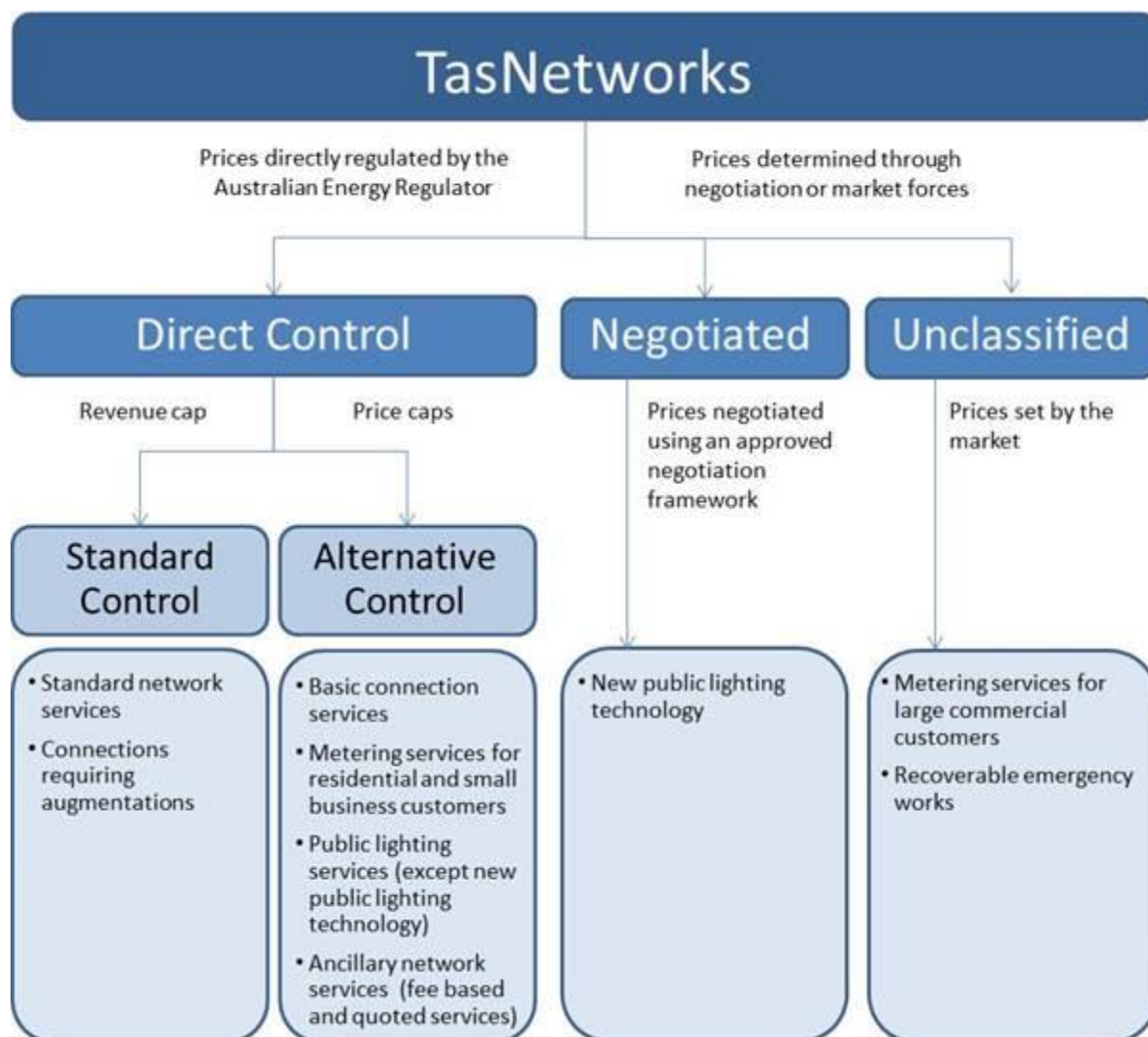
Where it considers a service to not be a Direct Control Service, the AER can also choose to classify services as either:

- ☐ **A Negotiated Service** - where parties negotiate a price for that service with us. Normally negotiated services are classified because large customers are in a position to negotiate price directly with TasNetworks. Our negotiation framework is offered in line with the requirements of the Rules; or
- ☐ **An Unclassified Service**, which is where a service is considered to be outside of AER regulated oversight. Unclassified services are also referred to as unregulated services.

### 5.2 What is our current position on classification?

We proposed the following classification of services to the AER for the 2017-19 distribution regulatory proposal. This service classification has been guiding the regulatory process and is depicted in figure 2.

**Figure 2: TasNetworks's proposed classifications for the provision of distribution services for the 2017 Revenue Reset**



### 5.3. Should our current classification change?

At this stage we are not considering major changes to the service classification outlined above. The AER may agree with this assessment as part of its upcoming draft distribution determination, due at the end of September 2016.

New rules will apply from December 2017 that will change the treatment, and service classification, of some metering services in the future. This is discussed below.

**Q2.** We are interested in your views on the distribution service classification and whether it appropriately categorises each of the services we provide.

*Further information to explain our proposed classification is included below.*



## ***Standard network services - Network maintenance and investment services***

We provide network services to our customers and we aim to do this in a safe and reliable manner. Services we provide by building and maintaining the shared distribution network, and supporting market and customer service systems, are by their nature difficult to attribute to single customers. Therefore it makes sense for these services to remain standard control services with the costs of providing these services shared by all customers.

### ***Connections***

We consider that connections requiring augmentations should be considered standard control services, and priced in accordance with our Connection Pricing Policy.

The majority of connections we receive are for basic connections to the existing network. We propose that these basic connection services<sup>1</sup> be classified as alternative control services so that customers pay for the service they receive. This classification supports an environment where competition could emerge in the provision of these services.

Our previous discussions with our customers indicated support for this approach.

### ***Public Lighting Services***

Public lighting services<sup>2</sup> involve the provision, construction and maintenance of public lighting and emerging public lighting technology. We currently own and operate over 42 000 public lighting installations across Tasmania, with our customers primarily being local councils.

We are not considering any changes to the classification of public lighting services, although competition for these services does already exist in some areas. Our position reflects recent engagement with customers, including as part of the 2017 distribution revenue reset process.

Our current thinking is that public lighting should remain an alternative control service in the 2019 regulatory period, and that new public lighting technology should remain as a negotiated service.


### ***Metering Services***

Basic meters for small customers in Tasmania are regulated, and provided as an alternative control service. Some metering services for larger customers<sup>3</sup> are currently provided as unregulated services.

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<sup>1</sup> For more details on how we currently provide basic connection services please refer to <https://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/2016-17-Basic-Connection-Services-Application-and-Price-Guide.pdf>

<sup>2</sup> For more details on how we currently provide public lighting services please refer to [http://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/PP004-Public-Lighting-Services-Application-and-Price-Guide-\(approved\).pdf](http://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/PP004-Public-Lighting-Services-Application-and-Price-Guide-(approved).pdf)



Under new national rules, all metering will become a competitive (or unclassified) service over time, as existing meters are replaced and new meters are installed.

We believe that regulated metering services for small customers should remain as an alternative control service.

We may need to develop some new services to help facilitate further contestability in the provision of metering. We will continue to work with our customers in relation to supporting new metering services.

### ***Ancillary Network Services (user pay services)***

We provide a number of ancillary services including site visits, meter testing, and tee up (pre-arranged works timing) services.

We consider that ancillary network services<sup>4</sup> should continue to be priced on a user pays principle and that these services should remain an alternative control service.

## **6. Form of Control**

### **6.1. What does form of control mean?**

Following on from service classifications, we must propose the pricing control mechanism for Direct Control Service revenues and/or prices.

The Rules dictate the options that are available to the AER when determining the type of control. When it comes to network services that are shared across the customer base (standard control services), the AER basically has a choice between either revenue cap or a price cap. We will recommend a form of control as part of its Framework and Approach proposal.

### **6.2. What is the current approach?**

Most network services are regulated under a 'revenue cap'. This is known as a 'form of control'.

A revenue cap sets out the allowed revenue amount that we can recover from our customers. This revenue is comprised of a number of elements, referred to as 'building block' components. The diagram below illustrates the building blocks that the AER uses to establish our costs and to set our revenues for the majority of our network services.

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<sup>3</sup> For more details on how we currently provide metering services please refer to [https://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/PP003-Metering-Services-Application-and-Price-Guide-\(approved\).pdf](https://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/PP003-Metering-Services-Application-and-Price-Guide-(approved).pdf)

<sup>4</sup> For more details on how we currently provide these services please refer to [http://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/PP005-Fee-Based-Services-Application-and-Price-Guide-\(approved\).pdf](http://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/PP005-Fee-Based-Services-Application-and-Price-Guide-(approved).pdf)

Unlike distribution services, the form control for transmission services is not proposed in the Framework and Approach. In fact the Rules require prescribed transmission services to be regulated under a 'revenue cap'.

## Economic regulation of networks



- +/- Service bonus/penalty
- +/- Pass-through items
- Opex, capex and other incentive schemes

We can propose different types of control for standard and alternative control services due to the differing nature of these services. This is discussed below.

### ***Distribution - Standard control services***

We are currently subject to a revenue cap for its standard distribution services. This applies to new network investment, and maintaining and operating the network safely. A revenue cap sets the maximum revenue that we are able to recover from our customers each financial year. The aim is to set the level of revenue to exactly match our efficient costs. Distributors comply with the constraint by forecasting electricity customer numbers, demand and usage for the next regulatory year and setting prices so the expected revenue is equal to or less than the total revenue.

At the end of each regulatory year, the distributor reports its actual revenues to the AER. The difference between the actual revenue recovered and the total revenue allowed is adjusted for in future years' revenue.

### ***Distribution - Alternative Control Services***

For those services that are considered ancillary services such as metering or customer requested activities, a price cap is generally used. This sets a maximum price that can be charged to each customer when the service is delivered. This is a formula based price cap based upon a combination of inputs such as labour, equipment and materials.



## 6.3 Should TasNetworks propose to change its form of controls?

We have recently engaged on the form of control for distribution services as part of the 2017 revenue reset. We do not propose further changes. We have provided information below on some of the key considerations.

### ***Distribution - Standard Control Services***

As mentioned above there are two types of form of control for standard control services, either a revenue cap or a price cap. The AER has a preference for revenue caps, and we do not envisage that changing from the current revenue cap arrangements will deliver better outcomes for our customers.

We consider that the revenue cap will continue to ensure the correct balance between investment certainty, price signals and a transition to fairer, more cost-reflective pricing.

**Q3.** We are interested in your views on the form of price control for distribution standard control services and your considerations on our preferred approach of applying a revenue cap.

### ***Distribution - Alternative Control Services***


Alternative control services such as metering, public lighting and ancillary network services are currently subject to a price cap form of regulation, which may involve a formula setting out efficient inputs to the price cap. We intend to propose a continuation of this form of price control for alternative control services as we consider it supports cost-reflective prices.

**Q4.** We are interested in your views on the form of price control for distribution alternative control services and your considerations on our preferred approach of applying a price cap to these services.

## 7. Incentive Schemes

The Rules grant the AER a number of options to ensure that when setting prices that networks are provided with a range of incentives to maintain or improve customer service outcomes while reducing costs. The incentive schemes aim to encourage efficient spending over time. Many of the schemes are similar in design across transmission prescribed services and distribution standard control services.

Our performance against the incentive schemes, and the resulting revenue impact, whether positive or negative, flows through to the charges faced by our customers. Distribution connected customers will see the impact of the distribution incentive schemes and a share of the transmission incentive schemes.



## 7.1 Expenditure incentive schemes

The Capital Expenditure Sharing Scheme (**CESS**) and Efficiency Benefit Sharing Scheme (**EBSS**) are intended to encourage us to maintain and incentivise efficient operating and investment decisions.

These schemes are quite similar between transmission and distribution and encourage us to deliver our services for lower than the capital and operating expenditure allowances, with the savings shared between TasNetworks and customers over the medium term.

We believe that both of these schemes provide us with the appropriate incentives to find ways to sustainably reduce our expenditure, and that customers benefit from lower long term electricity prices.

**Q5.** We are interested in your views on the application of the EBSS and the CESS for both transmission and distribution in the upcoming regulatory period?

## 7.2 Other incentive schemes

The Service Target Performance Incentive Scheme (**STPIS**) incentivises us to improve our service and reliability in cost effective ways, and to meet service obligations at efficient costs. The schemes differ across transmission and distribution, and are discussed separately below.

The final incentive scheme applicable to both transmission and distribution is the small-scale incentive scheme that the AER may develop to encourage more efficient investment or operation of the network in a manner that complements the existing incentive arrangements in place.

We support the current range of incentive schemes and believe they are an important balance between ensuring that costs are held at an appropriate level while improving reliability and delivering electricity services in a safe manner.


There are some additional schemes for distribution, which are discussed further below.

**Q6.** We are interested in your views on the suitability of each of the respective incentive schemes. We are also interested on your views as to how the incentive schemes work and interact as a whole.

## 8. Service incentive scheme – Transmission

There are three components of the transmission service scheme:

- ☐ a service component that measures plant availability and the number of loss of supply events;

- 
- ☐ a market impact component that measures the impact our transmission outages have on spot market prices for energy; and
  - ☐ a network capability component that provides incentives to increase the capability of the existing network.

These three elements all contain a weighting and contribute to the overall incentive cap which provides for between -3 and +4.5 per cent of revenue at risk. This means as a business we have the opportunity to be rewarded up to 4.5 per cent of revenue for above target service outcomes and have the potential for revenue loss up to 3 per cent for below target service outcomes.

There are a number of issues that we are considering to ensure that the STPIS regime offers the right balance between costs and service outcomes. We are interested in views from our customers around the service areas customers consider should be linked to financial incentives, and how large these incentives should be.

**Q7.** We are interested in your views on the elements of the transmission incentive schemes and the proposed STPIS incentive/penalty rates.

## 9. Incentive Schemes - Distribution


### 9.1. Service target performance incentive scheme

There are three components of the distribution service scheme:

- ☐ A service component that measures the average outage length and frequency for customers in different areas of the state
- ☐ A service component that measures how many fault-related calls are answered within 30 seconds
- ☐ A guaranteed level of service (**GSL**) component, based on the Tasmanian Economic Regulator's scheme.

The first two elements contain a 'moving' weighting and contribute to the overall incentive cap. We are subject to a cap of five per cent of our total revenue being at risk under the distribution STPIS scheme. Currently the customer service component is 0.5 per cent with the residual 4.5 per cent heavily linked to the reliability component of the scheme.

We also receive financial incentives under the GSL component: the AER generally provides a revenue allowance, using an 'average' amount for GSL payments based on past performance. We therefore have a financial incentive to reduce our GSL costs (eg where it is more cost effective to invest in the network).



The impact of the incentive schemes, whether they be positive or negative, flow through only to distribution connected customers. Thus, customers directly connected to the transmission network are not exposed to the outcome of these distribution schemes.

**Q8.** We are interested in your views in relation to the incentive properties within the STPIS regime for distribution? Do you support a higher or lower penalty/incentive or a different weighting of the scheme between reliability and customer service?

## 9.2. Demand management incentive scheme

The Demand Management Innovation Allowance (**DMIA**) is effectively an allowance to encourage innovation, especially in the area of demand management. The regulatory framework provides these incentives to bring forward non-network alternatives to meeting demand related network augmentations. However the AER has indicated that a new demand management incentive scheme and innovation allowance mechanism will be introduced by December 2016. It is expected that the scheme will only provide rewards rather than also imposing penalties.

We are particularly interested in how this new scheme will apply in the Tasmanian context. The AER has indicated that the new incentive scheme will allow networks to undertake expenditure on non-network options relating to demand management. The innovation allowance mechanism will provide businesses with funding for research and development into demand management projects.

**Q9.** We are interested in your views on how a demand management incentive scheme should apply in a Tasmanian context, and how that scheme should maximise opportunities for innovative solutions to encouraging demand mechanisms.

## 10. Other issues

**Q10.** Are there other issues that you, as a customers or stakeholder, would like to raise in regards to our upcoming Framework and Approach proposal?

## 11. We want to hear from you

We are interested on your views by Friday 14 October 2016 in relation to the Framework and Approach, or any other issues you may have at this initial stage of our 2019-24 regulatory proposals for our transmission and distribution networks. In particular we are interested in your responses in relation to the questions summarised below. Submissions or views can be sent to [revenue.resets@tasnetworks.com.au](mailto:revenue.resets@tasnetworks.com.au)



## 11.1. Summary of Questions

1. We are interested in your views as to what should be the length of the upcoming regulatory period to apply from 2019? Do you think that five years is an appropriate regulatory period?
2. We are interested in our customers' views on the distribution service classification and whether it appropriately categorises each of the services we provide.
3. We are interested in your views on the form of price control for distribution standard control services and your considerations on our preferred approach of applying a revenue cap.
4. We are interested in your views on the form of price control for distribution alternative control services and your considerations on our preferred approach of applying a price cap to these services.
5. We are interested in your views on the application of the Efficiency Benefit Sharing Scheme (**EBSS**) and the Capital Expenditure Sharing Scheme (**CESS**) for transmission and distribution in the upcoming regulatory period?
6. We are interested in your views on the suitability of each of the respective incentive schemes. We are also interested on your views as to how the incentive schemes work and interact as a whole.
7. We are interested in your views on the elements of the transmission incentive schemes and the proposed Service target performance incentive scheme (**STPIS**) incentive/penalty rates.
8. We are interested in your views in relation to the incentive properties within the STPIS regime for distribution? Do you support a higher or lower penalty/incentive or a different weighting of the scheme between reliability and customer service?
9. We are interested in your views on how a demand management incentive scheme (**DMIS**) should apply in a Tasmanian context, and how that scheme should maximise opportunities for innovative solutions to encouraging demand mechanisms.
10. Are there other issues that you, as a customer or stakeholder, would like to raise in regards to our upcoming Framework and Approach proposal?