Draft Decision

Ausgrid distribution determination

2015–16 to 2018–19

Attachment 14: Control mechanism for standard control services

November 2014

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on Ausgrid's 2015–19 distribution determination. It should be read with 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 mechanism

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection methodology

Attachment 19 – Pricing methodology

Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	aggregate service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
CPI-X	consumer price index minus X
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

Shortened form	Extended form
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
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue 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

14 Control mechanism for standard control services

The control mechanism imposes limits over the prices of direct control and alternative control services, and/or the revenue to be derived from these services. Our Stage 1 Framework and Approach (F&A) determined that the control mechanism should:

- be of the prospective CPI-X form (or some incentive-based variant)
- accord with Part C of chapter 6 of the National Electricity Rules (NER)
- have a basis as specified in the AER's draft and final distribution determinations.[1]

This attachment sets out the final formulaic expression of the revenue cap for the 2015–19 regulatory control period. It discusses:

- how the revenue cap will be applied
- how we will determine compliance with the price controls
- the mechanism through which Ausgrid will recover transmission and distribution use of system charges (TUoS and DUoS)—including adjustments for revenue under or over recovery—in the 2015–19 regulatory control period.[2]

Also discussed is how Ausgrid must report to us on its recovery of jurisdictional scheme amounts and its procedures for assigning or reassigning retail customers to tariff classes.[3]

14.1 Draft decision

Our draft decision for Ausgrid is as follows:

- The control mechanism for standard control services provided by Ausgrid is a revenue cap.[4]
- The revenue cap for any given regulatory year is the annual revenue requirement (ARR) (for distribution services) plus the maximum allowable revenue (MAR) (for transmission services) for that regulatory year (calculated using the formula in section 14.5.3) plus any adjustment required to move the DUoS under/over account to zero.
- The side constraints applying to the price movements of each Ausgrid tariff class must be consistent with the formula in Figure 14-2 Side constraints below.
- Ausgrid must demonstrate compliance with the control mechanism for standard control services in accordance with appendices A and B of this draft decision.
- Ausgrid must submit as part of its annual pricing proposal, a record of the amount of revenue recovered from TUoS charges and associated payments in accordance with appendix B of this draft decision.
- Ausgrid must report to us its jurisdiction scheme amounts recovery in accordance with appendices C of this draft decision.

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1 AER, *Stage 1 Framework and approach paper Ausgrid, Endeavour Energy and Essential Energy*, March 2013, p. 43.
2 NER, cl. 6.12.1
3 NER, cll. 6.12.1(17) and 6.12.1(20)
4 Ausgrid, Distribution, *Subsequent regulatory proposal 2015-19*, May 2014, p. 17.

- The procedures to be applied by Ausgrid for assigning retail customers to tariff classes or reassigning retail customers from one tariff class to another are specified in appendix D.

14.2 Ausgrid's proposal

Ausgrid proposed a revenue cap for standard control services which included certain assumptions for the revenue cap parameters.[5]

14.3 AER's assessment approach

Our Stage 1 F&A decided the control mechanism for standard control services would be a revenue cap. We also stated our distribution determination would set out the basis of the control mechanism. The basis must be of the prospective CPI-X form (or some incentive-based variant).[6]

Ausgrid accepted our high level control mechanism for standard control services but provided us with its suggested definitions for the following parameters—CPI, Allowed Revenue, incentive adjustment, annual adjustment, tolerance limit and approved pass through amounts.[7]

In determining the control mechanism for standard control services, we must consider the factors in clause 6.2.5(c) of the NER for each revenue adjustment mechanism proposed and its application. This approach (1) satisfies the requirements of the NER and (2) reaffirms the our decision in the Stage 1 F&A decision to apply a revenue cap control mechanism for Ausgrid's standard control services in the 2015–19 regulatory control period.

14.4 Reasons for draft decision

Our Stage 1 F&A deliberately set out a generic formula to give effect to the control mechanism for standard control services.[8] The NER requires our Stage 1 F&A to include a control formula for the control mechanism even though the control formula requires parameters that would only be completed in our final distribution determination. This draft decision clarifies our position regarding the control formula and its respective parameters.

14.5 Application of the revenue cap

Annual revenue requirement as opposed to maximum allowable revenue

The revenue cap for any given regulatory year is the annual revenue requirement (ARR) for distribution services and not the maximum allowable revenue (MAR). We consider this change necessary to reflect chapter 6 of the NER.

Definition of the Consumer Price Index

The inflation measure (data) used in the control mechanism should be as up to date as possible. It is also desirable to have consistency between the Consumer Price Index (CPI) used for the roll forward of the asset base for the current regulatory period (which was based on the year to December t–1) and the CPI used for determining the MAR going forward.

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5 Ausgrid, *Distribution, Subsequent regulatory proposal 2015-19*, May 2014, p. 309.
6 AER, *Stage 1 Framework and approach paper Ausgrid, Endeavour Energy and Essential Energy*, March 2013, p. 43.
7 Ausgrid, *Subsequent regulatory proposal 2015-19, Attachment 9.02 Application and Demonstration of compliance with control mechanisms for standard and alternative control services*, May 2014, pp. 3–12
8 AER, *Stage 1 Framework and approach paper Ausgrid, Endeavour Energy and Essential Energy*, March 2013, p. 43.

Ausgrid proposed the following method to calculate CPI for distribution standard control services and prescribed transmission services:

$$\Delta CPI = [\frac{CPI_{Mar,t-2} + CPI_{Jun,t-2} + CPI_{Sep,t-1} + CPI_{Dec,t-1}}{CPI_{Mar,t-3} + CPI_{Jun,t-3} + CPI_{Sep,t-2} + CPI_{Dec,t-2}}] - 1$$

We do not agree with Ausgrid's CPI formula for prescribed transmission services because it is inconsistent with our current CPI definition. Inconsistent application of inflation will result in tariffs that do not match the expected revenues. This mismatch would require a further calculation to be undertaken to account for the difference. In our view this would create unnecessary complexity in the control mechanisms. This mismatch can be eliminated through consistent CPI application.

We accept Ausgrid's proposal to retain the current CPI calculation for distribution standard control services.

Intra-period adjustment to WACC (W-factor)

Ausgrid proposed adding an additional parameter to the revenue cap formula to apply an intra-period adjustment to WACC to allow for an annual update to the return on debt in the 2015–19 regulatory period.[9]

As more fully explained in our paper setting out our proposed amendments to the post-tax revenue model, we consider that changes to revenue resulting from the annual return on debt update should be implemented through revising the X factors and no additional set of factors should be added an additional parameter would not be required to apply an intra-period adjustment to WACC because we have included the adjustments via our X factors.[10]

Issues relating to the WACC, and its adjustment, are more fully explained in the WACC attachment on the cost of capital. The 'X-factors' are more fully explained in attachment dealing with revenue.

Recovery of Emergency Recoverable Works Costs (E-factor)

We do not approve Ausgrid's inclusion of an E-factor in the revenue cap formula for the recovery of emergency recoverable works because it is an unclassified service and other residual costs are already allowed for (compensated) in opex.

Ausgrid proposed an E-factor in the revenue cap formula so it could recover residual costs associated with emergency recoverable works. In our Stage 1 F&A, we did not classify these works because we considered Ausgrid should recover these costs from the party responsible for the damage. Including it in the revenue control formula means that all customers would pay. We consider that this result is inappropriate for the reasons below.

As discussed in the attachment on services classifications (attachment 13), we consider that in circumstances where the party responsible for the damage is not identifiable, related costs are not recoverable. Therefore, works to repair that damage would not be considered emergency recoverable works. Rather, they would be activities undertaken which are classified as standard control services

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9 Ausgrid, *Distribution, Subsequent regulatory proposal 2015-19, Attachment 9.02 Application and Demonstration of compliance with control mechanisms for standard and alternative control services*, May 2014, p. 4.

10 AER, *Proposed amendment Electricity transmission and distribution network service providers Post-tax revenue models* , October 2013, p. 18.

and are already accounted for in the opex allowance. Including an E-factor in the control formula would result in double cost recovery which violates the opex criteria and pricing principles.

Incentive Adjustment

Ausgrid accepted our decision that an annual adjustment should be applied to the AAR for revenue from distribution services, as a consequence of the operation of an incentive scheme. As stated in the service standards attachment we will apply a Service Target Performance Incentive Scheme (S-factor) to Ausgrid in the 2015–19 regulatory control period.

Transitional Adjustment (T-factor)

We included a transitional adjustment parameter in our control formula to account for the difference in the notional revenue for the 2014–15 regulatory year established in this decision and the placeholder revenue in our transitional decision for NSW and ACT. We consider that a transitional adjustment parameter is no longer required as we have taken into account this difference as part of the true-up in establishing the smoothed total revenues over the 2015–19 period for this decision. Refer to revenue attachment for further details on the true-up.

Annual adjustment (B-factor): pass through and metering residual values

Our Stage 1 F&A included an annual adjustment (B-factor) to account for any differences in revenue recovered compared to ARR or a particular year. In its regulatory proposal Ausgrid accepted our B-factor.

Ausgrid also submitted that the B-factor should also contain 'tolerance limits' to limit price volatility.

We believe that the B-factor should account for:

- approved pass through amounts
- residual metering asset costs from alternative control exit fees.

Adding DUoS unders and overs to the B factor would over complicate the B-factor. Consequently we consider that DUoS unders and overs recovery should be accounted for in an additional factor outlined below. The discussion regarding tolerance limits are also below as it applies to the DUoS unders and over account.

Approved pass through amounts

The generic formulaic expression in our Stage 1 F&A does include a factor in the ARR to adjust for approved pass through amounts. At that time we envisaged that any approved pass through amounts would be adjusted for as part of the B-factor. Approved pass throughs will be recovered via the B-factor during 2015–19.

We consider that the control mechanism should be adjusted for any cost pass through amounts that we approve.

Residual metering assets costs from alternative control exit fees

We consider that recovering residual metering costs[11] by way of a lump sum unbundled exit fee in alternative control services would:

- not promote efficient long term outcomes for consumers and
- may also stymie meter switching given the lack of connection between a these costs and a customer's exact metering specifications.

We therefore consider that recovering these residual costs by way of an adjustment to standard control services would least distort efficient outcomes. Our detailed discussion on residual metering costs is found in the metering attachment of this draft decision.

In addition, to limit the risks of unstable prices, Ausgrid will implement tolerance limits to its recovery of residual metering asset costs from alternative control service exit fees. If the residual metering asset costs under/over recovery compared to the ARR for year t are:

- less than two per cent, the residual metering assets costs under/over recovery will be cleared within one regulatory year
- greater than two per cent, the residual metering assets costs under/over recovery will be recovered in the remainder of the regulatory control period.

Under and over recovery mechanism for DUoS

DUoS charges are recovered from distribution customers through the pricing proposal. Similar to the current regulatory control period, Ausgrid has proposed an unders and overs mechanism based on the audited closing balance in year t-2, and an estimate of the closing balance in year t-1. The over/under recovery in year t-1 is recovered via an adjustment in year t.

We consider this method reasonable because it reduces the likelihood of price shocks. This method also creates a smoothing of the DUoS under and over recovery amounts because it provides more updated and accurate estimated and forecast data. It is also consistent with our current approach for Ausgrid.[12]

Ausgrid additionally proposed a tolerance limit should apply to the DUoS unders and overs account. Ausgrid's proposed tolerance limit would restrict unstable prices.[13] We do not approve this proposal because we consider that Ausgrid can smooth prices by working with its customers to smooth its revenue i.e. by having a pricing strategy that would smooth out price shocks. Furthermore, a tolerance limit will allow Ausgrid to bank revenues that may result in greater price shocks in the future when they are ultimately recovered from customers. Our decision in applying a tolerance limit for Energex in 2010 has had this undesirable result.[14]

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11 Costs unrecovered upon a customer's departure from Ausgrid's metering services.
12 AER, *Final decision New South Wales distribution determination 2009–10 to 2013–14*, October 2009, pp. 462–463.
13 Ausgrid, *Distribution Subsequent regulatory proposal 2015-19, Attachment 9.2 Application and Demonstration of compliance with control mechanisms for standard and alternative control services*, May 2014, p.8.
14 AER, *Energex Distribution determination 2010–11 to 2014–15*, May 2010, p. 3.

We are also required to make a decision on how Ausgrid will report to us on the recovery of designated pricing proposal changes (DUoS unders and overs account).[15] The operation of this method is detailed in appendix A.

In deciding on the control mechanism for standard control services, we must consider the five factors under clause 6.2.5 (c) of the NER. In deciding that the DUoS unders and overs mechanism should operate, we considered that the impact on efficient tariff structures and the desirability for a consistent regulatory approach. Consideration of these factors is outlined in table 14.2 below.

Table 14-2 NER factors and the DUoS unders and overs mechanism

NER Factor	AER consideration
Efficient tariff structures	We consider efficient tariff structures should reflect the efficient costs of providing services. Mechanisms that do not result in changes in tariffs reflecting underlying changes in the costs of providing services distort the ability of tariffs to send appropriate signals to consumers. Such distortions are not consistent with the need to set efficient tariff structures.
Administrative costs	There are no additional administrative costs associated with Ausgrid's proposed approach to accounting for DUoS under and overs.
Previous regulatory arrangements	We have applied Ausgrid's proposed approach in the current regulatory period.
Desirability for a consistent regulatory approach	Ausgrid, Aurora and the Queensland DNSPs are subject to revenue caps in the NEM. The Queensland DNSPs and Aurora account for DUoS under and over recovery in the same way as proposed by Ausgrid.
Any other relevant factor	There are no other relevant factors.

Under and over recovery mechanism for TUoS

We have decided to apply Ausgrid's proposed TUoS under and over recovery mechanism to smooth the impact of over and under recovery into prices year on year. Our reasons are the same for the DUoS under and over recovery as set out above.

We have developed a TUoS unders and overs account based on the approach used in the current regulatory control period. See appendix B for a more detailed discussion.

14.5.1 Reporting on jurisdictional scheme amounts

We must decide how Ausgrid will report recovery of jurisdictional scheme amounts for each year of the regulatory control period and adjustments necessary in subsequent pricing proposals to account for over or under recovery of those charges.[16]

15 NER, cl. 6.12.1(19).
16 NER, cl. 6.12.1 (20).

Jurisdictional schemes amounts are those Ausgrid are required to pay pursuant to jurisdictional requirements recognised by the rules or the AER as amounts which may be recovered as part of Ausgrid's pricing proposal.[17]

We approve Ausgrid's method of reporting on jurisdiction scheme amounts because it similar to the current reporting method, which we have previously approved.[18]

14.5.2 Side Constraints

We consider the application of the unders and overs in the side constraint formula provides for the appropriate treatment of these revenue adjustments in keeping with clause 6.18.6 of the NER.

For each year after the first year of each regulatory period, side constraints will apply to the weighted average revenue to be raised from each tariff class. In accordance with NER, the permissible percentage increase is the greater of CPI–X plus 2 per cent or CPI plus 2 per cent. Recovery of revenue to accommodate cost pass throughs and pass through of designated pricing proposal charges and jurisdictional scheme amounts is disregarded in deciding whether the permissible percentage has been exceeded.

Ausgrid's proposal was silent on whether any revenue adjustment associated with under or over recovery of revenues should be subject to a side constraint.

14.5.3 Control mechanism formulas

As part of its pricing proposal, Ausgrid must submit to us proposed tariffs and charging parameters which lead to expected revenues consistent with the ARR (distribution services) and MAR (transmission services) formulas set out below, plus any unders and overs adjustment needed to move the balance of its DUoS and TUoS unders and overs account to zero.

Prescribed (Distribution) services

Ausgrid's pricing proposals must submit to the AER proposed tariffs and charging parameters. Ausgrid's revenues must be consistent with the ARR formula set out below plus any unders and overs adjustment needed to move the balance of its DUoS unders and overs account to zero.

Figure 14-1 Revenue cap formula

1. $ARR_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij}$ i=1,...,n and j=1,...,m and t=2,...,5

2. $ARR_t = AR_t \pm B_t$

3. $AR_t = AR_{t-1}(1+\Delta CPI_t)(1-X_t)(1+S_t)$

Where:

ARR_t is annual revenue requirement in year *t*.

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[17] The first is the NSW solar bonus scheme, the second is the NSW climate change fund, each of which are recognised under rule 6.18.7A(e)(2) and (3) respectively.

[18] AER 2014, *Placeholder determination for the transitional regulatory control period 2014-15 Ausgrid*, April 2014, p. 5.

p_t^{ij} is the price of component i of tariff j in year t.

q_t^{ij} is the quantity of component i of tariff j in year t.

AR_t is the annual smoothed revenue requirement in the Post Tax Revenue Model for year t. Adjusted as necessary to account for any difference between actual inflation and estimated inflation.

B_{t+1} is:

a. the approved pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER, plus

b. the residual metering costs as defined in the metering attachment of this draft decision. This value is subjected to a tolerance limit as outlined above

$$\Delta CPI_t = [\frac{CPI_{Mar,t-2} + CPI_{Jun,t-2} + CPI_{Sep,t-1} + CPI_{Dec,t-1}}{CPI_{Mar,t-3} + CPI_{Jun,t-3} + CPI_{Sep,t-2} + CPI_{Dec,t-2}}] - 1$$

CPI means the all groups index number for the weighted average of eight capital cities as published by the ABS, or if the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best estimate of the index.

X_t the smoothing factor determined in accordance with the PTRM as approved in the AER's final decision, and annually revised for the return on debt update in accordance with the formula specified in the return on debt appendix calculated for the relevant year

S_t is the STPIS factor sum of the raw s-factors for all reliability of supply and customer service parameters (as applicable) to be applied in year t.[19] S_t for 2015 and 2016 are set at zero.

Figure 14-2 Side constraints

Ausgrid will be required to demonstrate in its pricing proposal that proposed DUOS prices for the next year (t) will meet the following side constraints formula (expressed in percentage terms) for each tariff class:[20]

$$\frac{(\sum_{t=1}^{m} d_t^j q_t^j)}{(\sum_{t=1}^{m} d_{t-1}^j q_t^j)} \leq= (1+\Delta CPI_t)(1-X_t)(1+2\%)(1+S_t) \pm PT_t \pm DUoS_t \pm TUoS_t$$

[19] In the formulas in the STPIS attachment, the AR_{t-1} is equivalent to AR_t in this formula. Calculations of the S factor adjustment are to be made accordingly.

[20] NER, cl. 6.18.6

where each tariff class 'j' has up to 'm' components, and where:

d_t^j is the proposed price for component 'j' of the tariff class for year t

d_{t-1}^j is the price charged by the Ausgrid for component 'j' of the tariff class in year t–1

q_t^j is the forecast quantity of component 'j' of the tariff class in year t

ΔCPI_t is the annual percentage change in the ABS Consumer Price Index All Groups, Weighted Average of Eight Capital Cities from December in regulatory year t–2 to December in regulatory year t–1

X_t the smoothing factor determined in accordance with the PTRM as approved in the AER's final decision, and annually revised for the return on debt update in accordance with the formula specified in the return on debt appendix calculated for the relevant year

PT_t is an annual adjustment factor that reflects the pass through amounts approved by the AER with respect to regulatory year t

S_t is the STPIS factor sum of the raw s-factors for all reliability of supply and customer service parameters (as applicable) to be applied in year t.[21] S_t for 2015 and 2016 are set at zero.

$DUoS_t$ is an annual adjustment factor related to the balance of the DUoS unders and overs account with respect to regulatory year t

$TUoS_t$ is an annual adjustment factor related to the balance of the TUoS unders and overs account with respect to regulatory year t.

With the exception of the CPI and X factors, the percentage for each of the other factors above can be calculated by dividing the incremental revenues (as used in the ARR formula) for each factor by the expected revenues for regulatory year t–1 (based on the prices in year t–1 multiplied by the forecast quantities for year t).

Prescribed (transmission) services

Ausgrid has prescribed transmission services and must apportion its revenue between its distribution and transmission services. Therefore we are required to make a decision on the revenue cap formula for Ausgrid's transmission revenue.

We will apply the same revenue cap formula to Ausgrid for prescribed (transmission) standard control services as that applied in the current regulatory control period. Ausgrid's revenues must be

[21] In the formulas in the STPIS attachment, the AR_{t-1} is equivalent to AR_t in this formula. Calculations of the S factor adjustment are to be made accordingly.

consistent with the MAR formula set out below plus any unders and overs adjustment needed to move the balance of its TUoS unders and overs account to zero.

$$MAR_t = AR_t \pm PT_t$$

$$AR_t = AR_{t-1}(1+\Delta CPI_t)(1-X_t)$$

Where:

MAR_t is the maximum allowable average revenue in year t

AR_t is the allowable revenue in year *t*

PT_t is an annual adjustment factor that reflects the pass through amounts approved by the AER with respect to regulatory year t.

ΔCPI_t is the annual percentage change in the Australian Bureau of Statistics (ABS) Consumer Price Index All Groups, Weighted Average of Eight Capital Cities from December in year t–2 to December in year t–1.

X_t the smoothing factor determined in accordance with the PTRM as approved in the AER's final decision, and annually revised for the return on debt update in accordance with the formula specified in the return on debt appendix calculated for the relevant year.

A DUoS unders and overs account

To demonstrate compliance with its distribution determination in the 2015–19 regulatory control period, we require Ausgrid to maintain a DUoS unders and overs account. It must provide information on this account to us in its annual pricing proposal.[22]

Ausgrid must provide the amounts for the following entries in its DUoS unders and overs account for the most recently completed regulatory year (t-2), the current regulatory year (t-1) and the next regulatory year (t):

1. opening balance for year t-2, year t-1 and year t;
2. an interest charge for one year on the opening balance in year t-2 and an interest charge for one year on the opening balance in year t-1. These adjustments are to be calculated using the approved nominal WACC. No such interest charge applies to the opening balance for year t;
3. the amount of revenue recovered from DUoS charges in respect of that year, less any under/over adjustments approved by the AER for year t-2 and year t1, less the ARR for the year in question;
4. an interest charge for one year related to the net amounts in item 3 for year t-2 and an interest charge for one year for year t-1. These adjustments are to be calculated using the approved nominal WACC. No such charge applies to the net amount in item 2 for year t;
5. the total of items 1-4 to derive the closing balance for each year.

Ausgrid must provide details of calculations in the format set out in table A.1. All of Ausgrid's approved revenue adjustments operate on a one year lag and are therefore to be entered in the DUoS unders and overs account inclusive of an interest charge of one year. Amounts provided for the most recently completed regulatory year (t-2) must be audited. Amounts provided for the current regulatory year (t-1) will be regarded as an estimate. Amounts provided for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of DUoS charges, Ausgrid must attempt to achieve an expected zero balance on their DUoS unders and overs accounts in each forecast year in its annual pricing proposals in the 2015–19 regulatory control period, unless it can demonstrate for a given year that such an adjustment exceeds the agreed tolerance limits set out in this decision. In such circumstances, the balance at the end of the regulatory control period will reflect the amount by which the adjustment exceeded the first tolerance limit (that is, the amount by which the under/over adjustment exceeded two per cent of Ausgrid's ARR for year t).

The proposed prices for year t are based on the sum of the ARR for year t plus any adjustment for DUoS under or over recoveries.

[22] NER, cl. 6.12.1(19).

Table A-1 Example calculation of DUoS unders and overs account ($000, nominal)

	Year t–2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from DUOS charges	46,779	37,297	60,518
Less under/over adjustment approved by the regulator for year t–2	800 [a]		
Less ARR for the relevant year	43,039	43,012	59,927
Smooth revenues (ARt)	43,039	43,010	59,913
Approved pass throughs (pass through)	0	2	14
Under/over recovery for regulatory year	2,940	-5,715	591
DUOS unders and overs account			
Nominal WACC	8.79%	8.79%	8.06%
Opening balance	1,737	4,956	-569
Interest on opening balance	153	436	-46
Under/over recovery for regulatory year	2,940	-5,715	591
Interest on under/over recovery for regulatory year	126	-246	24
Closing balance	4,956	-569	0 [b]

Notes: (a) In this example, the regulator agreed Ausgrid could over recover its revenues by $800,000 in year t–2 due to under recoveries in year t–3.
(b) Ausgrid must attempt to achieve an expected zero balance on their DUoS unders and overs accounts in each forecast year in its annual pricing proposals in the 2015–19 regulatory control period.

B TUoS unders and overs account

To demonstrate compliance with its distribution determination in the 2015–19 regulatory control period, we require Ausgrid to maintain a TUoS unders and overs account. It must provide information on this account to us in its annual pricing proposal.[23]

Ausgrid must provide the amounts for the following entries in its TUoS unders and overs account for the most recently completed regulatory year (t-2), the current regulatory year (t-1) and the next regulatory year (t):

1. opening balance for year t-2, year t-1 and year t;
2. an interest charge for one year on the opening balance in year t-2 and an interest charge for one year on the opening balance in year t-1. These adjustments are to be calculated using the approved nominal WACC. No such interest charge applies to the opening balance for year t;
3. the amount of revenue recovered from TUoS charges applied in respect of that year, less any under/over adjustment approved by the AER for year t-2 (in relation to year t-3) and year t-1, less the amounts of all transmission related payments made by Ausgrid in respect of that year;
4. an interest charge for one year related to the net amounts in item 3 for year t-2 and an interest charge for one year for year t-1. These adjustments are to be calculated using the approved nominal WACC. No such interest charge applies to the net amount in item 2 for year t;
5. the total of items 1-4 to derive the closing balance for each year.

Ausgrid must provide details of calculations in the format set out in table B.1. Amounts provided for the most recently completed regulatory year (t-2) must be audited. Amounts provided for the current regulatory year (t-1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of TUoS charges, Ausgrid is to achieve a zero expected balance on its TUoS unders and overs account at the end of each of the forecast years in its annual pricing proposals in the 2015–19 regulatory control period.

[23] NER, cl. 6.12.1(19).

Table B-1 Example calculation of TUoS unders and overs account ($000, nominal)

	Year t–2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from TUOS charges	40,077	34,944	36,706 [a]
Less total transmission related payments	34,365	38,734	39,200
Transmission charges to be paid to TNSP	33,793	38,000	38,400
Avoided TUOS payments	572	734	800
Under/over recovery for regulatory year	5,712	-3,790	-2,494
TUOS unders and overs account			
Nominal WACC	8.28%	8.28%	na
Opening balance	0	5,948	2,494
Interest on opening balance	0	493	na
Under/over recovery for regulatory year	5,712	-3,790	-2,494
Interest on under/over recovery for regulatory year	236	-157	na
Closing balance	5,948	2,494	0 [b]

Notes: (a) Forecast revenue from TUoS charges will be set to achieve an expected zero balance in the TUoS unders and overs account for year t.
(b) This figure will be the under/over adjustment approved by the regulator for year t-1 for the annual price approval process in two years' time.

C Reporting on recovery of jurisdictional schemes

To demonstrate compliance with its distribution determination in the 2015–19 regulatory control period, we require Ausgrid to maintain a jurisdictional scheme unders and overs account. It must provide information on this account to us in its annual pricing proposal.[24]

Ausgrid must provide the amounts for the following entries in its jurisdictional schemes unders and overs account for the most recently completed regulatory year (t-2), the current regulatory year (t-1) and the next regulatory year (t):

1. opening balance for year t-2, year t-1 and year t;
2. an interest charge for one year on the opening balance in year t-2 and an interest charge for one year on the opening balance in year t-1. These adjustments are to be calculated using the approved nominal WACC. No such interest charge applies to the opening balance for year t;
3. either the amount of revenue recovered from jurisdictional charges applied in respect of that year or the amount included in the operating expenditure allowance within the 2009–14 Distribution Determination (as in the case of 2012–13 and 2013–14), less any under/over adjustment approved by the AER for year t-2 (in relation to year t-3) and year t-1, less the amounts of all jurisdictional scheme related payments made by Ausgrid in respect of that year;
4. an interest charge for one year related to the net amounts in item 3 for year t-2 and an interest charge for one year for year t-1. These adjustments are to be calculated using the approved nominal WACC. No such interest charge applies to the net amount in item 2 for year t;
5. the total of items 1-4 to derive the closing balance for each year.

[24] NER, cll. 6.18.7A(a) to (c).

Table C-1 Example calculation of jurisdictional unders and overs account ($000, nominal)

	Year t–2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from jurisdictional schemes	19,777	23,121	26,881
Jurisdictional scheme 1 payments	14,159	13,954	13,961
Jurisdictional scheme 2 payments	6,113	7,005	14,680
Total payments form jurisdictional scheme	20,272	20,959	28,641
Over (under) recovery for financial year	-495	2162	-1760
Overs and unders account			
Annual rate of interest applicable to balances	8.79%	8.79%	8.06%
Opening balance	-	- 517	1,693
Interest on opening balance	-	- 45	136
Over/ under recovery for financial year	- 495	2,162	-1,760
Interest on over/ under recovery	- 22	93	-69
Closing balance	- 517	1,693	0

D Assigning retail customers to tariff classes

We are required to decide on the principles governing assignment or reassignment of retail customers to tariff classes.[25] Ausgrid proposes to assign retail customers into one of four classes of network users, namely:

- the nature of their network usage i.e. residential or business
- the nature of their metering i.e. metered or unmetered
- the voltage level as measured at their metering point e.g. low, high or sub-transmission voltage
- a forecast of the extent of their network usage e.g. level of annual consumption, maximum demand.[26]

Ausgrid proposed to assign retail customers into these classes in accordance with the NER requirements by taking into account:

- the nature and extent of their usage
- the nature of their connection to the network
- whether remotely read interval metering or other similar metering technology has been installed at the customer's premises as a result of a regulatory obligation or requirement
- customers with similar connection and usage profile should be treated on an equal basis
- customers with micro-generation facilities should be treated no less favourable than customers without such facilities but with a similar load profile.[27]

Our decision on the principles that Ausgrid is to adhere to in assigning customers to tariff classes is outlined below.

D.1 AER's assessment approach

We apply the principles set out in clause 6.18.4 of the NER when formulating the provisions which Ausgrid must apply with assignment or re-assigning retail customers to tariff classes. A distributor's decision to assign a retail customer to a particular tariff class or to re-assign a retail customer from one tariff class to another should be subject to an effective system of assessment and review.

D.2 Reasons for draft decision

We do not accept Ausgrid's proposed procedure for assigning retail customers to tariff classes because we consider:

- the level of flexibility that Ausgrid has afforded itself in the re-assignment of retail customers allows it to assign and re-assign retail customers in a manner that does not accord with the NER[28]

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25 NER, cl. 6.12.1(17).
26 Ausgrid, *Distribution Subsequent regulatory proposal 2015-19, Attachment 9.01 Proposed Procedure for assigning customers to tariff classes*, June 2014, p. 3.
27 Ausgrid, *Distribution Subsequent regulatory proposal 2015-19, Attachment 9.01 Proposed Procedure for assigning customers to tariff classes*, June 2014, p. 3.
28 NER, cl. 6.18.4(a)(1)(i) and (ii).

- Ausgrid's proposed approach of notifying retailers instead of the affected customer is contrary to the NER, as it reduces the extent to which assignment decisions are subject to effective assessment and review.[29]

D.3 Reassignment existing customers to a different tariff class

Ausgrid's proposal departed from its current procedure for reassigning existing retail customers to a different tariff classes by increasing its discretion regarding when it can re-assign retail customers on the cost reflective network price tariff class.

We do not approve Ausgrid's proposal for more discretion in tariff class re-assignment. Their proposal is likely to reduce a retail customer's flexibility to affect being re-assigned to a tariff that will reflect the nature and extent of their usage. Under Ausgrid's proposal a retail customer's annual usage must exceed or fall short of the eligibility criteria of the cost reflective network price tariff class by 20 per cent before they are re-assigned to a different tariff. That is, large retail customers on the cost reflective network price tariff class would need to alter their usage by at least 20 per cent before they are allocated a new tariff class. We consider that +/- 20 per cent is too high. On balance we consider that a range of +/- 5 per cent would give retail customers a choice of the tariff class without significant impact on efficient pricing.

D.4 Approach of notifying retailers instead of the affected customer is contrary to the NER

Ausgrid's proposal submitted that notifications concerning tariff assignments and reassignments should be made to the retail customer's retailer consistent with the approach to network tariff assignment now contained in chapter 6B of the NER which now applies in New South Wales.

We do not approve Ausgrid's proposal to remove notifications of tariff class reassignment to retail customers because customer's being re-assigned by Ausgrid will not be subject to an effective system of assessment and review. Foremost, we consider clause 6B.A3.2 of the NER relates to bundled retail tariffs as opposed to large retail customers on unbundled retail tariff. Similar to providing notice and bills via Augrid's Deemed Standard Connection Contract under the NER, such notices should be sent to the affected customers in-writing directly, as the assignment or reassignment of a customer to a different tariff class will likely have a significant impact on the affected customer.[30] In addition, most, if not all, large retail customers are on market contracts. As such we are not aware whether the retail contract terms contain a provision that oblige a retailer to inform the large retail customer in a timely fashion.

D.5 Procedures for assigning or reassigning retail customers to tariff classes

The procedures outlined in this section apply to all direct control services.

Assignment of existing retail customers to tariff classes at the commencement of the 2015–19 regulatory control period

1. Ausgrid's retail customers will be taken to be "assigned" to the tariff class which Ausgrid was charging that retail customer immediately prior to 1 July 2015 if:

[29] NER, cl. 6.18.4(a)(4).
[30] In both the c/KW/h tariff rate and the times at which those tariffs are operable.

- they were an Ausgrid retail customer prior to 1 July 2015
- continue to be a retail customer of Ausgrid as at 1 July 2015.

Assignment of new retail customers to a tariff class during the 2015–19 regulatory control period

1. If, after 1 July 2015, Ausgrid becomes aware that a person will become a retail customer of Ausgrid, then Ausgrid must determine the tariff class to which the new retail customer will be assigned.

2. In determining the tariff class to which a retail customer or potential retail customer will be assigned, or reassigned, in accordance with paragraphs 2 or 5 of this section, Ausgrid must take into account one or more of the following factors:[31]

    a. the nature and extent of the retail customer's usage

    b. the nature of the retail customer's connection to the network[32]

    c. whether remotely-read interval metering or other similar metering technology has been installed at the retail customer's premises as a result of a regulatory obligation or requirement.

3. In addition to the requirements of paragraph 3 above, Ausgrid, when assigning or reassigning a retail customer to a tariff class, must ensure:

    a. retail customers with similar connection and usage profiles are treated equally[33]

    b. retail customers who have micro–generation facilities are not treated less favourably than retail customers with similar load profiles without such facilities.[34]

Reassignment of existing retail customers to another existing or a new tariff during the 2015–19 regulatory control period

1. Ausgrid will make an annual assessment of the nature of each retail customer's connection (i.e. type and voltage of the metering point) and usage of the network over the past 12 months on the basis of volume data as at 31 December.

    a. If the extent of network usage changes then existing retail customers will be reassigned to the appropriate tariff class as part of the next annual pricing proposal process in the following situations:

        i. If an existing retail customer currently assigned to the Cost Reflective Network Price (CRNP) tariff class reduces their annual consumption and maximum demand below 40 GWh or 10 MVA respectively then this retail customer will be assigned to a new tariff class for the purposes of the annual pricing proposal unless Ausgrid has reason to believe that this reassignment is unreasonable in the circumstances, such as in the case where the reduction in the extent of network usage is expected to be temporary in nature.

        ii. If an existing retail customer has increased their annual energy consumption above 40 GWh or recorded a maximum demand in excess of 10 MVA in the previous calendar year

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31 NER, cl. 6.18.4(a)(i).
32 The AER interprets 'nature' to include the installation of any technology capable of supporting time based tariffs.
33 NER, cl. 6.18.4(2).
34 NER, cl. 6.18.4(3).

prior to the network price change then Ausgrid will reassign this retail customer to a new tariff class for the purposes of the annual pricing proposal.

iii. To avoid unnecessary transaction costs associated with assigning retail customers to a new tariff class associated with temporary changes to network usage, Ausgrid will only be required to re-assign:

(i) existing retail customers to the CRNP tariff class if their historical volume data over this period exceeds the eligibility criteria for this tariff class by 5 per cent.

(ii) existing retail customers from the Cost Reflective Network Price (CRNP) tariff class to another tariff class if their historical volume data over this period falls below the eligibility criteria for this tariff class by more than 5 per cent.

iv. Ausgrid will have discretion over whether it is economically desirable to assign retail customers to the CRNP tariff class that satisfy the eligibility criteria, but lie within the ±5 per cent tolerance of the eligibility criteria for this tariff class.

b. If the voltage of the supply to the premise as measured at the metering point changes then the existing retail customer will be reassigned to the appropriate tariff class for the purposes of the next annual pricing proposal process commencing on 1 July.

c. Ausgrid may take into account other relevant information in determining whether a retail customer's tariff class remains appropriate.

d. Ausgrid may reassign a retail customer to another tariff class if the existing retail customer's load characteristics or connection characteristics (or both) have changed such that it is no longer appropriate for that retail customer to be assigned to the tariff class to which the retail customer is currently assigned or a retail customer no longer has the same or materially similar load or connection characteristics as other retail customers on the retail customer's existing tariff class, then it may reassign that retail customer to another tariff class. In determining the tariff class to which a retail customer will be reassigned, Ausgrid must take into account paragraphs 3 and 4 above.

Objections to proposed assignments and reassignments

1. Ausgrid must notify a retail customer in writing of the tariff class to which the retail customer has been assigned or reassigned, prior to the assignment or reassignment occurring.

2. A notice under paragraph 6 above must include advice informing the retail customer that they may request further information from Ausgrid and that the retail customer may object to the proposed reassignment. This notice must specifically include:

a. a written document describing Ausgrid's internal procedures for reviewing objections , if the retail customer provides express consent, a soft copy of such information via email

b. that if the objection is not resolved to the satisfaction of the retail customer under Ausgrid's internal review system within a reasonable timeframe, then, to the extent resolution of such disputes are within the jurisdiction of the Energy and Water Ombudsman or like officer, the retail customer is entitled to escalate the matter to such a body

c. that if the objection is not resolved to the satisfaction of the retail customer under Ausgrid's internal review system and the body noted in clause 7.b. above, then the retail customer is

entitled to seek a decision of the AER via the dispute resolution process available under Part 10 of the NEL.

3. If, in response to a notice issued in accordance with paragraph 7 above, Ausgrid receives a request for further information from a retail customer, then it must provide such information within a reasonable timeframe. If Ausgrid reasonably claims confidentiality over any of the information requested by the retail customer, then it is not required to provide that information to the retail customer. If the retail customer disagrees with such confidentiality claims, he or she may have resort to the dispute resolution procedures referred to in sections 7(a)—(b) above, mutatis mutandis.

4. If, in response to a notice issued in accordance with paragraph 7 above, a retail customer makes an objection to Ausgrid about the proposed assignment or reassignment, Ausgrid must reconsider the proposed assignment or reassignment. In doing so Ausgrid must take into consideration the factors in paragraphs 3 and 4 above, and notify the retail customer in writing of its decision and the reasons for that decision.

5. If a retail customer's objection to a tariff class assignment or reassignment is upheld by the relevant body noted in paragraph 7 b and c above, then any adjustment which needs to be made to tariffs will be done by Ausgrid as part of the next annual review of prices.

6. If a retail customer objects to Ausgrid's tariff class assignment Ausgrid must provide the information set out in paragraph 7 above and adopt and comply with the arrangements set out in paragraphs 8, 9 and 10 above in respect of requests for further information by the retail customer and resolution of the objection.

System of assessment and review of the basis on which a retail customer is charged

1. Where the charging parameters for a particular tariff result in a basis of charge varies according to the retail customer's usage or load profile, Ausgrid must set out in its annual pricing proposal a method by which it will review and assess the basis on which a retail customer is charged.

2. If the AER considers the method provided under paragraph 12 above does not provide for an appropriate system of assessment and review by Ausgrid of the basis on which a retail customer is charged, the AER may, at any time, request additional information or request Ausgrid to submit a revised pricing method.

3. If the AER considers Ausgrid's method for reviewing and assessing the basis on which a retail customer is charged, provided in accordance with paragraph 12 and 13 above, is not reasonable it will advise Ausgrid in writing.