

## What is incentive-based regulation?

Every five years, network businesses such as ElectraNet, submit a revenue proposal to the Australian Energy Regulator (AER) forecasting the efficient level of expenditure required to deliver safe and reliable network services.

The AER sets benchmark expenditure allowances for an efficient business:

- Capital expenditure (Capex) funds the cost of installing assets, such as substations and lines
- Operating expenditure (Opex) funds the cost of operating and maintaining the network

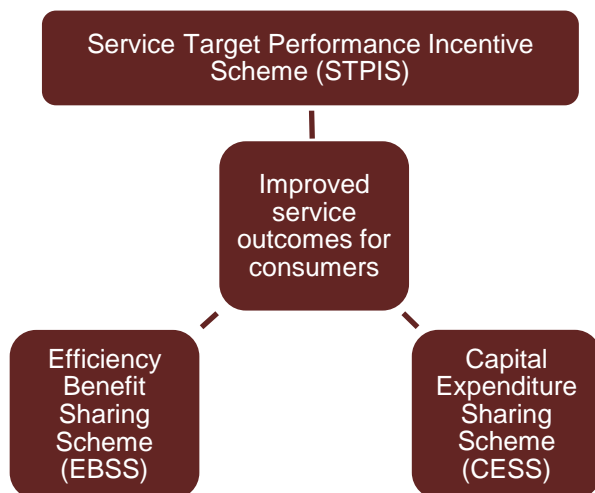
Once the efficient Capex and Opex allowances are set by the AER, ElectraNet is incentivised to provide the required services for less, through a number of incentive schemes.

Any underspend (or overspend) is retained (or borne) by the business for a defined period. At the end of this period the benefits of underspending (or costs of overspending) are shared with consumers. This is a key feature of 'incentive-based regulation'.

## How do the incentive schemes operate?

The incentive schemes encourage network businesses to make efficient decisions, and penalise businesses that do not.

They provide network businesses an incentive to pursue efficiency improvements in Capex and Opex, and share these with consumers, while also ensuring that cost efficiencies do not arise as a result of network businesses lowering service quality for consumers.



## What is the Efficiency Benefit Sharing Scheme?

The Efficiency Benefit Sharing Scheme (EBSS) works by allowing ElectraNet to retain underspends in Opex - and requiring it to bear the cost of any overspends - for a total of six years, regardless of the year in which these occur. In this way, the scheme is designed to drive ongoing cost savings so consumers then benefit from lower Opex in future regulatory periods.

The EBSS applies to ElectraNet in the current regulatory control period of 2013 to 2018 and continues to apply in the next period.

The combined effect of the AER's benchmark allowances and the EBSS is that Opex efficiency savings or losses are shared approximately 30:70 between ElectraNet and consumers. Savings flow through in the form of lower network prices in future periods.

## What is the Capital Expenditure Sharing Scheme?

The Capital Expenditure Sharing Scheme (CESS) provides network businesses with a similar reward and penalty for efficiency savings and allowance overspends in capex.

The CESS will apply to ElectraNet from 2018.

Under the incentive, ElectraNet will be entitled to retain the revenue from any underspends in Capex - and to bear the cost of any overspends - for a total of six years. In this way the scheme is designed to drive cost savings so consumers then benefit from lower future regulatory allowances.

The combined effect of the AER's benchmark allowances and the CESS is that Capex efficiency savings or losses are shared approximately 30:70 between ElectraNet and consumers. Savings flow through in the form of lower network prices in future periods.

In addition, if a business' Capex exceeds its allowance, the AER will examine the networks' spending. This is referred to as an ex-post efficiency review. If the AER determines that all or some of the overspending was inefficient, the excess spending may not be allowed to be added to its Regulated Asset Base. This means consumers will not pay for that expenditure through network prices in future periods.

## What is the Service Target Performance Incentive Scheme?

The Service Target Performance Incentive Scheme (STPIS) administered by the AER provides incentives to improve the performance of the electricity network, based on availability, reliability and market impact measures. The STPIS aims to ensure network businesses are not driven to reduce costs at the expense of service quality.

As part of the five yearly revenue determination process, the AER makes a decision on the application of the STPIS to ElectraNet for the regulatory control period and the values associated with the STPIS measures. Under the scheme, in each regulatory year ElectraNet's Maximum Allowed Revenue (MAR) is adjusted up or down based on its performance under the STPIS measures in the previous calendar year.

The STPIS applied to ElectraNet in the current regulatory period of 2013 to 2018 and an updated form of the scheme (Version 5) will apply to ElectraNet in the next regulatory control period of 2018 to 2023.

The STPIS comprises the following three components.

### 1. Service Component

The Service Component links regulated revenue to performance against defined service measures. It acts as a key indicator of network reliability.

The maximum bonus/penalty currently payable under the service component is  $\pm 1\%$  of MAR (this will increase under version 5 to  $\pm 1.25\%$ ) to improve network reliability by focussing on network outage performance. The measures that presently apply to ElectraNet include:

- Transmission line availability
- Unserved energy that results from a loss of supply
- Outage duration

This component is designed to encourage ElectraNet to reduce the number and length of unplanned network outages that result in supply interruptions and those planned outages that have the potential to do so.

The new version removes the line availability parameter and focuses on the frequency of unplanned plant outages only.

### 2. Market Impact Component

The Market Impact Component incentivises ElectraNet to minimise the effect of transmission outages on the wholesale price of electricity. This component measures the number of periods when equipment outages in the transmission network result in binding network constraints greater than a certain value. Currently this component is bonus only with the maximum bonus payable being  $+2\%$  of MAR.

Under Version 5 this incentive will move to a symmetrical reward/penalty of  $\pm 1\%$  of MAR.

### 3. Network Capability Component

The Network Capability Component is designed to encourage ElectraNet to identify suitable low cost operational and capital expenditure projects that improve the capability of the transmission network at the times and in locations where it is most needed. The intent is to remove congestion and thereby improve the efficiency of power flows, and act to place downward pressure on electricity prices.

The component operates through an incentive payment of up to  $1.5\%$  of MAR in return for expenditure on complying projects of up to  $1\%$  of the proposed MAR per year, and is dependent on the successful completion of the approved projects.

This component has applied to ElectraNet since 1 July 2015 and will continue to apply in the next regulatory control period of 2018 to 2023.

### How is network performance monitored?

ElectraNet is required to report its performance under the STPIS annually. The AER reviews the performance and approves the bonus/penalty to be recovered or paid in the following financial year, and publishes these performance outcomes.

# PROPOSED CONSUMER ADVISORY PANEL MEETINGS

Proposed Consumer Advisory Panel meeting dates against the key milestones of the ElectraNet revenue determination process for 2018 to 2023 regulatory control period.

Activity	Regulatory Determination	Consumer Advisory Panel
Consumer Advisory Panel Meeting #1 (completed)		25 August 2015
Consumer Advisory Panel Meeting #2		6 October 2015
ElectraNet notifies AER of the need for a Framework & Approach (F&A)	31 October 2015	
AER consults on F&A	30 November 2015	
Consumer Advisory Panel Meeting #3*		8 December 2015
AER publishes a position paper on F&A	February 2016	
Consumer Advisory Panel Meeting #4* - Summary of F&A		16 February 2016
Submissions close on AER position paper on F&A	April 2016	
Consumer Advisory Panel Meeting #5* - Draft Expenditure Forecasting Methodology (EFM)		24 May 2016
ElectraNet submits EFM to AER	30 June 2016	
AER publishes the F&A	31 July 2016	
Consumer Advisory Panel Meeting #6* - Summary of F&A		16 August 2016
Consumer Advisory Panel Meeting #7*		22 November 2016
Consumer Advisory Panel Meeting #8* - Summary of Draft Revenue Proposal (RP)		17 January 2017
<b>ElectraNet submits RP to AER</b>	<b>31 January 2017</b>	
AER publishes issues paper on ElectraNet's RP	28 March 2017	
Consumer Advisory Panel Meeting #9* - Summary of AER paper		11 April 2017
AER holds public forum	April 2017	
Submissions close on RP and AER Issues Paper	May 2017	
Consumer Advisory Panel Meeting #10* - Summary of submissions		18 July 2017
<b>AER publishes Draft Determination (DD)</b>	<b>30 September 2017</b>	
AER holds Pre-determination conference	October 2017	
Consumer Advisory Panel Meeting #11* - Summary of DD		17 October 2017
Consumer Advisory Panel Meeting #12* - Summary of Revised Revenue Proposal (RRP)		12 December 2017
<b>ElectraNet submits RRP to AER</b>	<b>December 2017</b>	
Submissions close on ElectraNet's RRP	January 2018	
Cross submissions (on others' submissions) close	February 2018	
Consumer Advisory Panel Meeting #13* - Summary of submissions		20 March 2018
<b>AER publishes Final Transmission Determination (FTD)</b>	<b>30 April 2018</b>	
Consumer Advisory Panel Meeting #14* - Summary of FTD		19 June 2018
Consumer Advisory Panel meetings to continue on an ongoing basis with future meetings arranged as required		

\*Dates are proposed and subject to change

# REVENUE DETERMINATION PROCESS 2018-2023



The Australian Energy Regulatory (AER) is responsible for the economic regulation of electricity transmission networks in the National Electricity Market (NEM). Regulated network businesses must apply to the AER to assess their revenue requirements, typically every five years. The key milestones for the revenue determination process under the National Electricity Rules are detailed below.

<p>Framework &amp; Approach</p> <p>31 Oct 2015 to 31 Jul 2016</p>	<p>ElectraNet must notify the AER of the need for the Framework &amp; Approach (F&amp;A) process. The notification is to include ElectraNet's approach to the application of a number of guidelines and schemes for the next regulatory control period.</p>
	<p>The AER publishes a position paper on a draft F&amp;A for consultation. This sets out the AER's proposed approach to the application of the following:</p> <ul style="list-style-type: none"> <li>• Service Target Performance Incentive Scheme</li> <li>• Expenditure Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS)</li> <li>• Expenditure forecast assessment guidelines</li> <li>• Whether depreciation will be based on forecast or actual capital expenditure in updating the regulatory asset base</li> </ul>
	<p>Public submissions on draft F&amp;A.</p>
	<p>The AER publishes the final F&amp;A. The paper is not binding on the AER or ElectraNet and the AER can change its position on any matters.</p>
<p>Expenditure Forecast Methodology</p> <p>30 Jun 2016</p>	<p>ElectraNet advises the AER of its approach to forecasting capital and operating expenditure.</p>
<p>Revenue Proposal</p> <p>31 Jan 2017</p>	<p>ElectraNet's Revenue Proposal (RP) outlines the program of work (capital and operating expenditure forecasts) and forecast revenue required to maintain and operate safe, reliable and efficient network services. The RP must meet the long-term needs of electricity consumers.</p>
<p>Issues Paper</p> <p>28 Mar 2017</p>	<p>The AER publishes an Issues Paper in which it identifies early key issues likely to be relevant to its assessment. This includes a 'first pass' assessment indicating its preliminary view on ElectraNet's RP.</p>
	<p>Public submissions on Revenue Proposal and Issues Paper.</p>
<p>Public Forum</p> <p>April 2017</p>	<p>The AER and their Consumer Challenge Panel present the early issues to stakeholders and discuss how they can provide input into the process. ElectraNet is provided the opportunity to give a summary of the RP.</p>
<p>Draft Determination</p> <p>30 Sep 2017</p>	<p>The AER uses a range of evidence to review and assess the RP, including historic cost trends, benchmarking against comparable businesses and expert advice. The Draft Determination (DD) includes the draft total capital and total operating expenditure forecasts, and the draft revenue the AER considers efficient, taking into account stakeholder consultation feedback.</p>
<p>Pre-Determination Conference</p> <p>Oct 2017</p>	<p>The AER and the Consumer Challenge Panel present to stakeholders to explain the DD.</p>
	<p>Public submissions on DD and Pre-Determination Conference.</p>
<p>Revised Revenue Proposal</p> <p>Dec 2017</p>	<p>ElectraNet's Revised Revenue Proposal (RRP) sets out revisions made to the RP to incorporate changes arising from the DD made by the AER and comments from stakeholders.</p>
	<p>Public submissions on RRP.</p>
<p>Final Determination</p> <p>30 Apr 2018</p>	<p>The AER publishes the Final Transmission Determination which contains the maximum allowed revenue (MAR) that ElectraNet may recover from customers through transmission network charges. It also includes the final total capital and operating forecasts the AER considers efficient, taking into account the long term interests of consumers.</p>

Key input for process:

ElectraNet

AER

Public