



DRAFT DECISION
TasNetworks distribution
determination
2017–18 to 2018–19

Attachment 13 – Classification
of services

September 2016

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Note

This attachment forms part of the AER's draft decision on TasNetworks' distribution determination for 2017–19. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for Electricity Distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

13 Classification of services

Service classification determines the nature of economic regulation, if any, applicable to specific distribution services. Classification is important to customers as it determines which network services are included in basic electricity charges, the basis on which additional services are sold, and those services we will not regulate. Our decision reflects our assessment of a number of factors, including existing and potential competition to supply these services.

We make a decision on the classification of TasNetworks' distribution services in accordance with the NER. Services are classified as direct control services or negotiated distribution services. Direct control services are further classified as standard control services or alternative control services. The classification that we apply determines the nature of the economic regulation we will apply to those services.

The classification of distribution services must be as set out in the relevant framework and approach (F&A) paper unless we consider that unforeseen circumstances justify departing from that proposed classification in our determination.¹ We set out our proposed approach to the classification of distribution services for TasNetworks in our final F&A published in July 2015.² In that paper, we proposed to group TasNetworks' distribution services as follows:

- network services
- connection services
- metering services
- public lighting services, and
- ancillary network services.

13.1 Draft decision

Our preliminary decision is to retain the proposed classification and reasons set out in our F&A for TasNetworks,³ with the exception of the following:

- We will classify basic connection services⁴ as an alternative control service for 2017–19. To be clear, this means that we are departing from our final F&A service

¹ NER, cl. 6.12.3(b).

² AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015.

³ AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, pp.

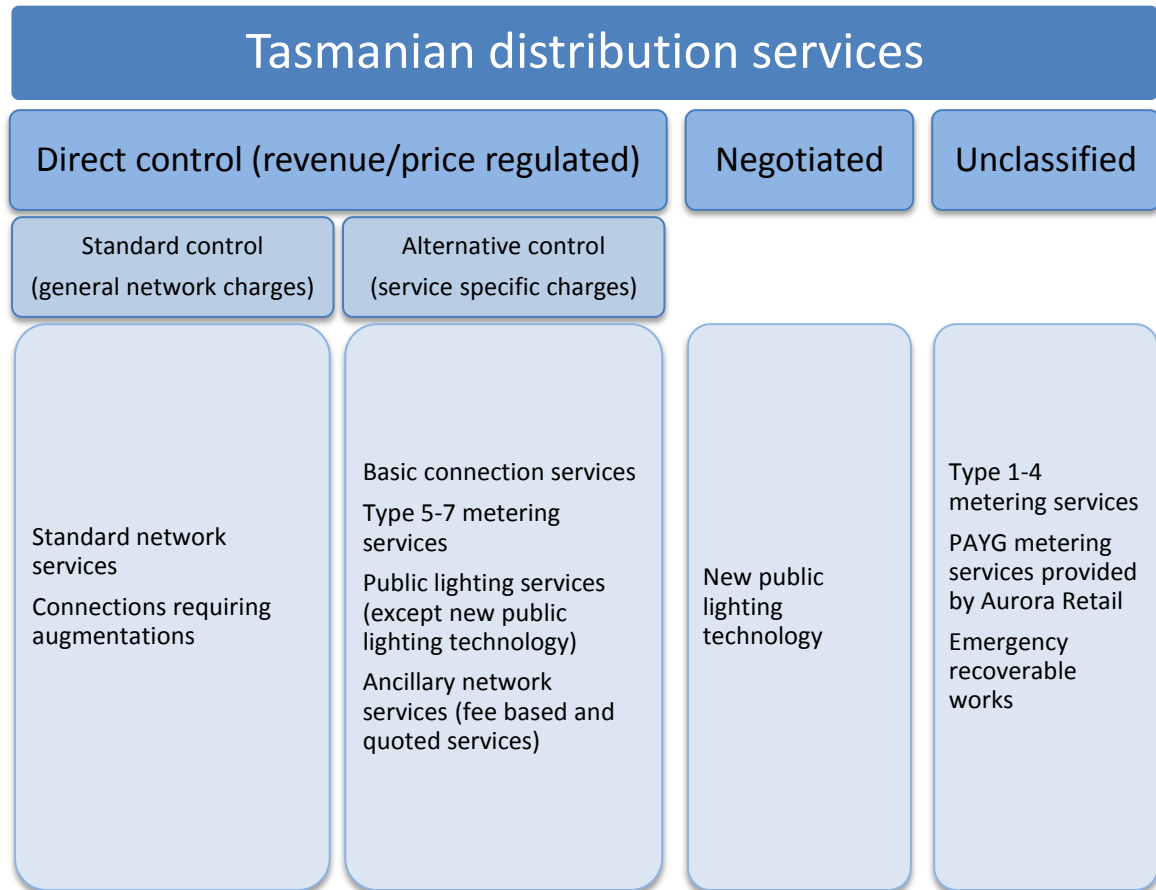
⁴ Consistent with Chapter 5A of the NER, we refer to 'basic connection services' as connection services with minimal or no augmentation. In the F&A, we distinguished between 'standard connection services' and 'connections requiring augmentation' in classifying these as standard control services. In this draft decision, therefore, we use the term 'basic connection services' as equivalent to the 'standard connection services' referred to in the F&A.

classification in relation to these services. For customers, however, TasNetworks' approach to connection charges for basic connection services remains effectively the same in the 2017–19 regulatory control period, as explained in section 13.4.

Figure 13-1 summarises our draft decision on service classifications for TasNetworks for the 2017–19 regulatory control period.

Appendix A sets out our detailed service classification decision.

Figure 13-1 AER draft decision on 2017–19 service classifications for TasNetworks



Our assessment of the classification of services determines how costs associated with the services will be recovered at a very high level. That is, whether the costs of a particular service will be recovered from basic electricity charges, as an additional charge, or recovered through an unregulated charge (i.e. not set by us). However, the detailed prescription of how service charges are set is not determined as part of service classification. Instead, that detail is discussed in the control mechanism attachments.⁵

⁵ Refer to Attachment 14 – Control mechanism and Attachment 16 – Alternative control services of our draft decision.

13.2 TasNetworks' proposal

TasNetworks proposed to adopt the service classifications as set out in our F&A for the 2017–19 regulatory control period, with one exception. TasNetworks proposed that connection services relating to the provision or alteration of a basic connection service should be classified as alternative control services instead of standard control services.⁶

TasNetworks provided the following reasons for the difference in the proposed classification. It explained that:

- Its recent decision to promote the contestable provision of some connection services supports the AER reassessing the classification of services.⁷
- Its proposed distribution connection pricing policy states that connection charges should ensure, where appropriate, the costs for a particular connection are borne by the party requesting the connection and not shared across the asset base.⁸
- Its proposed basic connection process and pricing will only be achievable if the regulator classifies these services as alternative control services.⁹
- Its approach will provide fairer outcomes to existing and future customers.¹⁰
- It is consistent with the treatment of basic connection services in Victoria.¹¹

13.3 Assessment approach

The NER allow us to group distribution services when classifying them rather than treating them as individual services.¹²

In making our classification decisions, we may:

- classify a service so the distributor may recover related costs from all customers (direct control – standard control service)
- classify a service so the user benefiting from the service pays (direct control – alternative control service)
- allow customers and distributors to negotiate the provision and price of some services – we will arbitrate should negotiations stall (negotiated distribution service)

⁶ TasNetworks, *Regulatory Proposal 2017–19*, p. 18.

⁷ TasNetworks, *Regulatory Proposal 2017–19*, p. 18.

⁸ TasNetworks, *AER Information Request, TasNetworks response to questions raised by the AER*, 21 June 2016, p. 5.

⁹ TasNetworks, *AER Information Request, TasNetworks response to questions raised by the AER*, 21 June 2016, p. 5.

¹⁰ TasNetworks, *Regulatory Proposal 2017–19*, p. 18.

¹¹ TasNetworks, *Regulatory Proposal 2017–19*, p. 18.

¹² NER, cl. 6.2.1 (b).

- not classify a service – we have no regulatory control over this service or the prices charged by the distributor (unregulated service).

In deciding whether to classify services as either direct control or negotiated services, or to not classify them, the NER require us to have regard to the 'form of regulation factors' set out in the NEL.¹³ The form of regulation factors include the presence and extent of barriers to entry by alternative providers and the extent to which any distributor market power is likely to be mitigated by any countervailing user or prospective user market power. The NER also require us to consider the previous form of regulation applied to services, the desirability for consistency in the form or regulation for similar services and any other relevant factor.¹⁴

In further classifying direct control services as standard control services or alternative control services, the NER require us to have regard to a further range of matters.¹⁵ These include the potential to develop competition in provision of a service and how our classification may influence that potential, whether the costs of providing the service are directly attributable to a specific person, and the possible effect of the classification on administrative costs.

The NER also specify that for a service regulated previously, unless a different classification is clearly more appropriate, we must:¹⁶

- not depart 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.

13.3.1 Interrelationships

In assessing what services we classify, we are setting the basis for the charges that can be levied for those services. To allow charges to be recovered for standard control services, assets associated with delivering those services are added to the regulatory asset base (RAB). A separate RAB may also be constructed for the capital costs associated with an alternative control service. There will usually be operating costs associated with the provision of a service as well.

13.4 Reasons for draft decision

This section sets out the reasons for our draft decision on the distribution service classifications for TasNetworks. We also set out our reasons for departing from our F&A proposed approach to classify basic connection services as standard control services. Since the final F&A was published in July 2015, we have considered:

¹³ NER, cl. 6.2.1(c); NEL, s. 2F.

¹⁴ NER, cl. 6.2.1(c).

¹⁵ NER, cl. 6.2.2(c).

¹⁶ NER, cl. 6.2.1(d) and 6.2.2(d).

- statements by TasNetworks in its regulatory proposal and information request responses¹⁷
- the inter-relationship between service classification, our connection charge guidelines,¹⁸ and TasNetworks' proposed distribution connection pricing policy for 2017–19 (attachments to its regulatory proposal)¹⁹
- views on service classification by the Tasmanian Government, submitted to us by TasNetworks.²⁰

Our draft decision is to depart from our final F&A position and classify basic connection services as alternative control services for the 2017–19 regulatory control period, for the reasons that follow:

- At the time of publishing the final F&A the AER did not foresee how TasNetworks' transitional arrangements, the AER's connection charge guidelines and our service classification decision would interact in the context of the Tasmanian Government's intention to encourage more competition in the provision of basic connection services.
- In accordance with the NER²¹, we consider it appropriate to retain consistency with the current regulatory approach which allows TasNetworks to charge customers for the cost of a basic connection.
- To retain the current regulatory approach, we must amend the classification of basic connection services from standard control to alternative control service.
- Classifying basic connection services as alternative control services will facilitate introduction of competition, as proposed by TasNetworks and the Tasmanian Government.
- The alternative, not changing the classification of basic connection services, would:
 - result in pricing instability for customers because TasNetworks would be forced to remove its existing charge for the duration of the upcoming two year regulatory control period, before re-introducing the charge at the next distribution reset in 2020 (when the classification would be changed)
 - potentially delay introduction of competition for basic connection services
 - not be in the long term interests of consumers.

¹⁷ TasNetworks, *Regulatory Proposal 2017–19*, p. 18; TasNetworks, *Distribution Connection Pricing Policy Overview (Attachment TN018)*, January 2016, p. 13; TasNetworks, *AER Information Request, TasNetworks response to questions raised by the AER*, 21 June 2016.

¹⁸ AER, *Connection charge guidelines for electricity retail customers under chapter 5A of the National Electricity Rules version 1.0*, June 2012.

¹⁹ TasNetworks, *Distribution Connection Pricing Policy Overview (Attachment TN018)*, January 2016 and *TasNetworks Distribution Connection Pricing Policy commencing 1 July 2017 (Attachment TN017)*, January 2016.

²⁰ Tasmanian Government (Minister for Energy), Letter to TasNetworks, 27 June 2016.

²¹ NER, cl 6.2.1(c)(3).

TasNetworks' regulatory proposal and information request response

In June 2016 we asked TasNetworks to identify sections of its regulatory proposal and connections policy where TasNetworks provided justification for its departure from the service classification for basic connections outlined in the final F&A. TasNetworks replied with a written response²² stating that:

- its regulatory proposal proposed that basic connection be reclassified as alternative control, mainly to support the promotion of contestable provision of some connection services²³
- its connection pricing policy overview proposed changes in TasNetworks' connection policy to comply with the AER's connection charge guidelines²⁴
- fair and efficient prices occur when new customers pay the costs they cause by connecting to the network.²⁵

Inter-relationship between service classification, AER connection charge guidelines and TasNetworks' proposed distribution connection pricing policy

Before TasNetworks (then Aurora Energy) was regulated by the AER for the 2012–17 period, it was regulated by the Tasmanian Energy Regulator (OTTER). For the 2012–17 period, Aurora proposed that basic connection services be classified as direct control services—standard control services, and the AER final determination agreed with that classification.

However, as 2012–17 was a transition period for Aurora under the NER transitional rules, Aurora was allowed to charge its customers a Basic Connection Service charge for the provision of Basic Connection Services,²⁶ a standard control service. This basis for charging was a carry-over from the OTTER regulation period. Normally under the NER, standard control services' costs are shared by all customers, while alternative control services have specific prices to enable the distributor to recover the full cost of each service from the individual customer using that service. Aurora's Customer Capital Contributions Policy for 2012–17²⁷ was deemed approved by the AER as Aurora's connection policy under the transitional rules.²⁸

TasNetworks has now submitted that its proposed basic connection process and pricing for 2017–19 will only be achievable if the regulator classifies these services as alternative control services. TasNetworks submitted that this classification will serve two purposes:

- it will maintain existing pricing arrangements for these services

²² TasNetworks, *AER Information Request, TasNetworks response to questions raised by the AER*, 21 June 2016.

²³ TasNetworks, *Regulatory Proposal 2017–19*, p. 18.

²⁴ TasNetworks, *Distribution Connection Pricing Policy Overview (Attachment TN018)*, January 2016, p. 152.

²⁵ TasNetworks, *Distribution Connection Pricing Policy Overview (Attachment TN018)*, January 2016, p. 10.

²⁶ Aurora Energy, *Policy: Customer Capital Contributions*, May 2011, p. 7.

²⁷ Aurora Energy, *Policy: Customer Capital Contributions*, May 2011.

²⁸ NER, cl. 11.46.8(a)

- retention of a price signal supports the framework for opening these services up to competition in the future.²⁹

We note that under our connection charge guidelines, if basic connection is classified as a standard control service, a distributor may charge a capital contribution for standard control connection services from a connection applicant, if the incremental cost exceeds the incremental revenue from that customer. This implies that TasNetworks would not be allowed to charge all its connecting customers, but only those where cost exceeds incremental revenue. This would be a change from its current charging practice, and a change in regulatory approach.

Tasmanian Government support for TasNetworks' proposed classification

The Tasmanian Government, though not consulted directly by the AER, in a letter to TasNetworks supported TasNetworks' view that basic connection services should be reclassified as alternative control services. The state government said it understood this approach will maintain existing price signals for these services while providing a pathway to opening these services up to competition in the future.³⁰

This view by the Tasmanian Government reinforces its intent to review in 2016–17 network customer connection processes and outcomes to identify opportunities for reform.³¹ The government acknowledged that stakeholders would like to see flexibility in the distribution connection process and that TasNetworks is considering options to make connection services contestable.

The state government also referred to current work by the COAG Energy Council which is looking at building a national contestability framework for electricity and gas distribution network connections.³² We think this is part of COAG's current work of conducting a strategic assessment of the adequacy of the current economic network regulatory framework to accommodate future market and technological changes.³³

Factors the AER must have regard to

In classifying a direct control service to either standard control service or alternative control service, we have revisited the matters in NER clause 6.2.2(c) listed below, in light of submissions from TasNetworks.. The AER must have regard to, among other matters:

²⁹ TasNetworks, *AER Information Request, TasNetworks response to questions raised by the AER* [email to AER], 21 June 2016, p. 5.

³⁰ Tasmanian Government (Minister for Energy), Letter to TasNetworks, 27 June 2016.

³¹ Tasmanian Government Department of State Growth, *Tasmanian Energy Strategy – Restoring Tasmania's energy advantage*, May 2015, p. 23.

³² Tasmanian Government Department of State Growth, *Tasmanian Energy Strategy – Restoring Tasmania's energy advantage*, May 2015, p. 19

³³ Council of Australian Governments (COAG) Energy Council, *Electricity network economic regulation; scenario analysis – Policy advice*, June 2015, available at <http://www.scer.gov.au/current-projects/networks>.

- the extent the costs of providing the relevant service are directly attributable to the person to whom the service is provided³⁴
- the potential for development of competition in the relevant market and how the classification might influence that potential³⁵
- the regulatory approach applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made.³⁶

We now agree with TasNetworks and the Tasmanian Government that services with potential for provision on a competitive basis, rather than by the local distributor only, should have specific prices to enable the distributor to recover the full cost of each service from the customers using that service.

Consultation on key issues

The Consumer Challenge Panel sub-panel 4 (CCP4), as requested by the AER, made a submission on whether the F&A for TasNetworks distribution for the 2017–19 regulatory period should be varied. CCP4 submitted that the classification of services should remain unchanged from the F&A which covered the 2012–17 regulatory period.³⁷

As mentioned above, we also considered the views on service classification expressed by:

- TasNetworks in its submission to the F&A process, regulatory proposal and information request response
- Tasmanian Government (although its view was indirectly obtained through TasNetworks).

Having considered the issues discussed above, we consider that TasNetworks' basic connection services should be classified as alternative control services. All other service classifications in the final F&A should remain unchanged.

³⁴ NER, cl. 6.2.2(c)(5)

³⁵ NER, cl. 6.2.2(c)(1)

³⁶ NER, cl. 6.2.2(c)(3)

³⁷ Aside from service classification, CCP4 suggested changes to other aspects of the F&A. See Consumer Challenge Panel, *Submission to the AER, Responding to request on whether to vary the Framework and Approach for TasNetworks Distribution revenue reset for 2017-2022 (sic) regulatory period*, 10 March 2015.

Appendix A – Classification of Tasmanian electricity distribution services

Service group	AER's proposed classification 2017-19	Current classification 2012-17
AER service group—network services		
Planning the distribution network	Standard control	Standard control
Designing the distribution network	Standard control	Standard control
Constructing the distribution network	Standard control	Standard control
Maintaining the distribution network and connection assets	Standard control	Standard control
Operating the distribution network and connection assets for DNSP purposes	Standard control	Standard control
Administrative support (call centre, network billing, etc.)	Standard control	Standard control
Emergency works	Standard control	Standard control
Emergency recoverable works	Unclassified	Standard control
AER service group—connection services		
Basic connection services	Alternative control	Standard control
Connections requiring augmentation	Standard control	Standard control
AER service group—metering services		
Standard metering services for type 5-7 meters	Alternative control	Alternative control

Service group	AER's proposed classification 2017-19	Current classification 2012-17
Special meter readings and meter testing of type 5-7 meters	Alternative control	Alternative control
PAYG metering services provided by Aurora Retail	Unclassified	Unclassified
AER service group—public lighting services		
Repair, replacement and maintenance of public lighting	Alternative control	Alternative control
Provision of new public lighting assets	Alternative control	Alternative control
New public lighting technology services	Negotiated	Negotiated
AER service group—ancillary services		
Energisation, de-energisation and re-energisation (includes disconnections and reconnections)	Alternative control (fee based)	Alternative control (fee based)
Meter alteration (adding and altering circuits)	Alternative control (fee based)	Alternative control (fee based)
Meter testing (including for single phase, three phase and current transformer meters)	Alternative control (fee based)	Alternative control (fee based)
Removal of meters and service connection	Alternative control (fee based)	Alternative control (fee based)
Renewable energy connection – including installation of import/export metering equipment	Alternative control (fee based)	Alternative control (fee based)
Temporary connections	Alternative control (fee based)	Alternative control (fee based)
Disconnect service connection	Alternative control (fee based)	Alternative control (fee based)
Truck tee up	Alternative control (fee based)	Alternative control (fee based)
Open turret or cabinet for electrical contractor	Alternative control (fee based)	Alternative control (fee based)

Service group	AER's proposed classification 2017–22	Current classification 2012–17
AER service group—ancillary services		
Moving mains, services or meters forming part of the network to accommodate extension, redesign or redevelopment of any premises	Alternative control (quoted)	Alternative control (quoted)
The provision of electric plant for the specific provision of top-up or stand-by supplies of electricity	Alternative control (quoted)	Alternative control (quoted)
Temporary supply	Alternative control (quoted)	Alternative control (quoted)
Reserve or duplicate supply	Alternative control (quoted)	Alternative control (quoted)
Network services and system augmentation required to receive energy from an embedded generator	Alternative control (quoted)	Alternative control (quoted)
Alteration and relocation of existing public lighting assets	Alternative control (quoted)	Alternative control (quoted)

