Replacement of framework and approach 2024–29

NSW, ACT, NT and TAS electricity distribution and TAS electricity transmission business

December 2021

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AER Reference: AER212493

Amendment Record

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1 Introduction

The Framework and Approach (F&A) is the first step in a process to determine efficient prices for electricity distribution and transmission services. The F&A determines, amongst other things, which distribution services the Australian Energy Regulator (AER) will regulate and certain aspects of a regulatory determination set out under the National Electricity Rules (the Rules). It facilitates early public consultation on the pricing mechanism for regulated services (for distribution businesses) and the incentive schemes that will encourage efficient network expenditure (for distribution and transmission businesses).

These are important aspects of the regulatory process and have a significant bearing on the regulatory proposals that Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, Power and Water Corporation and TasNetworks (as distribution businesses) and TasNetworks as a transmission business, are required to submit to us by 31 January 2023.

1.1 Why is the F&A important for consumers?

The F&A is important because it provides an opportunity for interested parties, including consumers, to have a say in which distribution services we should regulate and how much control we have over determining the prices for network services. Our intended approach on service classification will settle the ring-fencing obligations for particular services for a regulatory control period.[1]

The F&A also sets out information around incentive schemes that will apply to network service providers to encourage efficient investment and performance.

The sorts of issues we will consider in the F&A include:

- whether there is the possibility of increased competition in the provision of some distribution services traditionally provided only by network service providers. This might happen if, for example, we were satisfied there were no significant barriers to competitive provision of a particular service. In this event, we may decide not to regulate that service, leaving prices to be set by the market.
- whether the provision of distribution services should take place on a fee for service basis or perhaps as a service for which there is minimal oversight by us. For example, we may determine that a distribution business may bundle the costs for a particular service into a generic electricity supply service (standard control service). Alternatively, we may decide that charging for a service on a user-pays basis is more appropriate (alternative control service). Finally, we may allow consumers and network service

1 AER, *Ring-fencing guideline electricity distribution*, November 2021.

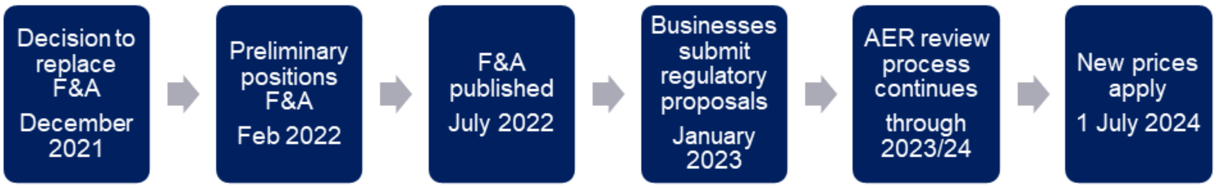
providers to negotiate the price of a service (negotiated distribution service) and only intervene if the parties cannot reach an agreement.

- whether incentive schemes will apply to distribution and transmission businesses, for example, to service quality, improvements in network reliability or capital and operating expenditure. The purpose of incentive schemes is to encourage network service providers to manage their business in a safe, reliable manner that serves the long-term interests of consumers. The schemes provide network service providers with incentives to only incur efficient costs and to meet or exceed service quality targets. In some instances, network service providers may incur a financial penalty if they fail to meet set targets.

We consider that consumers should be actively involved in the F&A process as the decisions made, particularly relating to classification of distribution services and pricing, will apply for a five-year period before they are reviewed.

Figure 1 provides an overview of where the F&A sits in the NSW, ACT, NT and TAS reset process for the regulatory control period of 1 July 2024 to 30 June 2029. Stakeholder consultation occurs throughout the process.

Figure 1 – Reset process



1.2 Our decision

For the 2024–29 regulatory control period we consider it prudent to undertake a more comprehensive review of the NSW, ACT, NT and Tasmanian F&A papers. As the transition of the energy market continues, expectations for the way consumers interact with the electricity network is also changing. In addition to this, a number of significant regulatory changes have been introduced (or are likely to be by end 2022) that are relevant for these jurisdictions. Some of these changes are outlined below.

As noted above, the electricity market is rapidly evolving, and electricity networks are becoming platforms for distributed energy resources (DER). This current F&A will be important in the process to ensure potential new services can be accommodated during the 2024-29 regulatory control period. The services being considered move away from the operation of 'traditional poles and wires' toward new options for leveraging the existing network through new technologies.

The networks began their discussions with customers early through a joint consultation process on the potential impact of emerging technologies, which included an online public forum and joint consultation paper which invited submissions from stakeholders. There are differences in the impact that potential developments will have in the upcoming reset for the different jurisdictions, for example Evoenergy in the ACT, does not expect to provide a leasing battery capacity service and is not responsible for public lighting in the ACT.

Regulatory changes include the following: rule changes to the framework for Stand Alone Power Systems (SAPS), including to incorporate SAPS as a distribution service; Access, pricing and incentive arrangements for Distributed Energy Resources (DER) rule change; and the AEMC has also flagged a review of the metering services framework. Changes the AER has implemented since the F&A for the 2019–24 regulatory control period include: the Service Classification Guideline[2]; and a recent review of the national ring-fencing guideline.[3]

This decision sets out our reasons to replace the current F&A papers for the next regulatory control period. Appendix A lists the specific matters we will include in the F&A papers. We will also consider any other relevant matters appropriate or convenient for us to address in the F&A papers.[4]

In accordance with the Rules, we intend to publish replacement F&A papers by 31 July 2022.[5] Consultation on the replacement F&A papers will commence with publication of a preliminary Framework and Approach paper for the NSW and ACT distributors and Northern Territory and TasNetworks, to be used as the basis for public consultation, in February 2022.

Before reaching this decision to replace the NSW, ACT and NT distributors and TasNetworks' F&A papers, we issued a notice under the Rules,[6] inviting submissions on whether it is necessary or desirable to amend or replace the current F&A papers for network service providers. Submissions closed on 30 November 2021 and we received two public responses.[7]

Southern Lights NSW submission covered pricing to respond to new technology, oversight of public lighting and incentive schemes for all distributors. The Southern Sydney Regional Organisation of Councils (SSORC) also made a submission in relation to public lighting in Ausgrid's distribution area and requested amendments to service classification for; System support services; customer export services; stand-alone power systems (SAPS); and, distribution asset rental (community batteries).

2 AER, *Service Classification Guideline*, September 2018.

3 AER, *Ring-fencing guideline electricity distribution*, November 2021.

4 NER, cll. 6.8.1(g) and 6A.10.1A(g). The AER would consult appropriately on any additional matters it wishes to include in the F&A.

5 NER, cll. 6.8.1(e) and 6A.101A(e).

6 NER, cll. 6.8.1(c)(2) and 6A.10.1A(c)(2). We issued this notice on 8 November 2021.

7 Public responses to our notice are available at; Ausgrid SSROC submission; Southern Lights submission.

The third submission is confidential however they requested amendments in alignment with other submissions. We have had regard to these submissions in reaching our decision.[8]

Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, Power and Water Corporation and TasNetworks each submitted requests to us to address a number of issues in their respective F&A papers that we are required to consider.[9] This is because the Rules include a provision that permits a network service provider to specify certain issues that must be addressed in its F&A.[10]

A copy of each service providers' request is published on our website alongside this decision[11] together with Southern Lights and SSROCs' submissions. Reasons for our decision follow.

2 Our reasons

This section sets out our reasons for deciding to replace the NSW, ACT, NT and Tasmanian F&A papers for the next regulatory control period of 1 July 2019 to 30 June 2024. The sections below correspond to the various components of the F&A.

2.1 Distribution service classification

We consider it necessary to replace the NSW, ACT, NT and Tasmanian F&A papers with respect to the classification of distribution services.[12] The Rules require us to determine which services provided by network businesses will be subject to regulation as well as the manner in which we will regulate those services.[13] That is, whether we will directly control prices through to deciding not to regulate a particular service. We make these decisions by assessing a range of factors to determine whether there is competition or potential for competition for the provision of that service.

We consider it timely to consider distribution service classification in NSW, ACT NT and Tasmania. As discussed in section 1.2, the rapid transition of the energy market, recent Rule changes and changes to the framework for the classification of services and ring-fencing are important catalysts which drive changes to distribution service classification.

SSROC submitted that in reviewing service classification, we should continue to regulate public lighting services in NSW. SSROC stated that the NSW distributors continue to hold an effective

8 NER, cll. 6.8.1(c)(3), 6.8.1(d) , 6A.10.1A(c)(3) and 6A.10.A(d) .

9 Evoenergy *Request to replace framework and approach paper*, October 2021, Ausgrid, *Request to replace framework and approach paper*, October 2021 ; Endeavour Energy, *Request to update framework and approach*, October 2021; Essential Energy, *Request to update to framework and approach*, October 2021; PWC, *Request to AER to made, or make an amended or replacement framework and approach*, October 2021; TasNetworks, *Letter to the AER on Framework and approach*, October 2021.

10 Service provider written requests were submitted in accordance with NER, cll. 6.8.1(c)(1) and 6A.10.1A(c)(1).

11 As required under NER, cll. 6.8.1(c)(3)(ii) and 6A.10.1A(c)(3)(ii).

12 NER, cl. 6.8.1(b)(2)(i).

13 NER, cll. 6.2.1 and 6.2.2.

monopoly of public lighting services and prospects for meaningful contestability and any subsequent competition are limited.[14]

2.2 Form of control

For distribution services classified as direct control services, we must determine the price or revenue controls (or some other hybrid arrangement) for each service or group of services. The form of control may be, for example, a cap on revenue or a cap on prices charged by the network service providers. The Rules set out assessment criteria we must consider.[15] Our assessment is particularly important as we have limited discretion to amend the form of control in our final determination.[16]

At present, NSW, NT, ACT and Tasmania operate under a revenue cap for standard control services and a price cap for alternative control services.

The Rules also require us to set out the control mechanism which we will apply.[17] Evoenergy and Endeavour Energy have requested amendments to the formula for the side constraint to provide additional clarity around interpretation of the formula. The control mechanism is the formulae we will use to calculate service prices. Again, we have limited discretion to alter control mechanism listed in the F&A at the time of the determination unless we consider unforeseen circumstances have arisen.[18] As a result, we consider it important to review the form of control applicable to the NSW, ACT, NT and Tasmanian electricity distribution businesses.

2.3 Dual-function assets

Dual-function assets are high voltage transmission assets forming part of the distribution network. Transmission network service providers usually operate these assets. Considering transmission assets as part of a distribution determination avoids the need for a separate transmission proposal. Where a network service provider notifies us that it owns, controls or operates dual-function assets, we assess how material the value of the dual-function asset is as a proportion of the total regulatory asset base values of standard control services. Based on this materiality, we will then decide whether the revenue attributed to dual-function assets are to be recovered according to the transmission or distribution pricing principles.[19]

14 SSROC *Submission to AER F&A review 2024-29*, November 2021.

15 NER, cl. 6.2.5.

16 NER, cll. 6.8.1(b)(1)(i) and 6.12.3(c) and (c1).

17 NER, cl. 6.8.1(b)(2)(ii).

18 NER, cl. 6.12.3(c1).

19 NER, cll. 6.8.1(b)(1)(ii) and 6.25(b)-(d).

Ausgrid and Evoenergy have advised us that they currently own, control or operate dual function assets.[20] We will review and decide how to price these assets as set out above in our F&A.

2.4 Application of incentive schemes

We have developed several mechanisms that provide incentives for network service providers to invest efficiently and therefore be more likely to operate in the long-term interests of consumers. These schemes include the service target performance incentive scheme, efficiency benefit sharing scheme, capital expenditure sharing scheme and demand management and embedded generation connection incentive scheme. The overall objectives of the schemes are to:[21]

- incentivise network service providers to spend more efficiently on capital and operating expenditure
- reduce the risk of consumers paying for unnecessary capital expenditure
- share efficient improvements and losses between network service providers and consumers
- encourage appropriate levels of service quality
- maintain network reliability as appropriate.

The NSW, ACT, NT and Tasmanian service providers acknowledged that the current review of incentive schemes, in particular the Capital Expenditure Sharing Scheme and Efficiency Benefits Sharing Scheme, will have an impact on how incentives are applied in the 2024-29 regulatory control period. Network businesses have also suggested that some of the parameters of the service target performance incentive scheme could be changed to better reflect the changing expectations of customers. As a result, network businesses are currently in consultation with their consumers on the design of Customer Service Incentive Schemes which they will propose for the 2024–29 regulatory control period.[22]

In light of the issues raised above, we consider that the application of all incentive schemes should be reviewed in the NSW, ACT, NT and Tasmanian F&A papers.[23]

20 Ausgrid, *Request to replace framework and approach paper,* October 2021; Evoenergy, *Request to update framework and approach,* October 2021.

21 AER, *Electricity distribution network service providers, Service target performance incentive schemes*, June 2008, p. 2; AER, *Better Regulation, Draft expenditure incentives*, 9 August 2013.

22 Evoenergy, *Request to replace the framework and approach paper*, October 2021, p.4.; Endeavour Energy, *Request to replace the framework and approach paper*, October 2021, pp.14-15; Ausgrid, *Request to replace the framework and approach paper*, October 2021, p.26.; Essential Energy, *Request to replace the framework and approach paper*, October 2021.

23 NER, cll. 6.8.1(b)(2)(iii)-(viii).

2.5 Other matters

2.5.1 New Services

Leasing of excess battery capacity

The electricity distributors in NSW, NT and Tasmania have flagged an intention to include the leasing of excess battery capacity to third parties as a potential service in the 2024–29 regulatory control period.

Stand Alone Power Systems

Networks have requested work related to distributor-led stand-alone power system deployments be included as a service for the 2024–29 regulatory control period.

Export Services

Electricity distributors have requested Customer export services back to the distribution network, including ‘basic’ and ‘additional’ exports for the 2024–29 regulatory control period.

System Support Services

NSW electricity distributors have also requested several activities be grouped under the general grouping of ‘System support services” to be classified as part of the common distribution service.

We will consider the request for these new services as part of the replacement F&As.

2.6 Decision summary

For the above reasons and having regard to the submissions, we consider it necessary to replace the F&A for NSW, ACT, NT and Tasmania for the next regulatory control period of 1 July 2024 to 30 June 2029. We expect to issue a discussion paper in early 2022 outlining preliminary views on the matters outlined in this decision. We must then publish final F&A papers by 31 July 2022.

Appendix A – Matters to be addressed in the F&A

The replacement NSW, ACT, NT and Tasmanian electricity distribution F&A will address the following matters:

- classification of distribution services (which services we will regulate)
- form of control mechanisms (how we will determine prices for regulated services) and the control mechanism formulae that give effect to the form of control mechanisms
- application of a range of incentive schemes that encourage things like service quality, improvements in network reliability or efficient capital and operating expenditure. This includes application of the:
  - service target performance incentive scheme
  - efficiency benefit sharing scheme
  - capital expenditure sharing scheme
  - demand management and embedded generation connection incentive scheme
  - small-scale incentive scheme
  - customer service incentive scheme
  - expenditure forecast assessment guidelines
  - whether depreciation for establishing the regulatory asset base the network service providers opening regulatory asset base for the 2024–2029 regulatory control period is to be based on actual or forecast capital expenditure.

The replacement Tasmanian electricity transmission F&A[24] will address the following matters:

- application of a range of incentive schemes that encourage things like service quality, improvements in network reliability or efficient capital and operating expenditure. This includes application of the:
  - service target performance incentive scheme
  - efficiency benefit sharing scheme
  - capital expenditure sharing scheme
  - demand management and embedded generation connection incentive scheme
  - small-scale incentive scheme
  - expenditure forecast assessment guidelines
  - whether depreciation for establishing the regulatory asset base the network service providers opening regulatory asset base for the 2024–2029 regulatory control period is to be based on actual or forecast capital expenditure.

24 We note TasNetworks' preference for a single F&A to capture our regulatory approach to reviewing its merged transmission and distribution business. The AER will consider this request and liaise with TasNetworks in due course. See TasNetworks, *Framework and Approach* , October 2021.