DRAFT DECISION

AusNet Services, CitiPower, Jemena, Powercor, and United Energy Distribution Determination 2021 to 2026

Attachment 14 Control mechanisms

September 2020

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on the distribution determinations that will apply to AusNet Services, CitiPower, Jemena, Powercor, and United Energy for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 – Customer service incentive scheme (applicable to AusNet Services only)

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Victorian f-factor incentive scheme

Contents

14 Control mechanisms

Control mechanisms impose limits over the prices of direct control services (standard and alternative control services) and/or the revenues that a distribution network service provider can recover from customers for these services. For standard control services, the National Electricity Rules (NER) require the control mechanism be of the prospective CPI–X form (or some incentive-based variant).[1]

We will regulate AusNet Services', CitiPower's, Jemena's, Powercor's, and United Energy's ("the Victorian distributors"') standard control services under a revenue cap control mechanism for the 2021–26 regulatory control period. Alternative control services will mostly be regulated under a price cap control mechanism, with type 5 and 6 (including smart metering) services operating under a revenue cap control mechanism. These treatments are consistent with the position in our Framework and Approach (F&A) for the Victorian distributors published in January 2019.[2] They are also consistent with the current approach for the Victorian distributors.

The Victorian businesses are transitioning regulatory years from calendar years to financial years, in line with other jurisdictions in the National Electricity Market (NEM) (for more information, see our Decision on the six-month extension). This requires a tailored approach to the price controls in the first years of the 2021–26 period, which is addressed in this attachment.

This attachment discusses:

- the form of control mechanisms for standard control services and the formulae that give effect to these control mechanisms[3]
- the form of control mechanisms for alternative control services and the formulae that give effect to these control mechanisms[4]
- how compliance with the control mechanisms is to be demonstrated[5]
    - this includes the mechanism through which the Victorian distributors will recover distribution use of system (DUoS) and type 5 and 6 (including smart metering) revenues, including adjustments for revenue under or over recovery
- how the Victorian distributors are to report on their recovery of designated pricing proposal charges and jurisdictional scheme amounts, and on the adjustments to be

1 NER, cl. 6.2.6(a).
2 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 54–73.
3 NER, cl. 6.12.1(11).
4 NER, cl. 6.12.1(12).
5 NER, cl. 6.12.1(13).

made to subsequent pricing proposals to account for over or under recovery of these charges or amounts.[6]

14.1 Draft decision

Our draft determination for the Victorian distributors is as follows:

- The form of control mechanism for standard control services is a revenue cap. The relevant draft decision X-factors can be found in Attachment 1 − Annual revenue requirement.
- The form of control mechanism for type 5 and 6 (inc. smart metering) services, which we classify as an alternative control service, is a revenue cap. The relevant draft decision X-factors can be found in Attachment 16 − Alternative control services.
- The form of control mechanism for all other alternative control services (network ancillary services, auxiliary and type 7 metering services, basic and enhanced connection services, connection application and management services and public lighting services) is a price cap. The relevant draft decision X-factors can be found in Attachment 16 − Alternative control services.
- Section 14.4.1 contains the revenue cap formulae for standard control services.
    - The revenue cap for any given regulatory year is the total allowed revenue, or TAR, calculated using the formula in Figure 14.1.
    - The side constraints applying to price movements for each of the Victorian distributors' tariff classes must be consistent with the formula in Figure 14.2.
- Section 14.5.1 contains the revenue cap formulae for type 5 and 6 (inc. smart metering) services.
    - The revenue cap for any given regulatory year is the total allowed revenue for metering, or TARM, calculated using the formula in Figure 14.3.
    - This revenue cap control mechanism formula includes a cost-pass-through mechanism as set out in our final F&A. We have not accepted the modified materiality threshold as proposed by some of the Victorian distributors. See Section 14.5.3 for our reasoning.
    - The side constraints applying to price movements for each of the Victorian distributors' tariff classes must be consistent with the formula in Figure 14.4.
- Section 14.5.2 contains the price cap formulae for all other alternative control services.
    - The price cap formulae for fee-based alternative control services − where the price can be determined in advance − are defined in Figure 14.5.

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[6] NER, cl. 6.12.1(19) and 6.12.1(20).

    - This price cap control mechanism formula for fee-based services includes a cost-pass-through mechanism as set out in our final F&A. We have not accepted the modified materiality threshold as proposed by some of the Victorian distributors. See Section 14.5.3 for our reasoning.
    - The price cap formula applying to the Victorian distributors' alternative control services provided on a quoted basis is set out in Figure 14.6.
    - We have not accepted the modifications to the quoted services formula proposed by the Victorian distributors. See Section 14.5.3 for our reasoning.
- The Victorian distributors' pricing proposals must demonstrate compliance with the revenue cap—in accordance with Figure 14.1—by including adjustments for DUoS revenue under or over recovery in accordance with Appendix A of this attachment.[7]
- The Victorian distributors' pricing proposals must demonstrate compliance with the type 5 and 6 (inc. smart metering) services revenue cap—in accordance with Figure 14.3—by including adjustments for type 5 and 6 (inc. smart metering) services revenue under or over recovery in accordance with Appendix B of this attachment.[8]
- The Victorian distributors' pricing proposals must demonstrate compliance with the price cap control formulae set out at Figure 14.5 and Figure 14.6.[9]
- Each Victorian distributor must submit, as part of its annual pricing proposal, a record of the amount of revenue recovered from designated pricing proposal charges and associated payments in accordance with Appendix C of this attachment.[10]
- Each Victorian distributor must submit, as part of its annual pricing proposal, a record of any jurisdictional scheme amounts it recovers and associated payments in accordance with Appendix D of this attachment.[11]
- Appendix E of this attachment details rules about how rounding is to be handled in the annual pricing approval process.[12]

14.2 The Victorian distributors' proposals

The Victorian distributors have accepted the decisions in our final F&A to:[13]

- Apply a revenue cap to standard control services.

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7 NER, cl. 6.18.2(b)(7).
8 NER, cl. 6.18.2(b)(7).
9 NER, cl. 6.18.2(b)(7).
10 NER, cl. 6.18.2(b)(7).
11 NER, cl. 6.18.2(b)(7).
12 NER, cl. 6.18.2(b)(7).
13 AusNet Services, *Regulatory Proposal 2022–26 Part III*, January 2020, p.267; CitiPower, *APP08 - Price control formula*, January 2020, pp. 2-8; Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, p. 1; Powercor, *APP08 - Price control formula*, January 2020, pp. 2-8; United Energy, *APP08 - Price control formula*, January 2020, pp. 3-9.

- Apply a revenue cap to type 5 and 6 (inc. smart metering) services.
- Apply price caps to all other alternative control services.

The Victorian distributors proposed the following bases for the control mechanisms for alternative control services:[14]

- For type 5 and 6 (inc. smart metering) services, apply a limited building block approach to develop prices in the first year and then a revenue path for the remaining years of the regulatory control period.
- For public lighting, apply a limited building block approach to develop prices in the first year and then a price path for the remaining years of the regulatory control period.
- For other price-capped alternative control services provided on a fee basis (including fee-based network ancillary, connection and metering-related services), apply a formula-based approach in the first year and then a price path for the remaining years of the regulatory control period.
- For price-capped alternative control provided on a quotation basis, apply a formula-based approach (cost build-up) including labour rates in the first year and then a price path for the labour rates in the remaining years of the regulatory control period.

The Victorian distributors proposed formulae that give effect to the revenue caps for standard control services and type 5 and 6 (inc. smart metering) services based on those set out in our F&A.[15] These proposed formulae reflect changes required to accommodate the shift in the regulatory control period from calendar years to financial year. The Victorian distributors proposed these formulae based on consultation with the AER.[16]

In addition, AusNet Services proposed that annual levies from Energy Safe Victoria (ESV) should be recovered through a factor in the standard control services revenue cap formula, as per the current treatment of Victorian Essential Service Commission (ESC) licence fees.[17]

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[14] AusNet Services, *Regulatory Proposal 2022–26 Part IV*, January 2020, pp. 5-6, 45-46, 58-60; CitiPower, *APP08 - Price control formula*, January 2020, pp. 5-8; Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, pp. 5-9; Powercor, *APP08 - Price control formula*, January 2020, pp. 5-8; United Energy, *APP08 - Price control formula*, January 2020, pp. 6-9.

[15] AusNet Services, *Regulatory Proposal 2022–26 Part III*, January 2020, pp. 268-272; AusNet Services, *Regulatory Proposal 2022–26 Part IV*, January 2020, pp. 5-6; CitiPower, *APP08 - Price control formula*, January 2020, pp. 2-5; Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, pp. 1-7; Powercor, *APP08 - Price control formula*, January 2020, pp. 2-5; United Energy, *APP08 - Price control formula*, January 2020, pp. 3-6.

[16] AER, *Price control formulas for Victoria 2021 extended period and 21–26 regulatory control period,* 2 December 2019, E-mail.

[17] AusNet Services, *Regulatory Proposal 2022–26 Part III*, January 2020, p. 271.

The Victorian distributors proposed formulae that generally give effect to the price caps for alternative control services based on those set in our F&A. However, the Victorian distributors proposed to introduce extra factors to the formula for quoted services:

- all of the Victorian distributors proposed to include a factor to account for the tax component of capital works[18]
- AusNet Services and Jemena proposed a margin be included to ensure competitive neutrality is maintained.[19]

Citipower, Powercor and United Energy proposed that we:[20]

- confirm our 2016–20 determination that the cost impacts of defined and nominated pass through events on the provision of alternative control services may be recovered under the pass through provisions
- modify the materiality threshold for pass through events that result in increased costs for alternative control services to one per cent of the revenue of impacted alternative control services, rather than the NER requirement of one per cent of the annual revenue requirement
- allow cost pass throughs relating to increases in the costs of providing alternative control services to be recovered from alternative control services customers via alternative control pricing, rather than standard control customers through standard control pricing. These distributors considered this to be more cost reflective than the approach we determined in the 2016–20 determinations.

Jemena did not include a side-constraint mechanism or formula for type 5 and 6 (inc. smart metering) services.[21]

14.3 Assessment approach

Our assessment of the form of control mechanisms for the Victorian distributors was set out in our final F&A.

The final F&A sets the form of control mechanism for standard control services as a revenue cap, which is binding on our determination.[22] The basis of the revenue cap must be of the prospective CPI–X form (or some incentive-based variant).[23]

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18 AusNet Services, *Regulatory Proposal 2022–26 Part IV*, January 2020, pp. 59-60; CitiPower, *APP08 - Price control formula*, January 2020, p. 8; Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, pp. 9-11; Powercor, *APP08 - Price control formula*, January 2020, p. 8; United Energy, *APP08 - Price control formula*, January 2020, p. 9.

19 AusNet Services, *Regulatory Proposal 2022–26 Part IV*, January 2020, pp. 59-60; Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, p. 11.

20 CitiPower, *Regulatory proposal 2021–26 - Managing uncertainty - CP APP04 - Uncertainty appendix*, January 2020, pp. 28–29; Powercor, *Regulatory proposal 2021–26 – Managing uncertainty – PAL APP04 - Uncertainty appendix*, January 2020, pp. 28–29; United Energy, *Regulatory proposal 2021–26 - Managing uncertainty - UE APP04 - Uncertainty appendix*, January 2020, pp. 28–30.

21 Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, p. 5.

Our final F&A deliberately set out a generic formula to give effect to the control mechanism for standard control services.[24] The generic formula requires the control mechanism parameters be specified with more precision in order to be implemented. This draft determination clarifies our position regarding the parameters of the control mechanism formula (see section 14.4).

Our final F&A set the form of control mechanism for alternative control services:

- as a revenue cap for type 5 and 6 (inc. smart metering) services
- as a price cap for all other alternative control services (e.g. ancillary network services, auxiliary metering services, basic connection services and public lighting).[25]

As for standard control services, our final F&A decision on the form of control mechanisms for alternative control services is binding on our determination.[26] Unlike standard control services, the NER is not prescriptive on the basis of the control mechanism for alternative control services.[27] This allows the Victorian distributors to have discretion over the approach they undertake to develop their initial prices.

Our final F&A set out the formulae that give effect to the control mechanisms for:

- type 5 and 6 (inc. smart metering) services. As for standard control services, the F&A set out a generic formula for these services. This draft determination clarifies our position regarding the control mechanism formula and its respective parameters in Section 14.5.1[28]
- other alternative control services:
    - a fee-based price cap formula
    - a price cap formula for quoted services.

These formulae are detailed below in section 14.5.2.

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22 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 59; NER, cl. 6.12.3(c).

23 NER, cl. 6.2.6(a).

24 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 66–68.

25 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 68; NER, cl. 6.12.3(c).

26 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 68; NER, cl. 6.12.3(c).

27 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 68; NER, cl. 6.12.3(c).

28 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 72–73.

We may only make changes to the formulae specified in the F&A where we are satisfied that there has been a material change in circumstances.[29] Our assessment approach to the control mechanism formulae is:

- to consider how to appropriately define elements or parameters of the generic formulae in a way that provides sufficient precision around the operation of the formulae (this is most relevant for revenue-capped services)
- to consider whether any material changes have taken place that would warrant a change to one or more of the formulae as set out in the F&A. If we are satisfied that a material change in circumstances has occurred, then we would either propose changes or consider the merits of proposed changes to the formulae as relevant.

For other elements of this draft decision, our assessment approach is to apply the requirements of the NER and consider where further amendments or clarifications are appropriate to our decision. We consider there are benefits in maintaining a consistent approach to the control mechanisms across distributors within the same jurisdiction and across jurisdictions where possible, subject to specific circumstances and new information that becomes available over time.

14.4 Draft decision for standard control services

The following sets out our draft decision on the control mechanism formulae for standard control services and provides further discussion of the parameters of the revenue cap control mechanism. It also discusses our draft decision in relation to deliberately under-recovered revenue, and the reporting of designated pricing proposal charges and jurisdictional scheme amounts, and the rounding of inputs in annual pricing proposals.

14.4.1 Control mechanism formulae for standard control services

Our decision on the formulae that give effect to the control mechanism must be as set out in the F&A unless we consider that a material change in circumstances occurs that justifies departing from that approach.[30] Figure 14.1 sets out the revenue cap formula for distribution services.

The formula in the F&A included an Adjusted Annual Revenue (AAR) factor, which represented the adjusted annual smoothed revenue requirement. This factor allowed for the adjustment to revenue requirements for the service target performance incentive scheme (STPIS). In our F&A, we identified the ongoing STPIS review at the time. We further noted that any relevant STPIS adjustments may be made under either the S- or I-factors as set out in the F&A, and that this would be considered during the

[29] NER, cl. 6.12.3(c1).
[30] NER, cl. 6.12.3(c1).

revenue determination process.[31] After the final F&A was published, we finalised the STPIS review and released our new STPIS guideline.

Now that we have completed our review and published the revised STPIS, our draft decision is to apply the revised STPIS. We consider that there has been a material change in circumstances which requires us to depart from the F&A and apply the revised STPIS to this decision process.[32] STPIS outcomes will now be specified as a fixed monetary amount, rather than a percentage adjustment.[33] This causes the need to adjust how we account for STPIS in the revenue cap control formula.

As a result of the new application of the STPIS under the I-factor, the escalation by the S factor is no longer required, and has been removed from the revenue cap formula. In doing this, there is no longer a need to escalate the annual smoothed revenue in year 1 prior to applying adjustments. As the STPIS operates on a two-year lag, STPIS rewards for the first two years will be calculated as percentages. However, we will translate STPIS values for the first two years into monetary values to be applied in the revenue cap formula under the I-factor adjustment. Further explanation can be found in Section 14.4.2.

As a result of the transition of the regulatory year from calendar years to financial years, a number of elements will require adjustments to transition appropriately. This applies to the incentive schemes, which are applied on a lag once performance from certain years are known. These transitional approaches are found in Figure 14.1, and are detailed further in Section 14.4.2.

Figure 14.1 Revenue cap formula[34]

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

2. $$TAR_t = AAR_t + I_t + B_t + C_t$$ t = 1,2...,5

3. $$AAR_t = AR_t$$ t = 1

4. $$AAR_t = AAR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t)$$ t = 2,3…,5

where:

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31 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 67; NER, cl. 6.12.3(c).

32 NER, cl. 6.12.3(c1).

33 AER, *Amendment to the Service Target Performance Incentive Scheme - Explanatory Statement*, November 2018, p. 3.

34 All parameters are in nominal terms unless otherwise specified.

TAR_t is the total allowable revenue in year t.

p_t^{ij} is the price of component 'j' of tariff 'i' in year t.

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t.

t is the regulatory year.

AR_t is the annual smoothed revenue requirement in the Post Tax Revenue Model (PTRM) for year t.

I_t is the sum of incentive scheme adjustments in year t. Likely to incorporate revenue adjustments relating to outcomes of:

- the fire start incentive scheme (f-factor) in relation to financial year t-3 to be applied in years t=1 to 5 (e.g. 2018/19 f-factor to be applied in 2021–22)
- the STPIS in relation to:
  - regulatory year t-3 to be applied in years t=1,2 (i.e. 2019 STPIS to be applied in 2021–22, 2020 STPIS to be applied in 2022–23)
  - regulatory year t-2 to be applied in years t=2 to 5 (i.e. 2021 6-month STPIS to be applied in 2022–23, 2021–22 STPIS to be applied in 2023–24, and so on).[35]
- the demand management incentive scheme (DMIS) in relation to:
  - regulatory year t-3 to be applied in years t=1,2 (i.e. 2019 DMIS to be applied in 2021–22, 2020 DMIS to be applied in 2022–23)
  - regulatory year t-2 to be applied in years t=2 to 5 (i.e. 2021 6-month DMIS to be applied in 2022–23, 2021–22 DMIS to be applied in 2023–24, and so on).[36]
- the demand management innovation allowance (DMIA) in relation to the 2016–20 regulatory control period[37] to be applied in regulatory year t=2 only[38]

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35 In the year 2022–23, the STPIS performance outcomes for both the 2020 year and the 2021 6-month period will be applied.

36 In the year 2022–23, the DMIS performance outcomes for both the 2020 year and the 2021 6-month period will be applied.

37 The DMIA measurement will be extended to incorporate the 2021 6-month period.

38 The DMIA will be replaced by the demand management innovation allowance mechanism (DMIAM) from 1 June 2021, and will be applied in year 2 of the 2026–31 regulatory control period.

- any other related incentive schemes as applicable[39] that are to be applied in year t.

B_t is the sum of annual adjustment factors for year t. It includes:

- the true-up for any under or over recovery of actual revenue collected through DUoS charges calculated using the following method:

$$DUoS\ Under\ and\ Overs\ True-Up_t = -(Opening\ Balance_t)(1 + WACC_t)^{0.5}$$

where:

$DUoS\ Under\ and\ Overs\ True-Up_t$ is the true-up for the balance of the DUoS unders and overs account in year t.

$Opening\ Balance_t$ is the opening balance of the DUoS unders and overs account in year t as calculated by the method in appendix A.

$WACC_t$ is the approved weighted average cost of capital (WACC) used in regulatory year t in the DUoS unders and overs account in Appendix A. This WACC figure will be a nominal WACC figure that reflects actual inflation rather than forecast inflation. To calculate this nominal WACC, the real vanilla WACC from the annual update PTRM will be escalated for actual inflation.

- license fee charges incurred by the Victorian businesses, charged by the Victorian Essential Service Commission. The recovery of license fee charges will occur on a two-year lag, and will therefore be indexed by two years interest, calculated using the following method:

$$L_{t-2} \times (1 + WACC_t) \times (1 + WACC_{t-1})$$

where:

L_{t-2} is the sum of the license fees paid by the distributor to the Victorian Essential Services Commission relating to regulatory year t-2. As these license fees are calculated on a financial year, there is no consideration required for transitioning this factor across the move to financial years.

C_t is the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER. It will also include any end-of-period adjustments in regulatory year t.

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[39] This does not reflect those incentive schemes that are calculated and applied through our regulatory determination, such as the capital expenditure sharing scheme (CESS) or efficiency benefit sharing scheme (EBSS).

ΔCPI_t is the annual percentage change in the ABS consumer price index (CPI) All Groups, Weighted Average of Eight Capital Cities[40] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1
>
> divided by
>
> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2
>
> minus one.

For example, for 2021–22, year t–2 is the December quarter 2019 and year t–1 is the December quarter 2020.

X_t is the X-factor for each year of the 2021–26 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year.

Side constraints

Figure 14.2 sets out the side constraints formula. For each regulatory year after the first year of a regulatory control period, side constraints apply to the weighted average revenue raised from each tariff class. In accordance with the NER, the permissible percentage increase is the greater of CPI–X plus 2 per cent or CPI plus 2 per cent.[41] Recovery of certain revenues, such as those to accommodate pass throughs and incentive schemes, are disregarded in deciding whether the permissible percentage has been exceeded.[42]

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40 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

41 NER, cl. 6.18.6(c).

42 NER, cl. 6.18.6(d).

Figure 14.2 Side constraints formula[43]

For t=2,3,…,5:

$$\frac{\left(\sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij} q_t^{ij}\right)}{\left(\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_t^{ij}\right)} \leq (1+\Delta CPI_t) \times (1-X_t) \times (1+2\%) + I_t' + B_t' + C_t'$$

where each tariff class has "n" tariffs, with each up to "m" components, and where:

p_t^{ij} is the proposed price for component ‘j’ of tariff 'i' for year t.

p_{t-1}^{ij} is the price charged for component ‘j’ of tariff 'i' in year t–1.

q_t^{ij} is the forecast quantity of component ‘j’ of tariff 'i' in year t.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[44] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2

minus one.

For example, for 2021–22, year t–2 is the December quarter 2019 and year t–1 is the December quarter 2020.

X_t is the X-factor for each year of the 2021–26 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year. If X>0, then X will be set equal to zero for the purposes of the side constraint formula.

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43 All parameters are in nominal terms unless otherwise specified.

44 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

I_t' is the annual percentage change in the sum of incentive scheme adjustments described in Figure 14.1 applied in year t. This percentage should be calculated by dividing the incremental revenues (the difference between the I-factor used in the total annual revenue formula for t and t-1) by the expected revenues for regulatory year t-1 (based on prices in year t-1 multiplied by the forecast quantities for year t).

B_t' is the annual percentage change from the sum of annual adjustment factors for year t and includes true-up for any under or over recovery of actual revenue collected through DUoS charges calculated using the method in Figure 14.1. This percentage should be calculated by dividing the incremental revenues (as used in the total annual revenue 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).

C_t' is the annual percentage change from the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER. It will also include any end-of-period adjustments in regulatory year t. This percentage should be calculated by dividing the incremental revenues (the difference between the C-factor used in the total annual revenue formula for t and t-1) 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).

14.4.2 Definition of control mechanism formula parameters

Total allowable revenue

In this draft determination, the revenue cap for any given regulatory year is the TAR for distribution services (as defined in Figure 14.1).

Intra-period adjustment to the weighted average cost of capital

Changes to the TAR resulting from the trailing average cost of debt update will be implemented through annual revisions to the X-factors. Further discussion on this adjustment can be found in Attachment 3—Rate of return—which discusses the WACC annual adjustment and Attachment 1—Annual revenue requirement—which details issues relating to X-factors.

Incentive scheme adjustments (I factor)

The I factor parameter is for annual TAR adjustments relating to a service provider's performance against relevant incentive schemes. The I factor for a given regulatory year will account for relevant incentive scheme rewards and/or payments.

For the Victorian distributors this factor captures the STPIS, DMIA,[45] DMIS and fire start incentive scheme.[46] The inclusion of these schemes is consistent with the Victorian distributors' proposals.

For the avoidance of doubt, the I-factor does not incorporate incentive schemes where the amounts to be recovered are set as part of our building blocks in our regulatory determination (e.g. the capital expenditure sharing scheme (CESS) or efficiency benefit sharing scheme (EBSS)).

Service target performance incentive scheme

The STPIS component of the I-factor was previously applied as a percentage adjustment to annual revenue, as determined by the AER.[47] Our final F&A identified that a STPIS review was ongoing. We noted that the relevant STPIS adjustments could be made under either the S- or I-factors set out in the F&A and that this would be considered during the revenue determination process.[48] Under the new STPIS guideline[49] the STPIS component will be applied as a monetary amount added to or subtracted from the annual revenue (in line with other incentive schemes).

The STPIS is typically applied to revenue on a two-year lag (different treatments are needed to accommodate the transition to financial years, as detailed below). This is because the Victorian distributors would typically submit compliance reports for year t-2 before the start of year t. We then determine the adjustment for year t-2 to be applied in the year t annual pricing proposal.

Given this lag, there will be a transitional phase in the 2021–26 regulatory control period. In years 1 and 2 of the regulatory control period, the S-factor would generally be provided as a percentage adjustment to annual revenue. However, to simplify the process for these first two years of the regulatory control period, we will translate the S-factor percentages into equivalent monetary values to be incorporated directly into the I-factor. In subsequent years, any revenue increments or decrements related to the STPIS will be included in the I-factor adjustment as a monetary amount.

In addition, we note that the expected transition from calendar to financial years is expected to require an additional adjustment for the first two years.

- For the first year of the new regulatory control period (year t=1 or 2021–22), the STPIS component of the I-factor is expected to include any adjustments

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45 The DMIA will be replaced by the DMIAM, with application of this incentive scheme to occur in the same manner as the DMIA from the 2026-31 regulatory control period.

46 AER, *Electricity distribution service providers: Service target performance incentive scheme*, November 2018, pp. 34-35.

47 AER, *Electricity distribution network service providers: Service target performance incentive scheme: Appendix C*, 1 November 2009, p. 32.

48 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 67; NER, cl. 6.12.3(c).

49 AER, *Electricity distribution service providers: Service target performance incentive scheme*, November 2018, pp. 34-35.

relating to year t-3 (2019). It is not anticipated this will incorporate adjustments relating to year t-2 (2020) as these are not expected to be available in time.

- For the second year of the new regulatory control period (year t=2 or 2022–23), the STPIS component of the I-factor is expected to include any adjustments relating to year t-3 (2020) and year t-2 (first half of 2021).
- For the third and subsequent years (years t=3 to 5 or 2023–24 onwards), the STPIS component of the I-factor is expected to revert to including any adjustments relating to year t-2 (e.g. 2021–22 outcomes are applied in 2023–24).

Demand management innovation allowance and incentive scheme

The details of the DMIAM (to replace the DMIA), and of the new DMIS, were proposed by the AER in November 2017.[50]

The current DMIA applies to the Victorian distributors in the current regulatory control period. The operation of this mechanism requires that we determine and apply any carryover amount from underspending the allowance as a deduction from the distributor's revenue requirement in the subsequent regulatory control period.[51]

As a consequence, it is necessary to include a factor adjusting for the carryover amount for this mechanism in the next regulatory control period. This adjustment is applied to the I-factor in year 2 of the regulatory control period.

The new DMIAM will replace the DMIA from 1 June 2021. As a result of this, any carryover amount from the DMIAM will apply in the 2026–31 regulatory control period, applied similarly to the approach adopted for DMIA.

For the new DMIS, the Victorian distributors will submit compliance reports for year t-2 before the start of year t. We will then determine the total financial incentive recoverable for year t-2 to be applied in the year t annual pricing proposal.

Due to the early application of the DMIS, a transition from calendar to financial years is expected to require an additional adjustment for the first two years.

- For the first year of the new regulatory control period (year t=1 or 2021–22), the DMIS component of the I-factor is expected to include any adjustments relating to year t-3 (2019). It is not anticipated this will incorporate

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50 AER, *Demand management incentive scheme*, November 2017; AER, *Explanatory Statement, Demand management incentive scheme*, November 2017; AER, *Demand management innovation allowance mechanism*, November 2017; AER, *Explanatory statement, Demand management innovation allowance mechanism*, November 2017; AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

51 AER, *Demand Management Innovation Allowance Mechanism; Electricity distribution network service providers*, December 2017, p.7.

adjustments relating to year t-2 (2020) as these are not expected to be available in time.

- For the second year of the new regulatory control period (year t=2 or 2022–23), the DMIS component of the I-factor is expected to include any adjustments relating to year t-3 (2020) and year t-2 (first half of 2021).
- For the third and subsequent years (years t=3 to 5 or 2023–24 onwards), the DMIS component of the I-factor is expected to revert to including any adjustments relating to year t-2 (e.g. 2021–22 outcomes are applied in 2023–24).

Fire start incentive scheme

The fire start incentive scheme (known as 'f-factor') provides incentives to the Victorian distributors to reduce the risk of fire starts due to electricity infrastructure, and to reduce the risk of loss or damage caused by fire starts.[52] The fire start incentive scheme currently operates on a 2½ year lag. That is, it is applied in the regulatory year commencing 18 months after the performance year ends (e.g. 2017–18 performance was applied as an adjustment to the 2020 revenue allowance).

With the expected transition of the regulatory year from a calendar to financial year basis, the f-factor will be better aligned and will operate on a three-year lag in the next regulatory control period (e.g. 2018/19 performance will be applied as an adjustment to the 2021–22 revenue allowance). This reflects that smaller lags (e.g. a two-year lag) are not feasible due to the required timeframes for determining the f-factor adjustment. CitiPower, Powercor, and United Energy expressed concern that applying the f-factor on a 3-year lag on a permanent basis would dilute incentives.[53] However, due to the processes required to calculate the f-factor, including those undertaken by external parties, the timelines do not allow for a shorter lag on this incentive scheme.

With the shift from a 2½- to 3-year lag expected to be made at the same time as the transition from calendar to financial years, and with no adjustment expected to be made for f-factor scheme amounts in the 6-month extension period, no further adjustments are expected to be required to accommodate the transition of the f-factor.

Annual adjustments (B factor)

The B-factor parameter is for annual TAR adjustments required within the 2021–26 regulatory control period. Consistent with our final F&A the B-factor will include 'true-up' adjustments for DUoS revenue under or over recovery and adjustments relating to license fees.[54]

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52 AER, *Final determination - f-factor for Victorian electricity distribution network service providers*, June 2017, p. 16.

53 CitiPower, Powercor, United Energy, *Price control formula,* 5 December 2019, e-mail.

54 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 67.

Unders and overs account

In the F&A we noted that the B-factor was likely to include adjustments for the unders and overs account. Our draft determination is that the B-factor will include a true-up for the net present value of under or over recovered revenue. This true-up will be calculated based upon the DUoS unders and overs account kept in accordance with the method in appendix A.

Under a revenue cap, the Victorian distributors' revenues in year t will be adjusted annually to clear (or true-up) any under or over recovery of actual revenue collected through DUoS charges in year t–2 (and/or t–3 where applicable) and any estimated under or over recovery of revenues in year t–1 (and/or t–2 where applicable).

With the expected transition of regulatory years from a financial to calendar year basis, and with no DUoS under or over recovery amounts expected to be adjusted for in setting prices for the first half of 2021, Appendix A sets out the requirement that the unders and overs account for the first two years of the new regulatory control period will be adjusted to incorporate an additional year.

For any regulatory year t, we will base the level of this adjustment on the opening balance of the DUoS unders and overs account.

As the under or over recovery in regulatory year t will have six months of nominal WACC applied to it during the regulatory year, while the opening balance of the DUoS unders and overs account will have one year of nominal WACC applied during the regulatory year, we consider that the true-up requires an adjustment by six months of WACC to be on a common basis. The WACC applied in the unders and overs account will reflect actual inflation, and be sourced from the annual updates provided by the AER and escalated for actual inflation. This is to be known as the nominal adjusted WACC.

As the purpose is to offset the opening balance, we consider that the sign of the true-up should be the reverse of the sign of the opening balance. For clarity, if a distributor has recovered below its allowable revenue prior to year t, this balance will be negative and this true-up should be positive to allow the distributor to recover that revenue in year t to bring the balance of the unders and overs account to zero.[55]

The B-factor used in the unders/overs account for the calculation of TAR excludes the true-up for DUoS revenue under/over recovery for the regulatory year, and is therefore expected to be zero where there are no defined annual adjustments.

Licence fees

In the current regulatory control period, the B-factor includes an adjustment to allow the Victorian distributors to recover the licence fees that they are charged by the ESC. The

[55] The balance of the unders and overs account is to be below zero to ensure compliance with the revenue cap. For more detail see appendix A of this attachment.

F&A provides for the annual adjustment factors to be included in the B-factor to be decided in the distribution determination.[56]

In its proposal, AusNet Services submitted that annual levies from ESV should be treated similarly to these licence fees, with any such levies recouped directly from customers as an adjustment in the annual pricing process. AusNet Services indicated that they anticipated significant increases in these levies.[57] Our consideration of this proposal is covered in Attachment 6 - operating expenditure.[58]

Our draft determination is that the Victorian ESC licence fees will continue to be included in the B-factor as set out in the F&A, and that the annual ESV levies shall not be included in the B-factor. As Victorian ESC licence fees are applied on a financial year basis, and are not expected to be applied in the 6-month extension, there is no transitional treatment to be considered, and will simply be applied on a two year lag.

Cost pass through adjustments (C factor)

The C-factor is for annual TAR adjustments relating to AER-approved cost pass through amounts, and can also include AER-approved end-of-period adjustments. These could include once-off adjustments to revenue required during the 2021–26 regulatory control period that are not able to be accounted for in the other factors of the revenue cap formula.

We consider this factor acts in a complementary manner with the B-factor which makes annual adjustments to TAR. Should the B-factor fail to capture all of the revenue adjustments required in the 2021–26 regulatory control period through its annual function, true-up adjustments in the final year of the 2021–26 regulatory control period may be required. The C-factor provides an avenue for this to be done.

The wording of the phrase 'end-of-period adjustments' is intentionally broad to allow for a range of adjustments that may be required. Such adjustments could be proposed by the distributor, or consideration initiated by the AER (including on receipt of relevant stakeholder submissions). However, for the avoidance of doubt, end of period adjustments (positive or negative) may only − and must − be included in the C-factor where the AER has decided to apply a given adjustment (for example, as part of a regulatory determination).

For the 2021−26 regulatory control period, we anticipate that the C-factor could include any amounts the AER decides to be added to or subtracted from the distributor's annual smoothed revenue requirement in the (standard control services) PTRM to adjust for any true-ups or other adjustments that are required in transitioning from calendar years to financial years. The AER intends, as part of its final decision for the

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56 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 67.

57 AusNet Services, *Regulatory Proposal 2022–26 Part III*, January 2020, p.271.

58 AER, AusNet Services distribution determination 2021–26 - Attachment 6 - Operating expenditure, September 2020, pp. 42-43.

2021−26 regulatory control period, to identify any adjustments or true-ups that may be necessary to correct for discrepancies arising from the transition to financial years. The AER further intends that any such amounts would be implemented through the C-factor in the control mechanism formula.

More detail on the types of costs that can be included as a cost pass through are set out in Attachment 15—Pass through events.

Calculation of the consumer price index escalation

When calculating the change in the CPI for use in the standard control services control mechanism formula we will apply the annual movement between the Australian Bureau of Statistics' (ABS) published December quarter data.

Use of the December quarter data will mean the Victorian distributors will apply an actual CPI escalation (rather than an estimated or 'placeholder' CPI escalation) when they submit their pricing proposals. The use of an actual CPI escalation will allow the process for setting prices to be more transparent, which is consistent with the intent of the pricing rule provisions.[59]

Historically, the Victorian distributors have used June CPI, which is what was included in our F&A for the Victorian distributors.[60] Due to the change in the new regulatory control period from calendar years to financial years, we consider a material change in circumstances has occurred, warranting a departure from the F&A. As the Victorian distributors will be moving into regulatory years consistent with the rest of the NEM, we consider that the approach to CPI should also be consistent. The December quarter data is the latest CPI data available at the time the Victorian distributors will submit their annual pricing proposals for the new regulatory control period.

The application of this calculation is set out in Figure 14.1 in more detail.

14.4.3 Deliberately under-recovered revenue

We accept there are times when the Victorian distributors may decide to recover below their allowed level of revenue. This is in contrast to unintentional under recovery due to a clerical error or a natural variation between forecast quantities of a service offered and actual quantities achieved. In the event of intentional under-recovery, this revenue will not be counted as an under recovery for the purpose of the under and overs account and by extension will therefore not subsequently increase the total allowable revenue in future years.

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59 NER, cl. 6.18.5 (g)(3).

60 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 67-68.

This approach was set out in our F&A,[61] and is consistent with recent regulatory determinations for distributors in other NEM jurisdictions.

14.4.4 Reporting on designated pricing proposal charges

We must decide how the Victorian distributors will report on the recovery of designated pricing proposal charges[62] for each year of the 2021–26 regulatory control period and how to account for any under or over recovery of revenue associated with those charges.[63]

We apply an under and over recovery mechanism to facilitate this reporting and account for the true-up of under and over recovery of revenue. This approach is similar to the DUoS revenue under and over recovery mechanism and is consistent with the requirements of the NER.[64] The operation of this method is detailed in Appendix C.

14.4.5 Reporting on jurisdictional scheme amounts

We must decide how the Victorian distributors will report on the recovery of jurisdictional scheme amounts for each year of the 2021–26 regulatory control period and how to account for any under or over recovery of revenue associated with those charges.[65]

Our draft decision jurisdictional scheme amounts under and over recovery mechanism approach is consistent with the requirements of the NER.[66] It is also consistent with the approach applied to electricity distributors in other jurisdictions. The operation of this method is detailed in Appendix D.

14.4.6 Rounding of inputs in annual pricing proposal process

When reporting on compliance as part of the annual pricing proposal process each year of the 2021–26 regulatory control period, we require that certain calculation inputs be used on an unrounded basis while others may be used on a rounded basis.

The process for rounding and the specific inputs to be rounded are detailed in Appendix E.

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61 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 64-65.

62 Designated pricing proposal charges are charges related to: designated pricing proposal services (prescribed exit fees, prescribed common transmission services and prescribed transmission use of system services); avoided customer transmission use of system charges; charges provided by another distributor (but only to the extent they comprise of designated pricing proposal services or standard control services); and charges or payments related specified in NER clause 11.39.

63 NER, cl. 6.12.1 (19).

64 NER, cll. 6.12.1(19), 6.18.7.

65 NER, cl. 6.12.1 (20).

66 NER, cl. 6.18.7A.

14.5 Draft decision for alternative control services

In our final F&A, we set out our decision to apply a revenue cap to type 5 and 6 (inc. smart metering) services and price caps to all other alternative control services.[67] The Victorian distributors accepted the AER's forms of control mechanism as stated in the final F&A.[68]

The Victorian distributors proposed formulae for alternative control services for the 2021–26 regulatory control period that generally reflect the F&A paper, with the exception of the control mechanism for price-capped services provided on a quoted basis. The distributors proposed adjustments to this quoted price cap formula to incorporate a tax element, or a tax element and a margin element.

CitiPower, Powercor and United Energy also proposed we modify the materiality threshold for pass through events that result in increased costs for alternative control services to one per cent of the revenue of impacted alternative control services, rather than the one per cent of the annual revenue requirement for direct control services specified in the NER. Further, they also proposed that we allow cost pass throughs relating to increases in the costs of providing alternative control services to be recovered from alternative control services customers via alternative control pricing, rather than standard control customers through standard control pricing.[69]

Our final formulae in the F&A are binding, unless we consider there is a material change in circumstances which would justify varying these formulae.[70] We do not consider that such a change has arisen for alternative control services on the basis of the information that has been provided to us.

14.5.1 Control mechanism formulae for type 5 and 6 (inc. smart metering) services

Consistent with our final F&A, the revenue cap formula that will apply to the Victorian distributors' type 5 and 6 (inc. smart metering) services is below.[71] We confirm that this includes a pass through mechanism; for our decision on the materiality threshold applying to this mechanism see Section 14.5.3.

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67 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 54.

68 AusNet Services, *Regulatory Proposal 2022–26 Part III*, January 2020, p.267; CitiPower, *APP08 - Price control formula*, January 2020, pp. 2-8; Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, p. 1; Powercor, *APP08 - Price control formula*, January 2020, pp. 2-8; United Energy, *APP08 - Price control formula*, January 2020, pp. 3-9.

69 CitiPower, *Regulatory proposal 2021–26 - Managing uncertainty - CP APP04 - Uncertainty appendix*, January 2020, p. 28; Powercor, *Regulatory proposal 2021–26 – Managing uncertainty – PAL APP04 - Uncertainty appendix*, January 2020, p. 29; United Energy, *Regulatory proposal 2021–26 - Managing uncertainty - UE APP04 - Uncertainty appendix*, January 2020, p. 29.

70 NER, cl. 6.12.3(c1).

71 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 72-73.

As for the unders and overs account for standard control services, the unders and overs account for type 5 and 6 (inc. smart metering) services will be adjusted to accommodate a t-3 year in the first two years of the regulatory control period to accommodate the expected transition of regulatory years from a calendar to financial basis.

In addition, and mirroring our draft decision for standard control services, our intention is that the C-factor will include any amounts the AER decides to be added to or subtracted from the distributor's annual smoothed revenue requirement in the metering PTRM to adjust for any adjustments or true-ups that are required in transitioning from calendar years to financial years. For a discussion of this issue, see 'cost pass through adjustments (C factor)' in Section 14.4.2.

Similar to standard control services, we have adjusted the calculation of CPI to reflect the change from calendar years to financial years. That is, we have adjusted the CPI calculations to use the December quarter data, which is the latest CPI data available to Victorian distributors at the time of submitting annual pricing proposals for financial years. For a discussion of this issue, see 'calculation of the consumer price index escalation' in Section 14.4.2. The application of this calculation is set out in Figure 14.3 in more detail.

We have also corrected a minor error that was present in the F&A for the revenue cap formula to apply to Victorian distributors' type 5 and 6 (inc. smart metering) services. Our F&A incorrectly stated that the formula to calculate the annual revenue requirement in years t=2, 3, 4, 5 also applies in year t=1. However, consistent with the current regulatory control period, the annual revenue requirement in year t=1 is set in our regulatory determination, and no adjustment is required.

Figure 14.3 Revenue cap formula to apply to the Victorian distributors' type 5 and 6 (inc. smart metering) services

$$TARM_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij}$$

i = 1,…,n and j = 1,…,m and t = 1, 2…,5

$$TARM_t = AR_t + T_t + B_t + C_t$$

t = 1, 2...,5

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

t = 2, 3, 4, 5

where:

$TARM_t$ is the total allowable revenue for type 5 and 6 (inc. smart metering) services in year t.

p_t^{ij} is the price of component 'j' of tariff 'i' in year t.

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t.

t is the regulatory year.

AR_t is the annual smoothed revenue requirement for year t. In year t=1, the annual smoothed revenue requirement is set in our final decision PTRM.

AR_{t-1} is the annual smoothed revenue requirement approved for year t-1.

T_t is the adjustments in year t for true-ups relating to the AMI-OIC. There are no adjustments expected for the 2021–26 regulatory control period, and therefore the T factor will have a value of 0.

B_t is the sum of annual adjustment factors for year t and includes the true-up for any under or over recovery of actual revenue collected through type 5 and 6 (inc. smart metering) charges calculated using the following method:

$$Metering\ Unders\ and\ Overs\ True-Up_t = -(Opening\ Balance_t)(1+WACC_t)^{0.5}$$

where:

$Metering\ Unders\ and\ Overs\ True-Up_t$ is the true-up for the balance of the type 5 and 6 (inc. smart metering) services unders and overs account in year t.

$Opening\ Balance_t$ is the opening balance of the type 5 and 6 (inc. smart metering) services unders and overs account in year t as calculated by the method in appendix B.

$WACC_t$ is the approved weighted average cost of capital used in regulatory year t in the type 5 and 6 (inc. smart metering) services unders and overs account in appendix B. This WACC figure will be a nominal WACC figure that reflects actual inflation rather than forecast inflation. To calculate this nominal WACC, the real vanilla WACC from the annual update type 5 and 6 (inc. smart metering) services PTRM will be escalated for actual inflation.

C_t is the sum of approved cost pass through amounts (positive or negative) attributed to these metering services with respect to regulatory year t, as determined by the AER. It will also include any applicable end-of-period adjustments in regulatory year t.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[72] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1
>
> divided by
>
> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2
>
> minus one.

For example, for 2021–22, year t–2 is the December quarter 2019 and year t–1 is the December quarter 2020.

X_t is the X-factor for each year of the 2021–26 regulatory control period as determined in the metering PTRM, and annually revised for the return on debt update in accordance with the formula specified in Attachment 3—rate of return—calculated for the relevant year. This annual update of the metering PTRM will be provided alongside (or prior to) the pre-populated pricing model template prior to submission of the annual pricing proposal each year.

Side constraints

For each regulatory year after the first year of a regulatory control period, our draft decision is that side constraints should apply to the prices for each metering service. Consistent with the approach defined by the NER for standard control services, the permissible percentage increase is the greater of CPI–X plus 2 per cent or CPI plus 2 per cent and the recovery of certain revenues, such as those to accommodate pass throughs and under/over-recoveries, will be disregarded in deciding whether the permissible percentage has been exceeded.[73] However, as metering prices are charged to each class of meter and not at any lower level of categorisation, side constraints will be measured against the price movements, rather than weighted averages of revenues within a class of services (as per distribution charges).

In its proposal Jemena did not include a side-constraint mechanism or formula for type 5 and 6 (inc. smart metering) services.[74] Jemena reasoned that there is no requirement in the NER for a side constraint on any alternative control service, and that this approach was consistent with the F&A.

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[72] If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

[73] NER, cll. . 6.18.6(c) and 6.18.6(d).

[74] Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, p. 5.

While we agree that there is no requirement in the NER for a side constraint on any alternative control service, we consider it is appropriate for a side constraint mechanism to be applied where a revenue cap is in place. This provides protections for consumers from movements in individual metering prices that are significantly above the average price movement resulting from the use of the revenue cap.

This approach is consistent with the inclusion of a side constraint mechanism for type 5 and 6 (inc. smart metering) services in the current regulatory control period for Victorian distributors. The F&A did not address side constraints for type 5 and 6 (inc. smart metering) services, however applying this side constraint mechanism in this determination is not inconsistent with the F&A.

Our draft decision is to apply a side constraint to type 5 and 6 (inc. smart metering) services, and the side constraints formula is set out in Figure 14.4.

Figure 14.4 Side constraints formula[75]

For t=2, 3, 4, 5:

$$\frac{p_t^i}{p_{t-1}^i} \leq (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) + T_t' + B_t' + C_t'$$

where:

p_t^i is the proposed price for tariff 'i' for year t.

p_{t-1}^i is the price charged for tariff 'i' in year t–1.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[76] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2

minus one.

For example, for 2021–22, year t–2 is the December quarter 2019 and year t–1 is the December quarter 2020.

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75 All parameters are in nominal terms unless otherwise specified.

76 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

X_t is the X-factor for each year of the 2021–26 regulatory control period as determined in the metering PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year. This annual update of the metering PTRM will be provided alongside (or prior to) the pre-populated pricing model template prior to submission of the annual pricing proposal each year.

T_t is the annual percentage change from the sum of the annual adjustment factors for year t relating to the AMI-OIC. There are no adjustments expected for the 2021–26 regulatory control period, and therefore the T-factor will have a value of 0.

$B_t^{'}$ is the annual percentage change from the sum of annual adjustment factors for year t and includes true-up for any under or over recovery of actual revenue collected through type 5 and 6 (inc. smart metering) services charges calculated using the method in Figure 14.3.

C_t' is the annual percentage change from the sum of approved cost pass through amounts (positive or negative) attributed to these metering services with respect to regulatory year t, as determined by the AER. It will also include any applicable end-of-period adjustments in regulatory year t. This percentage should be calculated by dividing the incremental revenues (the difference between the C-factor used in the total annual revenue formula for t and t-1) 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).

With the exception of the CPI and X-factor, the percentage for each of the other factors above can be calculated by dividing the incremental revenues (as used in the total annual revenue 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).

14.5.2 Control mechanism formulae for alternative control services other than type 5 and 6 (inc. smart metering) services

This section sets out our draft decision on the control mechanism formulae for price-capped alternative control services.

Fee-based services

Consistent with our final F&A, the price cap formula that will apply to the Victorian distributors' fee-based alternative control services (excluding revenue-capped type

5 and 6 (inc. smart metering) services) is below.[77] We confirm that this includes a pass through mechanism; for our decision on the materiality threshold applying to this mechanism see Section 14.5.3.

Figure 14.5 Price cap formula to apply to the Victorian distributors' fee-based alternative control services

$$\overline{p}_t^i \geq p_t^i \qquad \text{i=1,...,n and t=1, 2,…,5}$$

$$\overline{p}_t^i = \overline{p}_{t-1}^i \times (1 + \Delta CPI_t) \times (1 - X_t^i) + A_t^i$$

Where:

$\overline{p}_t^i$ is the cap on the price of service i in year t.

p_t^i is the price of service i in year t. For the first year of the regulatory control period, the cap on the price of service i will be as per the schedule of approved charges set out in Attachment 15.

$\overline{p}_{t-1}^i$ is the cap on the price of service i in year t–1.

t is the regulatory year.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[78] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1
>
> divided by
>
> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2
>
> minus one.

For example, for 2021–22, year t–2 is the December quarter 2019 and year t–1 is the December quarter 2020.

X_t^i is the X-factor for service i in year t. The value of this factor is as specified in Attachment 15 – Alternative Control Services.

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[77] AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 70-71.

[78] If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

A_t^i is the sum of any adjustments for service i in year t. Likely to include, but not limited to adjustments for any approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

Quoted services

Consistent with our final F&A, the price cap formula that will apply to the Victorian distributors' alternative control services provided on a quotation basis is below.[79]

The Victorian distributors proposed that a tax element be incorporated into the price control formula for quoted ancillary network services. Both AusNet Services and Jemena also proposed a margin in the formula. As detailed in section 14.5.3, our draft decision is to not include a tax or margin component in the price cap formula to apply to quoted ancillary network services.

When charging for quoted services:

- The Victorian distributors must provide itemised invoices to the customer or the service recipient.
- The charges must be consistent with good industry practice in terms of the resource requirements.

Figure 14.6 Price cap formula to apply to the Victorian distributors' quoted alternative control services

$$Price = Labour + Contractor\ Services + Materials$$

Where:

$Labour$ consists of all labour costs directly incurred in the provision of the service, which may include labour on-costs, fleet on-costs and overheads. Labour is escalated annually by $(1 + \Delta CPI_t)(1 - X_t^i)$ where:

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[80] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1

divided by

[79] AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 70-71.

[80] If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2

minus one.

For example, for 2021–22, year t–2 is the December quarter 2019 and year t–1 is the December quarter 2020.

X_t^i is the X- factor for service i in year t. The value of this factor is as specified in attachment 15 – alternative control services.

$Contractor\ Services$ reflect all costs associated with the use of external labour including overheads and any direct costs incurred. The contracted services charge applies the rates under existing contractual arrangements. Direct costs incurred are passed on to the customer.

$Materials$ reflect the cost of materials directly incurred in the provision of the service, material storage and logistics on-costs and overheads.

14.5.3 Reasons for draft decision for alternative control services

Cost pass through mechanism for revenue-capped type 5 and 6 (inc. smart metering) services and price-capped fee-based alternative control services

In this draft decision we maintain the cost-pass-through mechanisms for the above services as set out in our final F&A. That is, to retain a cost-pass-through factor in the control formula for these alternative control services and to maintain the existing materiality threshold. Accordingly, we do not accept the modified materiality threshold proposed by CitiPower, Powercor and United Energy.

The elements of CitiPower's, Powercor's and United Energy's proposals as set out in Section 14.2 were considered and dealt with in our F&A. Specifically, we determined to establish a pass through mechanism for alternative control services but to retain the existing pass through materiality threshold, being 1 per cent of direct control service revenue. [81] [82] For example, we included a C-factor in the revenue cap formula for metering (type 5 and 6 (inc. smart metering) regulated services) and an A-factor in the

[81] The F&A incorrectly referred to 1 per cent of standard control service revenue, however the NER states that the materiality threshold is 1 per cent of direct control services revenues, being the aggregate of all standard and alternative control services revenue. We do not believe that this error in the F&A overrides the NER.

[82] AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy Regulatory control period commencing January 2021*, January 2019, p. 58.

price cap formula for fee-based ACS to address cost pass throughs.[83] We stated in our final F&A paper:[84]

> While a 1 per cent materiality threshold applies to pass throughs for standard control services, if applied to alternative control services revenue this threshold would be inappropriately low. This is because alternative control services revenue, in total, is a small fraction of standard control services revenue. Typically in the order of 10 per cent or less. Using 1 per cent of such small revenues as a pass through threshold would transfer operational risk to customers rather than have it managed by the DNSP – the party best able to manage that risk […] This means that an event, which increases the cost of providing metering services, would only qualify for a potential pass through if the event's costs were at least 1 per cent of standard control service revenue, as provided for in the NER.

Our position on a modified materiality threshold for alternative control services remains unchanged from that stated in our F&A paper. However, we consider that a pass through event may occur that impacts both standard control services and alternative control services. Where this occurs, we consider that a business may be able to propose a pass through with elements that will be passed through in standard control services, and other elements passed through in alternative control services where appropriate. Where the administrative burden of applying an amount of the pass through to alternative control services exceeds the benefit of segregating the amounts, we consider the total pass through amount can be allocated to be passed through to standard control services. This can be provided for within a cost pass through proposal.

Quoted services - billing transparency

Following feedback we received throughout the New South Wales 2019–24 regulatory determinations, particularly from Accredited Service Providers, with regards to a lack of transparency around invoices received, we consider it appropriate to introduce requirements around transparency of billing.[85] This will aid in achieving consistency between regulatory arrangements for similar services across all jurisdictions.[86]

Quoted services formula - margin component

AusNet Services and Jemena proposed a margin component to be included in the cost build-up for quoted ancillary network services. Both distributors reasoned that this

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83 AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy Regulatory control period commencing January 2021*, January 2019, pp. 71-71 and pp. 72-73.

84 AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy Regulatory control period commencing January 2021*, January 2019, pp. 58-59.

85 AER, *Ausgrid draft decision attachment 13 - Control mechanisms*, November 2018, pp. 17-18; AER, *Endeavour Energy draft decision attachment 13 - Control mechanisms*, November 2018, p. 15; AER, *Essential Energy draft decision attachment 13 - Control mechanisms*, November 2018, pp. 16-17.

86 NER, cl. 6.2.5(d)(4).

component should be introduced to preserve competitive neutrality, citing SA Power Network's 2020–25 proposal (submitted on 31 January 2019),[87] and our subsequent draft decision (published on 8 October 2019).[88]

As set out in Section 14.3, our final F&A decision on the form of control mechanisms for alternative control services is binding on our determination. We may only make changes to the formulae specified in the F&A where we are satisfied that there has been a material change in circumstances.[89]

A margin component in the quoted services formula was proposed by TasNetworks in their 2019–24 proposal.[90] We were satisfied with TasNetworks' reasoning and accepted this margin in our draft decision.[91] We subsequently accepted SA Power Networks' proposal to include a margin in the quoted services formulae because we were satisfied with their reasoning that there had been a material change in circumstances since the F&A that allowed us to deviate from what was set in the F&A.[92]

We are not satisfied that there has been a material change in the circumstances since the F&A that would allow us to consider changing the quoted services formula to introduce other component. We are also not satisfied that AusNet Services or Jemena have provided sufficient reasoning for us to determine that the introduction of a margin in the quoted services formula is appropriate.

Our draft decision is to not include a margin component in the cost build-up of quoted ancillary network services. We will consider any further information submitted through the revised proposals as to whether there are grounds to consider that a material change in circumstances has occurred.

Quoted services formula - tax component

The Victorian distributors proposed a tax component to be included in the cost build-up for quoted ancillary network services. Jemena provided substantive reasoning to consider the inclusion of this component,[93] while AusNet Services cited the competitive neutrality reasoning also provided for the margin component.[94] Citipower, Powercor and United Energy did not provide any reasoning for including this component, incorrectly stating it was consistent with the F&A.[95]

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87 SA Power Networks, *Attachment 14 - Alternative control services*, January 2019, p. 36.

88 AER, *SA Power Network draft decision attachment 13 - Control mechanisms*, October 2019, p. 20.

89 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 59; NER, cl. 6.12.3(c).

90 TasNetworks, *Transmission and distribution regulatory proposal 2019–2024*, January 2018, p. 209.

91 AER, *TasNetworks draft decision attachment 13 - Control mechanisms*, September 2018, pp. 20-21.

92 AER, *SA Power Network draft decision attachment 13 - Control mechanisms*, October 2019, p. 20.

93 Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, pp. 9-11.

94 AusNet Services, *Regulatory Proposal 2022–26 Part IV*, January 2020, pp. 59-60.

95 CitiPower, *APP08 - Price control formula*, January 2020, p. 8; Powercor, *APP08 - Price control formula*, January 2020, p. 8; United Energy, *APP08 - Price control formula*, January 2020, p. 9.

As set out immediately above, the NER allows that we may only make changes to the formulae specified in the F&A where we are satisfied that there has been a material change in circumstances.[96]

We do not consider that the businesses have demonstrated that there has been a material change in circumstances since the publication of the F&A that would allow for a deviation from the price control formula. For example, in its proposal Jemena provides an explanation of the rationale for including a tax component, however, it did not raise this issue during the F&A process and has not provided reasons why there has been a material change in circumstances since the publication of the F&A. Similarly, AusNet Services explains the rationale for a tax component as being based on the principle of competitive neutrality, however, it did not raise this issue during the F&A process and has not provided reasons why there has been a material change in circumstances since the publication of the F&A.

We view the limitations set out in the NER on changes to control mechanism formulae following publication of the relevant F&A as being designed to limit the ability to make amendments after this point. As such, we consider it is a matter of principle that submitting changes to control mechanism formulae set out in the F&A in the proposal is not appropriate unless there has been a material change in circumstances. These issues should be addressed through the F&A consultation process.

However, we also note that the network pricing objective set out in the NER provides that the tariffs a distributor charges retail customers for direct control services should reflect the distributor's efficient costs of providing those services.[97] We consider that the rationale presented by Jemena indicates that it may not be in a position to recover the efficient costs of providing quoted services in the absence of amendments to the quoted services control mechanism formula. However, we do not consider that Jemena has provided us with sufficient evidence to determine whether an inability to charge a tax component on its quoted services would have a material impact on its ability to recover efficient costs.

We encourage the distributors in their revised proposals to provide further information on why the proposal to introduce a tax element was included at the proposal stage and not at the F&A stage (and if a material change has occurred in that intervening period) and, if relevant, to provide evidence of the magnitude of the tax component for a range of quoted services in order to determine whether inability to charge this would result in the distributor being unable to recover its efficient costs in a material way. We will assess any further information submitted in the revised proposals to determine whether there are grounds to consider that a material change in circumstances has occurred and to consider interactions with the network pricing objective.

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96 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 59; NER, cl. 6.12.3(c).

97 NER, cl. 6.18.5(a).

Our draft decision is to not include a tax component in the cost build-up of quoted ancillary network services.

14.5.4 New services introduced during the regulatory control period

We understand that there are times where a business cannot foresee a new service at the time of the regulatory determination. This is especially relevant in public lighting where new technologies are emerging, including more advanced LED lamps and the integration of smart devices in public lighting infrastructure. While we appreciate that there may be benefits in allowing for the introduction of new services within a regulatory control period in limited circumstances, we also consider that customers should benefit from the protections offered by the regulatory framework where possible. For example, we consider that, where a new service falls within an established service grouping that is regulated, consumers should benefit from the regulatory protections offered for the service grouping. This section sets out how new services are to be introduced within the regulatory control period.

Where new services are to be introduced during the regulatory control period, and where such services were not identified at the time of our determination but clearly fall within one of the established service groupings, a quoted price approach is to be adopted based on a similar service within that same service grouping.[98] This quoted price approach is to be proposed at the time of the relevant annual pricing proposal, with the price coming into effect from the date the approved pricing proposal is effective. This is consistent with our F&A, and regulatory determinations across all NEM jurisdictions.

For example, the price for a new type of public lighting would be proposed at the time of the next annual pricing proposal based on the same approach as a similar public lighting service. The AER would review the proposed new service and its pricing as part of its annual pricing approval process. This approach would give the Victorian distributors additional flexibility to introduce new services while offering consumers the protections associated with price regulation.

The Victorian distributors must advise us of any new alternative control services to be created within the regulatory control period as part of their annual pricing proposals. The proposal should provide a detailed description of the service along with how the new service will be charged.

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[98] AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 68-69.

A DUoS unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2021–26 regulatory control period, each Victorian distributor must maintain a DUoS unders and overs account in its annual pricing proposal.

The Victorian distributors must provide the amounts for the following entries in their DUoS unders and overs accounts for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):

1. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the adjusted nominal WACC for each intervening year between regulatory year t–2 and year t. The WACC applied for each year will be the real vanilla WACC approved by the AER in the relevant annual update, escalated for actual inflation for the relevant year.
3. The amount of revenue recovered from DUoS charges in respect of that year, less the total annual revenue for the year in question.
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the respective nominal WACC calculated as per step 2.
5. The total sum of items 1–4 to derive the closing balance for each year.

The Victorian distributors must provide details of calculations in the format set out in Table 14.1.

In general:

- Amounts provided for the most recently completed regulatory year (t–2) must be audited.[99]
- Amounts provided for the current regulatory year (t–1) will be regarded as an estimate.
  - The estimated revenue amounts provided for the t-1 current regulatory year should be the best estimate of expected revenue for the year. The inclusion of the t-1 year in the unders and overs account is intended to smooth any impacts of the t-2 true-up before they occur, reducing price volatility resulting from this true-up mechanism.
  - Victorian distributors should provide supporting information as to how those estimates are calculated and why they should be considered the best estimate.

[99] A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

- Amounts for the next regulatory year (t) will be regarded as a forecast.
    - The Victorian distributors should provide supporting information as to how those forecasts are calculated and why they should be considered reasonable.

In exceptional circumstances, the jurisdictional scheme amounts unders and overs account can accommodate additional years—such as year t–3.[100]

Such a case arises in accommodating the transition of calendar years to financial years. Accordingly, a three-period account will be maintained for the years 2021–22 and 2022–23. The section below sets out our expectations as to how these additional periods will be treated, and where audit requirements apply.

In 2021–22:

- t–3 will represent the actual (audited) results of the 2019 year
- t–2 will represent the estimated (unaudited) results of the 2020 year
- t–1 will represent the estimated (unaudited) results of the 2021 regulatory control period
- t will represent the forecast results of the 2021–22 year.

In 2022–23:

- t–3 will represent the actual (audited) results of the 2020 year
- t–2 will represent the actual (audited) results of the 2021 regulatory control period
- t–1 will represent the estimated (unaudited) results of the 2021–22 year
- t will represent the forecast results of the 2022–23 year.

In proposing variations to the amount and structure of DUoS charges, the Victorian distributors are expected to achieve a closing balance as close to zero as practicable in their DUoS unders and overs accounts in each forecast year in their annual pricing proposals during the 2021–26 regulatory control period. The Victorian distributors are also expected to achieve a closing balance that is less than zero (i.e. a negative amount) to maintain compliance with the operation of the revenue cap. Where a positive closing balance is proposed, this will be considered as exceeding the revenue cap, and therefore not compliant.

[100] Any amounts provided for additional years prior to t-2 must be audited.

Table 14.1 Example calculation of DUoS unders and overs account ($'000, nominal)

	Year t–2 (actual)	Year t–1 (estimate)	Year t (forecast)
(A) Revenue from DUoS charges	**45 779**	**40 269**	**39 510**
(B) Less TAR for regulatory year =	**43 039**	**41 427**	**44 429**
+ Adjusted annual smoothed revenues (AAR_t)	40 189	41 393	44 393
+ Incentive scheme amounts (I_t)[a]	1 026	34	36
+ Annual adjustments (B_t)[b]	0	0	0
+ Cost pass through amounts (C_t)	1 824	0	0
(C) Revenue deliberately under-recovered in year	**1 000**	**0**	**0**
(A minus B plus C) Under/over recovery of revenue for regulatory year	**3 740**	**–1 158**	**–4 919**[c]
DUoS unders and overs account			
Adjusted nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	1 737	5 656[d]	4 778
Interest on opening balance	87	311	287
Under/over recovery of revenue for regulatory year	3 740	–1 158	–4 919
Interest on under/over recovery for regulatory year	92	–31	–145
Closing balance	**5 656**	**4 778**	**0**[e]

Notes: (a) Includes incentive schemes as set out in our determination, with the exception of those incentive schemes that are calculated and applied through our regulatory determination (e.g. CESS and EBSS).
(b) B_t parameter calculations in the DUoS unders and overs account exclude the true-up for DUoS revenue under/over recovery for regulatory year and are therefore expected to be 0.
(c) Approved DUoS revenue under/over recovery for regulatory year t.
(d) Opening balance is the previous year's closing balance.
(e) The Victorian distributors are expected to achieve a closing balance as close to zero as practicable (and ≤0) in their DUoS unders and overs accounts in each forecast year in their annual pricing proposals for the 2021–26 regulatory control period.

B Type 5 and 6 (inc. smart metering) services unders and overs account

To demonstrate compliance with its applicable distribution determination during the 2021–26 regulatory control period, each Victorian distributor must maintain a type 5 and 6 (inc. smart metering) services unders and overs account in its annual pricing proposal.[101]

The Victorian distributors must provide the amounts for the following entries in their type 5 and 6 (inc. smart metering) services 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. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the adjusted nominal WACC for each intervening year between regulatory year t–2 and year t. The WACC applied for each year will be the real vanilla WACC approved by the AER in the relevant annual update, escalated for actual inflation for the relevant year.
3. The amount of revenue recovered from metering charges in respect of that year, less the total annual revenue for the year in question.
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the respective nominal WACC calculated as per step 2.
5. The total sum of items 1–4 to derive the closing balance for each year.

The Victorian distributors must provide details of calculations in the format set out in Table 14.2.

In general:

- Amounts provided for the most recently completed regulatory year (t–2) must be audited.[102]
- Amounts provided for the current regulatory year (t–1) will be regarded as an estimate.
  - The estimated revenue amounts provided for the t-1 current regulatory year should be the best estimate of expected revenue for the year. The inclusion of the t-1 year in the unders and overs account is intended to smooth any impacts of the t-2 true-up before they occur, reducing price volatility resulting from this true-up mechanism.

[101] NER, cl. 6.18.2(b)(7).

[102] A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

        - Victorian distributors should provide supporting information as to how those estimates are calculated and why they should be considered the best estimate.
    - Amounts for the next regulatory year (t) will be regarded as a forecast.
        - Victorian distributors should provide supporting information as to how those forecasts are calculated and why they should be considered the reasonable.

In exceptional circumstances, the jurisdictional scheme amounts unders and overs account can accommodate additional years—such as year t–3.[103]

Such a case arises in accommodating the transition of calendar years to financial years. Accordingly, a three-period account will be maintained for the years 2021–22 and 2022–23. The section below sets out our expectations as to how these additional periods will be treated, and where audit requirements apply.

In 2021–22:

- t–3 will represent the actual (audited) results of the 2019 year
- t–2 will represent the estimated (unaudited) results of the 2020 year
- t–1 will represent the estimated (unaudited) results of the 2021 regulatory control period
- t will represent the forecast results of the 2021–22 year.

In 2022–23:

- t–3 will represent the actual (audited) results of the 2020 year
- t–2 will represent the actual (audited) results of the 2021 regulatory control period
- t–1 will represent the estimated (unaudited) results of the 2021–22 year
- t will represent the forecast results of the 2022–23 year.

In proposing variations to the amount and structure of metering charges, the Victorian distributors are expected to achieve a closing balance as close to zero as practicable in their metering unders and overs account in each forecast year in their annual pricing proposals for the 2021–26 regulatory control period. The Victorian distributors are also expected to achieve a closing balance that is less than zero (i.e. a negative amount) to maintain compliance with the operation of the revenue cap. Where a positive closing balance is proposed, this will be considered as exceeding the revenue cap, and therefore not compliant.

[103] Any amounts provided for additional years prior to t-2 must be audited.

Table 14.2 Example calculation of type 5 and 6 (inc. smart metering) services unders and overs account ($'000, nominal)

	Year t–2 (actual)	Year t–1 (estimate)	Year t (forecast)
(A) Revenue from type 5 and 6 (inc. smart metering) charges	**45 779**	**40 269**	**39 510**
(B) Less TARM for regulatory year =	**43 039**	**41 427**	**44 429**
+ Adjusted annual smoothed revenue (AAR_t)	41 215	41 427	44 429
+ Annual adjustments (B_t)[a]	0	0	0
+ Cost pass through amount (C_t)	1 824	0	0
(C) Revenue deliberately under-recovered in year	**1 000**	**0**	**0**
(A minus B plus C) Under/over recovery of revenue for regulatory year	**3 740**	**–1 158**	**–4 919**[b]
Type 5 and 6 (inc. smart metering) services unders and overs account			
Adjusted nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	1 737	5 656[c]	4 778
Interest on opening balance	87	311	287
Under/over recovery of revenue for regulatory year	3 740	–1 158	–4 919
Interest on under/over recovery for regulatory year	92	–31	–145
Closing balance	**5 656**	**4 778**	**0**[d]

Notes: (a) B_t parameter calculations in the type 5 and 6 (inc. smart metering) services unders and overs account exclude the true-up for type 5 and 6 (inc. smart metering) services revenue under/over recovery for regulatory year and are therefore expected to be 0.

(b) Approved type 5 and 6 (inc. smart metering) services revenue under/over recovery for regulatory year t.

(c) Opening balance is the previous year's closing balance.

(d) The Victorian distributors are expected to achieve a closing balance as close to zero as practicable (and ≤0) in their type 5 and 6 (inc. smart metering) services unders and overs accounts in each forecast year in their annual pricing proposals for the 2021–26 regulatory control period.

C Designated pricing proposal charges[104] unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2021–26 regulatory control period, each Victorian distributor must maintain a designated pricing proposal charges unders and overs account in its annual pricing proposal.[105]

The Victorian distributors must provide the amounts for the following entries in their designated pricing proposal charges unders and overs accounts for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):

1. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the adjusted nominal WACC for each intervening year between regulatory year t–2 and year t. The WACC applied for each year will be the real vanilla WACC approved by the AER in the relevant annual update, escalated for actual inflation for the relevant year.
3. The amount of revenue recovered from designated pricing proposal charges in respect of that year, less the total annual revenue for the year in question.
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC.
5. The total sum of items 1–4 to derive the closing balance for each year.

The Victorian distributors must provide details of calculations in the format set out in Table 14.3. In general, amounts provided for the most recently completed regulatory year (t–2) must be audited while amounts provided for the current regulatory year (t–1) will be regarded as an estimate.[106] Amounts for the next regulatory year (t) will be regarded as a forecast.

In exceptional circumstances, the jurisdictional scheme amounts unders and overs account can accommodate additional years—such as year t–3.[107]

Such a case arises in accommodating the transition of calendar years to financial years. Accordingly, a three-period account will be maintained for the years 2021–22

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[104] Designated pricing proposal charges are charges related to: designated pricing proposal services (prescribed exit fees, prescribed common transmission services and prescribed transmission use of system services); avoided customer transmission use of system charges; charges provided by another distributor (but only to the extent they comprise of designated pricing proposal services or standard control services); and charges or payments related specified in NER clause 11.39.

[105] NER, cll. 6.18.2(b)(6), 6.12.1(19), 6.18.7.

[106] A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

[107] Any amounts provided for additional years prior to t-2 must be audited.

and 2022–23. The section below sets out our expectations as to how these additional periods will be treated, and where audit requirements apply.

In 2021–22:

- t–3 will represent the actual (audited) results of the 2019 year
- t–2 will represent the estimated (unaudited) results of the 2020 year
- t–1 will represent the estimated (unaudited) results of the 2021 regulatory control period
- t will represent the forecast results of the 2021–22 year.

In 2022–23:

- t–3 will represent the actual (audited) results of the 2020 year
- t–2 will represent the actual (audited) results of the 2021 regulatory control period
- t–1 will represent the estimated (unaudited) results of the 2021–22 year
- t will represent the forecast results of the 2022–23 year.

In proposing variations to the amount and structure of designated pricing proposal charges, the Victorian distributors are required to achieve a closing balance that is less than zero (i.e. a negative amount) to maintain strict compliance with the NER.[108] Where a positive closing balance is proposed, this will be considered as exceeding the estimated amount of designated pricing proposal charges, and therefore not compliant.

The Victorian distributors are also expected to achieve a closing balance as close to zero as practicable in their designated pricing proposal charges unders and overs account in each forecast year in their annual pricing proposals during the 2021–26 regulatory control period.

[108] NER, cl. 6.18.7(b).

Table 14.3 Example calculation of designated pricing proposal charges unders and overs account ($'000, nominal)

	Year t–2 (actual)	Year t–1 (estimate)	Year t (forecast)
(A) Revenue from designated pricing proposal charges (DPPC)	**40 077**	**34 944**	**36 609**
(B) Less DPPC related payments for regulatory year =	**34 365**	**38 734**	**39 200**
+ DPPC to be paid to TNSP	33 672	37 933	38 000
+ Avoided TUoS/DPPC payments	572	734	800
+ Inter-distributor payments	121	67	400
(A minus B) Under/over recovery of revenue for regulatory year	**5 712**	**–3 790**	**–2 540**[a]
DPPC unders and overs account			
Adjusted nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	167	6 028[b]	2 467
Interest on opening balance	8	332	148
Under/over recovery of revenue for regulatory year	5 712	–3 790	–2 540[a]
Interest on under/over recovery for regulatory year	141	–103	–75
Closing balance	**6 028**	**2 467**	**0**[c]

Notes: (a) Approved DPPC revenue under/over recovery for regulatory year t.

(b) Opening balance is the previous year's closing balance.

(c) In addition to complying with clause 6.18.7(b) of the NER (e.g. closing balance ≤0), the Victorian distributors are expected to achieve a closing balance as close to zero as practicable in their DPPC unders and overs accounts in each forecast year in their annual pricing proposals for the 2021–26 regulatory control period.

D Jurisdictional scheme amounts[109] unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2021–26 regulatory control period, each Victorian distributor must maintain a jurisdictional scheme amounts unders and overs account in its annual pricing proposal.[110]

The Victorian distributors must provide the amounts for the following entries in their jurisdictional scheme amounts unders and overs accounts for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):

1. An opening balance for year t–2, year t–1 and year t.
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the adjusted nominal WACC for each intervening year between regulatory year t–2 and year t. The WACC applied for each year will be the real vanilla WACC approved by the AER in the relevant annual update, escalated for actual inflation for the relevant year.
3. The amount of revenue recovered from jurisdictional scheme amounts charges in respect of that year, less the total annual revenue for the year in question;
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the respective nominal WACC calculated as per step 2.
5. The total sum of items 1–4 to derive the closing balance for each year.

The Victorian distributors must provide details of calculations in the format set out in Table 14.4. In general, amounts provided for the most recently completed regulatory year (t–2) must be audited while amounts provided for the current regulatory year (t–1) will be regarded as an estimate.[111] Amounts for the next regulatory year (t) will be regarded as a forecast.

In exceptional circumstances, the jurisdictional scheme amounts unders and overs account can accommodate additional years—such as year t–3.[112]

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[109] Jurisdictional scheme amounts are amounts a distributor is required under a jurisdictional scheme obligation as defined by the NER to: pay a person; pay into a fund established under an Act of a participating jurisdiction; credit against charges payable by a person; or reimburse a person, less any amounts recovered by the distributor from any person in respect of those amounts other than under the NER.

[110] NER, cll. 6.12.1(20), 6.18.2(b)(6A), 6.18.7A(b) and (c).

[111] A reasonable assurance report sufficiently meets these auditing requirements. Where amounts provided match other audited submissions to the AER, further assurance is not required (e.g. RINs), and should be referenced.

[112] Any amounts provided for additional years prior to t-2 must be audited.

Such a case arises in accommodating the transition of calendar years to financial years. Accordingly, a three-period account will be maintained for the years 2021–22 and 2022–23. The section below sets out our expectations as to how these additional periods will be treated, and where audit requirements apply.

In 2021–22:

- t–3 will represent the actual (audited) results of the 2019 year
- t–2 will represent the estimated (unaudited) results of the 2020 year
- t–1 will represent the estimated (unaudited) results of the 2021 regulatory control period
- t will represent the forecast results of the 2021–22 year.

In 2022–23:

- t–3 will represent the actual (audited) results of the 2020 year
- t–2 will represent the actual (audited) results of the 2021 regulatory control period
- t–1 will represent the estimated (unaudited) results of the 2021–22 year
- t will represent the forecast results of the 2022–23 year.

Where a Victorian distributor receives a government subsidy for jurisdictional schemes in lieu of recovering these amounts directly from jurisdictional scheme charges (or part thereof), it will be required to record the subsidy amount received as revenue. This will not impact the operation of the unders/overs account. Where a Victorian distributor receives a full government subsidy for jurisdictional schemes it will not recover any amounts from customers in relation to those jurisdictional schemes.

In proposing variations to the amount and structure of jurisdictional scheme charges, the Victorian distributors are required to achieve a closing balance that is less than zero (i.e. a negative amount) to maintain strict compliance with the NER.[113] Where a positive closing balance is proposed, this will be considered as exceeding the estimated amount of jurisdictional scheme amounts, and therefore not compliant.

The Victorian distributors are also expected to achieve a closing balance as close to zero as practicable in their jurisdictional scheme amounts unders and overs account in each forecast year in their annual pricing proposal during the 2021–26 regulatory control period.

[113] NER, cl. 6.18.7A(b).

Table 14.4 Example calculation of jurisdictional scheme amounts unders and overs account ($'000, nominal)

	Year t–2 (actual)	Year t–1 (estimate)	Year t (forecast)
(A) Revenue from jurisdictional schemes	**19 777**	**23 121**	**26 965**
(B) Less jurisdictional scheme payments for regulatory year =	**20 272**	**20 959**	**28 641**
+ Jurisdictional scheme 1 payments	14 159	13 954	13 961
+ Jurisdictional scheme 2 payments	6 113	7 005	14 680
(A minus B) Under/over recovery of revenue for regulatory year	**–495**	**2162**	**–1 676**[a]
Jurisdictional scheme amount unders and overs account			
Adjusted nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	–52	–562[b]	1 628
Interest on opening balance	–3	–31	98
Under/over recovery of revenue for regulatory year	–495	2 162	–1 676[a]
Interest on under/over recovery for regulatory year	–12	59	–50
Closing balance	**–562**	**1 628**	**0**[c]

Notes: (a) Approved jurisdictional scheme amounts revenue under/over recovery for regulatory year t.

(b) Opening balance is the previous year's closing balance.

(c) In addition to complying with clause 6.18.7A(b) of the NER (e.g. closing balance ≤0), the Victorian distributors are expected to achieve a closing balance as close to zero as practicable in their jurisdictional scheme amount unders and overs accounts in each forecast year in their annual pricing proposals for the 2021–26 regulatory control period.

E Rounding of inputs in annual pricing proposals

The following sets out our draft determination around how Victorian distributors are required to use calculation inputs (e.g. whether on a rounded or unrounded basis) in the pricing approval process to demonstrate compliance.

Unrounded inputs to be used in calculations

'Unrounded', for this purpose, will be taken to mean at least fifteen digit floating point precision (the level of accuracy at which numbers will be stored in Microsoft Excel workbooks of .XLS, .XLSX, .XLSM or .XLSB). This definition accepts that numbers with fewer than fifteen floating digits may not require fifteen digits to express (such as 2.25 being equivalent to 2.25000000000000) but will meet the definition of fifteen digit floating point precision.

Unrounded values should be maintained throughout calculations. Where a calculation produces an output which is to be used as an input in another calculation, rounding should not occur. Rounding should be applied to final outputs only, unless otherwise specified.

Unrounded inputs should be taken from approved Excel models where appropriate. X-factors should be unrounded inputs taken from the approved model. Where appropriate, inputs should be calculated as an alternative to using a rounded value.

For example, inflation should be used as calculated based around the CPI tables as provided by the ABS, or the AER's nominated best available substitute should this index cease to be calculated. The result of this calculation should be taken as is, not rounded before use. Table 14.5 sets out the required level of precision for an inflation calculation.

Table 14.5 Demonstration of inflation calculation

	Required Precision
The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2 (example)	112.1
The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1 (example)	114.6
ΔCPI_t	2.23015165031222%

Unrounded inputs include all those not specified below as suitable to be rounded in a given situation.

Instances where rounding is acceptable

In general, rounding in calculations must be done on a 'nearest' basis. So rounding to two decimal places means rounding to the nearest two decimal places, not rounding up automatically or down automatically. This accepts the convention that if a number falls precisely between two points, it can be rounded up (e.g. 2.245 can be rounded to 2.25 rather than 2.24). An exception to this for prices charged by the distributor is noted below, as these must be less than or equal to the price cap.

Price cap control mechanism formulae

When applying a price cap, the value of $\overline{p}_t^i$ should be rounded to the nearest two decimal places each year. When calculating the value of the price cap for the following period, the rounded value of the previous year's price cap must be used in the control mechanism formula to determine the value of the new price cap to ensure consistency in the price cap from year-to-year.

Table 14.6 Demonstration of price cap calculation (with rounding)

	Required Precision
$\overline{p}_{t-1}^i$	$23.28
X factor (example: should be taken from model)	-7.12546236955321%
ΔCPI_t	2.23015165031222%
$\overline{p}_t^i$ (unrounded)	$25.4938708296164
$\overline{p}_t^i$ (rounded)	$25.49

Prices p_t^i charged by the distributor can be rounded to as few or as many decimal places as required, subject to being less than or equal the two decimal place value of $\overline{p}_t^i$. In the above table, this would mean a price of $25.49 would be acceptable, as would a price of $25.4899. However, a price of $25.493 would not be compliant.

For the avoidance of ambiguity, where a price is expressible as a rate for a period of time, rounding of the price cap will apply to the largest relevant time period. So the price of an hourly service will be capped on an hourly basis. However, a service which can be priced either on a daily rate or an annual rate will have rounding apply to the cap on the annual rate. The daily rate should then represent the annual rate divided by 365, or 366 if the regulatory year to which the price applies includes 29 February 2024. This resulting daily rate may be expressed on a rounded basis (with discretion on the appropriate level of decimal places to apply) but must be based on a rounding to the nearest decimal place.

Revenue cap control mechanism formulae

The following variables used in the revenue cap formula should be rounded to no fewer than two decimal places: adjusted annual smoothed revenue requirement, sum of incentive scheme adjustments, sum of annual adjustment factors and sum of approved cost pass through amounts.

However, prices, quantities, X-factors, CPI and adjustments inputs (incentive scheme performance adjustments, approved cost pass through adjustments, etc.) must be used unrounded in the revenue cap formula.

Shortened forms

Shortened form	Extended form
AAR	Adjusted Annual Revenue
ABS	Australian Bureau of Statistics
AER	Australian Energy Regulator
CESS	capital expenditure sharing scheme
CPI	consumer price index
DPPC	designated pricing proposal charges
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
distributor /DNSP	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ESC	Essential Service Commission (VIC)
ESV	Energy Safe Victoria
F&A	framework and approach
NEM	National Electricity Market
NER	National Electricity Rules
NSP	network service provider
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
STPIS	service target performance incentive scheme
TAR	Total allowed revenue
TARM	Total allowed revenue for metering
WACC	weighted average cost of capital