



Discussion paper

**Priorities and objectives
of
electricity
transmission network service provider
performance reports**

December 2008

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Shortened forms

AER	Australian Energy Regulator
capex	capital expenditure
DMIS	demand management incentive scheme
DNSP	distribution network service provider
EBSS	efficiency benefit sharing scheme
MAR	maximum allowed revenue
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Electricity Rules
opex	operating expenditure
RAB	regulatory asset base
RIO	regulatory information order
SCONRRR	Steering committee on national regulatory reporting requirements
STPIS	service target performance incentive scheme
TNSP	transmission network service provider

1 Regulatory functions of the AER

1.1 Overview of the AER and its role in performance reporting

The AER is the economic regulator of the non-contestable elements of electricity transmission services provided by transmission network service providers (TNSPs) in the National Electricity Market (NEM). The AER also has responsibility for monitoring the electricity wholesale market, including responsibility for monitoring and reporting on compliance and enforcing the National Electricity Law (NEL) and the National Electricity Rules (NER). In 2008, the AER formally assumed responsibility for the economic regulation of electricity distribution network service providers (DNSPs). The responsibility for gas transmission and gas distribution transferred to the AER, with the enactment of the new National Gas Law and National Gas Rules, on 1 July 2008.

In its performance reporting role, the ACCC/AER has demonstrated a long term commitment to providing stakeholders with information on the outcomes of the regulatory process, and views reporting as a vital part of its overall functions. Performance reporting is essential to the transparency and accountability necessary to underpin efficiency based regulation.

1.2 Purpose of this paper: to outline proposed priorities and objectives for electricity TNSP performance reports.

This paper outlines a set of proposed priorities and objectives for electricity TNSP performance reports. Stakeholders are invited to provide submissions on the proposed priorities and objectives by 16 January 2009.

The AER will develop and publish a statement of approach to TNSP performance reporting outlining the final priorities and objectives which will be developed with regard to stakeholder submissions. The statement of approach will be reviewed when required to reflect changing priorities and objectives of performance reporting.

It is intended that a paper proposing priorities and objectives for electricity DNSP performance reporting will be prepared at a future date once a complete framework of regulatory information instruments has been established for those networks.

1.3 Changes to the regulatory framework

The framework for reporting on the performance of electricity network service providers has changed with amendments to the NEL and NER effective from 1 January 2008.

The previous regulatory framework required the AER to obtain written consent from TNSPs to publish their information. This could have led to an incomplete picture of network performance in the NEM where that consent was not provided. This consent

requirement has now been replaced with consultation requirements (see section 4.1 below for arrangements applying to the preparation of the 2007/08 report).

The new NEL and NER provisions require the AER to consult with network service providers, bodies representative of network service providers, and the public generally prior to publishing performance reports on the Transmission and Distribution Networks. The purpose of consultation is to determine appropriate priorities and objectives to be addressed through the preparation of network service provider performance reports.

The regulatory framework governing the preparation of TNSP network service provider performance reports is outlined in Appendix B.

1.4 Background to previous performance reporting by the AER

Information has been submitted annually by TNSPs in accordance with the relevant ACCC/AER Information and Service Standards Guidelines since 2002. The annual performance reports prepared from this information provide revenue, profit, expenditure, and service standards information on each of the TNSPs regulated by the AER: Directlink, ElectraNet, EnergyAustralia, Murraylink, Powerlink, SP AusNet, Transend, TransGrid and VENCORP.

The reports provide transparency regarding the financial and operational performance of the transmission businesses. This is achieved by providing stakeholders with access to comparative data on the financial performance of TNSPs and including a comparison of actual revenue and expenditure outcomes with the forecasts incorporated in revenue cap decisions.

In preparing these reports the AER has taken into account confidentiality considerations and TNSPs' comments. Additionally, the TNSPs have provided written consent allowing the disclosure of this information. There have been 5 editions of the reports to date, available on the AER's website www.aer.gov.au.

Appendix A summarises the contents of previous TNSP performance reports. The AER considers that the types of information available in the previous reports remain appropriate for future performance reports, though it may be augmented to reflect the priorities and objectives of performance reporting.

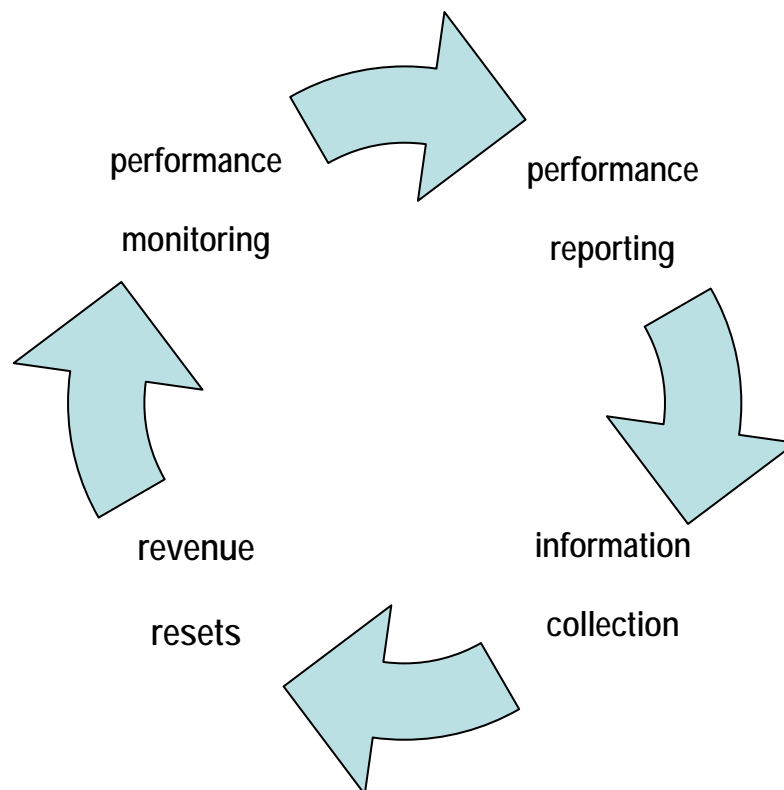
2 Priorities and objectives of performance reporting

2.1 Overview

The AER is responsible for the economic regulation of TNSPs in the NEM. Under the NEL and the NER the AER carries out a wide range of economic regulatory functions, including performance reporting.

Performance reporting is an important function of any utility regulator. Reporting the performance of regulated entities reduces the asymmetry of information between regulated networks and other stakeholders. Performance reporting also provides an incentive for regulated businesses to improve their performance.

Figure 1: performance reporting's role in regulation of network businesses



Reporting on the performance of regulated businesses is part of the regulatory cycle and should be viewed as an input into the revenue determination process. Reporting and explaining information that will be used in revenue resets will make those processes more transparent and accessible.

2.2 Priorities and objectives of performance reporting and the national electricity objective

To establish appropriate priorities and objectives of performance reporting it is necessary to refer to the relevant provisions of the NEL and NER which provide the regulatory framework governing these matters.

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:

Section 28V Preparation of network service provider 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;
 - (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.

As required by section 28V(1), the AER must ensure that the report will contribute to the achievement of the national electricity objective which is set out in s.7 of the NEL:

Section 7 The 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.

The national electricity objective promotes efficient investment, operation and use of electricity services. This objective encompasses capital and operating expenditure by the TNSPs as well as performance against a number of the AER's incentive based schemes including the service target performance incentive scheme (STPIS), the efficiency benefit sharing scheme (EBSS), and the demand management incentive scheme (DMIS).

Efficient investment and operation is encouraged by yardstick comparisons between TNSPs (a factor that is also recognised by jurisdictional regulators when reporting on DNSPs – see 2.4 and Appendix C below). Such comparisons are enabled by performance reports where actual expenditure and financial performance is made publicly available, as well as the outcomes against the incentive schemes. Therefore, preparation of such reports by the AER will contribute to the achievement of the national electricity objective.

The national electricity objective is also reflected in the NER in clauses 6A.6.6(a) and 6A.6.7(a) – the operating expenditure and capital expenditure objectives. TNSPs must include in their revenue proposals the forecast expenditure required to achieve the expenditure objectives, in particular the level of expenditure required to:

- maintain the quality, reliability and security of prescribed transmission services
- maintain the reliability, safety and security of the transmission system through the supply of prescribed transmission services.

Clauses 6A.6.6(c) and 6A.6.7(c) then go on to require an assessment by the AER of whether the forecast operating and capital expenditure reasonably reflect the efficient costs of achieving the operating and capital expenditure objectives.

Once a revenue determination has been made by the AER which includes forecast capital and operating expenditure for each year of the regulatory period covered by the determination, it is then necessary to monitor actual outcomes. In this case, performance reports can detail actual expenditure against forecast expenditure, allowing TNSPs an opportunity to provide explanations for any variances between the two. Again, the reporting of this information contributes to the achievement of the national electricity objective.

Annual information disclosure

Clause 6A.17 of the NER is also directly relevant when determining appropriate priorities and objectives of performance reporting:

6A.17(1)(d)

The certified annual statements and additional information provided by a Transmission Network Service Provider to the AER under this rule 6A.17 may be used by the AER only for the following purposes:

- (1) to monitor, report on and enforce the compliance of the provider with the total revenue cap for the provider for a regulatory control period, the maximum allowed revenue for the provider for each regulatory year, and any requirements that are imposed on the provider under a transmission determination;

- (2) to monitor, report on and enforce compliance with the provider's Cost Allocation Methodology;
- (3) as an input regarding the financial, economic and operational performance of the provider, to inform the AER's decision-making for the making of revenue determinations or other regulatory controls to apply in future regulatory control periods; and
- (4) to monitor and report on the performance of the provider under any service target performance incentive scheme that applies to it;
- (5) for the preparation of a network service provider performance report.

Once again, the national electricity objective is reflected in these provisions, concentrating as it does on revenue cap outcomes, correct cost allocation practices, and performance under the STPIS. Information gathered may also be used in the preparation of TNSP performance reports.

Benchmarking

The national electricity objective emphasises promoting efficient investment, operation and use of electricity services. Clauses 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, respectively, that would be incurred by an efficient TNSP over the regulatory period. As discussed above, making the comparative performance of TNSPs publicly available allows stakeholders including customers to make informed assessments, thereby encouraging greater participation in the regulatory process. The national electricity objective is framed with the long term interests of consumers of electricity in mind.

2.3 Preliminary position

2.3.1 Objectives of performance reporting

After considering the regulatory framework the AER considers that the appropriate objectives in publishing network performance reports are to:

A. Provide transparency

Performance reporting is good regulatory practice in that it promotes transparency and understanding of the AER's decisions. It also promotes transparency in the TNSP's investment and expenditure decisions.

Without transparent reporting of the outcomes of the regulatory process, efficient investment in and efficient operation of electricity systems may not be achieved. Information on the price, quality, reliability and security of supply of electricity needs to be provided to meet this end. Customers and other stakeholders require access to this information if they are to have meaningful input into the regulatory process.

B. Maintain accountability to provide an incentive to increase performance

By publicly reporting performance information TNSPs will become further accountable for their performance. Accountability will help to ensure that the overall goals of the network businesses are in line with the national electricity objective. This

will provide TNSPs with an incentive to increase their service performance while maintaining efficient investment levels in their networks.

2.3.2 Priorities of performance reporting

In order to achieve these objectives the priorities of reporting are to:

- Report on service performance
- Report on compliance with the TNSP's approved cost allocation methodology
- Report the profitability of TNSPs
- Report on performance against and compliance with revenue determinations in a format that allows for comparison between different jurisdictions and regulatory control periods
- Report information in a format that can be utilised for future revenue determinations, to reduce information asymmetry and make the revenue reset process more streamlined
- Assess whether the national electricity objective is being achieved through regulation and revenue determinations in particular

2.4 Current practices of jurisdictional regulators

As part of the process to determine appropriate priorities and objectives of performance reporting the AER has found it useful to examine the priorities and objectives of other economic regulators in Australia who undertake a similar task. While the detail of regulatory reporting may differ from regulator to regulator, reflecting the particular framework that applies, their overall goals remain similar.

An examination of the priorities and objectives of the jurisdictional regulators reveals that they publish reports on the regulated networks for three reasons:

1. To provide transparency
2. To maintain accountability
3. To provide comparative information on business performance as an incentive for businesses to improve performance

A summary of current practices is detailed in Appendix C.

2.5 Conclusion

The proposed priorities and objectives of performance reporting are considered appropriate in the circumstances as they give effect to the regulatory framework as follows:

- They reflect the overriding requirements of the NEL to foster the achievement of the national electricity objective through efficiency based regulation

- They reflect the particular requirements of the NER to provide transparency and accountability by TNSPs
- They are common core objectives of economic regulators dealing with network service providers in similar circumstances

3 Consultation process

The AER will undertake consultation as required by the NEL and NER in developing the priorities and objectives of TNSP performance reporting. The consultation arrangements are outlined below.

3.1 Administrative and timing issues for the 2007-08 TNSP performance report

A number of administrative issues arise from the new requirements the NEL and NER. As section 28V of the NEL came into effect on 1 January 2008, any performance reporting on the 2007-08 period falls within the previous and current NEL and NER requirements.

In summary, this means that prior to the publication of the TNSP performance report for 2007-08 the AER will be required to:

- Consult on the overall priorities and objectives of the report prior to the commencement of its preparation;
- Obtain written consent from TNSPs to disclose their information as the first part of the reporting period is governed by the earlier disclosure provisions under clause 6A.18 of the NER (as it was then); and
- Give the TNSPs an opportunity to comment on the report prior to its release.

This process will occur prior to the publication of the report which is intended to be released in mid 2009.

3.2 Next steps

Stakeholders are invited to make submissions on the appropriate priorities and objectives of TNSP performance reporting. Submissions will close on Friday 30 January 2009. It is anticipated that the AER will release the statement of approach to TNSP performance reporting in the first quarter of 2009.

Appendix A:

Contents of previous TNSP performance reports

The preceding discussion on appropriate priorities and objectives of future performance reporting by the AER is in response to amendments to the NEL and NER, effective from 1 January 2008. The AER considers it of use to that discussion to provide a summary of its earlier TNSP performance reports for the information of stakeholders.

Previous TNSP performance reports covering the annual reporting periods 2002/03 to 2006/07 have been structured as follows:

Summary

This chapter summarises:

- Revenue cap outcomes
- TNSP's expenditure as a proportion of the regulatory asset base (RAB)
- Aggregate actual and forecast capex
- Aggregate actual and forecast opex
- Service standards performance

This information is useful in making comparisons between networks and for the particular network over time. Aggregate figures give insights into industry trends.

Introduction

This chapter outlines the scope of the report, sources of information, and the AER's role in compliance monitoring.

Network characteristics

This chapter outlines the NEM and the physical characteristics of TNSPs eg. length of transmission system, number of substations, value of RAB, MAR, peak demand and amount of electricity transmitted for the year.

Financial indicators

This chapter deals with the financial health of the individual TNSPs, using industry aggregates for comparison, and details:

- Aggregate TNSP financial performance covering revenue, opex, grid support payments, depreciation, EBIT (operating profit), interest paid, tax, net profit after tax, dividends paid, RAB, total assets, total debt, total liabilities, total equity
- Aggregate financial indicators covering EBIT/interest cover, return on assets, return on equity, gearing ratio
- Aggregate tax and dividends paid
- Individual TNSP financial performance covering EBIT (operating profit), net profit after tax, dividends paid
- Individual TNSP financial indicators covering EBIT/interest cover, return on assets, return on equity, gearing ratio
- Analysis of individual results.

Trends in financial performance are disclosed to provide interested parties with information on individual TNSP profitability and the level of dividends paid to their owners. Such information is important in any assessment of a TNSP's financial health and efficiency in utilising assets. The information is useful for yardstick comparisons with other TNSPs, and in assessing that particular TNSP's performance over time. The information is also relevant when assessing the TNSP's performance under its revenue determination.

Revenue

This chapter outlines the aggregate and individual revenue outcomes for TNSPs and takes into account payments and penalties under the AER's STPIS.

Capital expenditure

This chapter details:

- Aggregate TNSP capex performance
- Individual TNSP capex performance
- Explanations for variances between actual and forecast expenditure.

Providing information on a TNSP's actual capex against the forecast level is essential in the interests of transparency and accountability. Trends in expenditure can provide early notice to interested parties of issues they may wish to raise. The TNSP's explanations for variances between actual and forecast expenditure can also be scrutinised more fully given early notice. This will facilitate informed public input into future decisions of the AER.

Operating and maintenance expenditure

This chapter details:

- Aggregate TNSP opex performance
- Individual TNSP opex performance
- Explanations for variances between actual and forecast expenditure.

As with capital expenditure, providing information on a TNSP's actual opex against the forecast level is essential in the interests of transparency and accountability. Trends in expenditure can provide early notice to interested parties of issues they may wish to raise. The TNSP's explanations for variances between actual and forecast expenditure can also be scrutinised more fully given early notice. This will facilitate informed public input into future decisions of the AER.

Service standards

This chapter explains the operation of the AER's STPIS. Service quality information is submitted in accordance with the AER's Service Standards Guidelines. There are currently 7 TNSPs that report annually under these guidelines and are either rewarded or penalised up to 1% of MAR depending on their performance.

A TNSP's service performance cannot be fully understood without knowing the details of their operating expenditure. For example, is performance declining due to a cut back in maintenance? The AER's performance reports combine this information to give interested parties a comprehensive picture.

Appendix A: Financial summary and indicators

This appendix provides data on each TNSPs financial performance and position covering revenue, opex, grid support payments, depreciation, EBIT (operating profit), RAB, total assets, total debt, total liabilities, total equity, and financial indicators such as return on assets for the last 5 years.

Such information provides insights for stakeholders over a number of years as trends are revealed.

Appendix B: Service standards performance

This appendix details the annual performance of the 7 TNSPs currently reporting against the Service Standards Guidelines.

Appendix B:

Regulatory framework

The following provisions of the NEL and NER are relevant when considering the AER's functions and obligations with respect to network performance reporting and associated consultation processes.

National Electricity Law

General NEL provisions

Section 15 of the NEL outlines the functions and powers of the AER, including:

'15(1)(ea) to prepare and publish reports on the financial and operational performance of network service providers in providing electricity network services...

15(2) The AER has the power to do all things necessary or convenient to be done for or connection with the performance of its functions.'

Section 16(1) of the NEL states:

'The AER must, in performing or exercising an AER economic regulatory function or power -

(a) perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national electricity objective...'

The national electricity objective is stated at section 7 of the NEL as follows:

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.

Specific NEL provisions

Section 28V (2) Preparation of network service provider performance reports

- (3) 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.

- (4) A report prepared under this section may-
 - (c) deal with the financial or operational performance of the network service provider in relation to-
 - (iv) complying with (as the case requires) distribution service standards or transmission service standards;
 - (v) standards relating to the provision of electricity network services to network service users or end users; and
 - (vi) the profitability of network service providers in providing electricity network services; and
 - (d) 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.

National Electricity Rules

Specific provisions dealing with consultation requirements - clause 8.7.4

Preparation of network service provider performance report (Section 28V of the NEL)

- (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 the report.

Specific provisions dealing with TNSP performance reporting - clause 6A.17.1(d)

The certified annual statements and additional information provided by a Transmission Network Service Provider to the AER under this rule 6A.17 may be used by the AER only for the following purposes:

- (6) to monitor, report on and enforce the compliance of the provider with the total revenue cap for the provider for a regulatory control period, the maximum allowed revenue for the provider for each regulatory year, and any requirements that are imposed on the provider under a transmission determination;
- (7) to monitor, report on and enforce compliance with the provider's Cost Allocation Methodology;
- (8) as an input regarding the financial, economic and operational performance of the provider, to inform the AER's decision-making for the making of revenue determinations or other regulatory controls to apply in future regulatory control periods; and
- (9) to monitor and report on the performance of the provider under any service target performance incentive scheme that applies to it;
- (10) for the preparation of a network service provider performance report.

Appendix C:

Reporting goals of jurisdictional regulators

The goals of regulatory reporting on network service providers by the jurisdictional regulators are outlined below.

Economic Regulatory Authority of Western Australia

The purpose of this report¹ is to bring transparency and accountability to the performance of electricity distribution businesses that supply small use customers and to benchmark, where possible, performance against similar businesses in other electricity markets.

Essential Services Commission of South Australia

This Report:

- describes key issues and developments in each of the electricity and gas distribution sectors and the electricity transmission sector;
- provides information on the non-financial and financial performance of the electricity (ETSA Utilities) and gas (Envestra) distribution entities and the electricity transmission entity (ElectraNet) operating in South Australia (SA); and
- comments on performance of these businesses against specified service standards.

As with previous performance reports, this Report:

- informs the SA community of:
 - the extent to which reform in the energy supply industry is delivering benefits to the community;
 - how current performance compares with performance historically and in other jurisdictions, as well as with relevant service standards; and
- assists the Commission to achieve its legislative objectives to monitor and promote improvements in performance.²

Essential Services Commission of Victoria

The Essential Services Commission publishes annual performance reports on the supply quality, customer service and profitability of the monopoly energy distribution businesses, to promote competition by comparison. These reports encourage distributors to improve their performance relative to other

¹ Economic Regulatory Authority of Western Australia, *2006/07 Annual Performance Report Electricity Distributors*, 25 February 2008, pg. viii.

² Essential services commission of South Australia, *2006/07 Annual Performance Report: Performance of South Australian Energy Networks*, November 2007, pg 1.

distributors and also give customers comprehensive information about the services they receive.³

Independent Competition and Regulatory Commission

While the reporting of performance information is part of a utility's obligations under the conditions of its licence, it is more importantly part of the process of providing information to the marketplace and, in particular, to consumers. Such reporting both provides assurance that service quality and other service obligations are being met, and is an important means of reducing the information asymmetry that exists between utilities and regulators and consumers. Through these reports, regulators and consumers can see whether utilities are meeting their service obligations and how utilities in the ACT perform in relation to the market in general.

The Commission expects that, as they become better informed about the services they use, consumers will become more active and vocal participants in reviewing the pricing of services and in setting meaningful performance standards.⁴

Independent Pricing and Regulatory Tribunal

This information paper focuses on the level of customer service provided by electricity retailers in NSW. It is one in a series of information papers published by the Independent Pricing and Regulatory Tribunal of NSW (IPART), which aims to ensure that all stakeholders, including customers, have ready access to information about electricity distribution and retail businesses.⁵

Office of the Tasmanian Energy Regulator

This Report⁶ performs a significant role in maintaining public accountability of energy entities within Tasmania. It is a comprehensive independent review of the service standards, quality, reliability and pricing of the industry in the State. In combination with a licensing system that ensures participants are competent to deliver proper energy services and a robust planning system, this Report provides assurance to consumers of the ongoing integrity and capability of the industry and monitors the delivery of appropriate service for cost.

Queensland Competition Authority

This report provides an assessment of the financial performance of Ergon Energy for 2006-07, including a comparison with the financial forecasts that were included in the Authority's 2005 Determination and comparisons with the past financial performance of Ergon Energy.⁷

³ Essential Services Commission of Victoria, *Electricity distribution comparative performance report 2006*, 25 October 2007, pg iii

⁴ Independent Competition and Regulatory Commission, *Licensed Electricity, Gas and Water and Sewerage Utilities Performance Report for 2004–05*, February 2007, pg iii.

⁵ Independent Pricing and Regulatory Tribunal, *NSW electricity information paper no 1/2008 Electricity retail businesses' performance against customer service indicators For the period 1 July 2002 to 30 June 2007*, 1 August 2008, pg 1

⁶ Office of the Tasmanian Energy Regulator, *Tasmanian Energy Supply Industry Performance Report*, 1 December 2007, pg v.

⁷ Queensland Competition Authority, *Financial and Service Quality Performance 2006-07: Ergon Energy*, March 2008, pg 1