FINAL DECISION

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

Attachment 14 Control mechanisms

April 2021

AUSTRALIAN ENERGY REGULATOR

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AER reference: 63599, 63600, 63601, 63602, 63603

Note

This attachment forms part of the Australian Energy Regulator's (AER) final decision on the distribution determination 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 final decision.

The final 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 12 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Negotiating framework

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14 Control mechanisms

Control mechanisms impose limits over the prices an electricity distribution network service provider can charge and/or the revenues it can recover from customers for the provision of its direct control services (standard and alternative control services).

The forms of the control mechanisms that will apply to a distribution determination and the formulae that give effect to those control mechanisms are considered during the framework and approach (F&A) stage.[1] We have limited discretion to depart from the control mechanisms set out in the F&A paper.[2] For example, we can only depart from the formulae if we consider there has been a material change in circumstance.

This attachment sets out our final decision for the determination of:

- the form and formulae of the control mechanism for standard control services[3]
- the forms and formulae of the control mechanisms for alternative control services[4]
- how compliance with the control mechanisms is to be demonstrated[5]
    - including the mechanisms for recovering distribution use of system (DUoS) and type 5 and 6 metering (including smart metering) revenues, including adjustments for any revenue under or over recovery, and
- how to report the recovery of designated pricing proposal charges and jurisdictional scheme amounts, and the adjustments to be made to subsequent pricing proposals to account for any over or under recovery of these charges or amounts.[6]

14.1 Final decision

Our final decision for the determination of the control mechanisms that will apply to the Victorian distributors for the 2021–26 regulatory control period is the same as our draft decision, except we have:

- updated definitions of the formulae to facilitate the transition of the regulatory year timing from calendar years to financial years
- updated the I-factor definition in the standard control service revenue cap formulae to include annual adjustments for the customer service incentive scheme (CSIS)

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1 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 54–73.
2 NER, cl. 6.12.3(c) and (c1).
3 NER, cl. 6.12.1(11).
4 NER, cl. 6.12.1(12).
5 NER, cl. 6.12.1(13).
6 NER, cl. 6.12.1(19) and 6.12.1(20).

- allowed CitiPower to smooth its recovery of under-recovered distribution revenues in 2020 due to significantly reduced electricity consumption caused by the COVID-19 pandemic, and
- provided additional guidance on the annual pricing process relating to the transition to financial years as regulatory years and the resulting six-month extension period.

Control mechanism for standard control services

The form of control mechanism for standard control services is a revenue cap (section 14.4.5). The revenue cap formula is set out in Figure 14.1. The side constraints applying to annual price movements for each tariff class must be consistent with the formula in Figure 14.2.

The annual pricing proposals must demonstrate compliance with the standard control services revenue cap by:

- including adjustments for DUoS revenue under or over recovery in accordance with Appendix A of this attachment[7]
- recording the amount of revenue recovered from designated pricing proposal charges and associated payments in accordance with Appendix C,[8] and
- recording any jurisdictional scheme amounts it recovers and associated payments in accordance with Appendix D.[9]

Type 5 and 6 metering (including smart metering) services

The form of control mechanism for type 5 and 6 metering (including smart metering) services is a revenue cap (section 14.5.1). The revenue cap formula is set out in Figure 14.3. The side constraints applying to annual price movements for each of the Victorian distributors' tariff classes must be consistent with the formula in Figure 14.4.

The annual pricing proposals must demonstrate compliance with the type 5 and 6 metering (including smart metering) services revenue cap by including adjustments for under or over recovery in accordance with Appendix B of this attachment.[10]

Other alternative control services

The form of control mechanism for other alternative control services, including metering exit fees, public lighting and ancillary network services (fee based and quoted services), is a price cap (Section 14.5.2). The price cap formulae for fee-based alternative control services − where the price can be determined in advance − are set out in Figure 14.5. The price cap formula applying to the Victorian distributors' alternative control services provided on a quoted basis is set out in Figure 14.6.

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7 NER, cl. 6.18.2(b)(7).
8 NER, cl. 6.18.2(b)(6).
9 NER, cl. 6.18.2(b)(6A).
10 NER, cl. 6.18.2(b)(7).

For all services, Appendix F of this attachment sets out the requirements for the treatment of rounding values in annual pricing proposals. [11]

14.2 The Victorian distributors' revised proposals

The Victorian distributors accepted most aspects of our draft decision.[12] In their revised proposals, the Victorian distributors' also proposed the following for inclusion in our final decision:

- In regard to standard control services:
    - CitiPower, Powercor, and United Energy proposed an option be introduced to allow deferral of under-recovered revenues arising in year 2020 due to the COVID-19 pandemic.[13]
    - CitiPower, Powercor, and United Energy proposed that the I-factor definition be amended to specifically include the CSIS.[14]
    - AusNet Services proposed that recovery of deliberate under-recoveries should be allowed as they can arise from providing relief to customers.[15]
    - AusNet Services, CitiPower, Powercor, and United Energy proposed the levies they pay to Energy Safe Victoria (ESV) be recovered through the B-factor in the revenue cap formulae.[16]
    - The Victorian distributors proposed that new Australian Energy Market Operator (AEMO) market participant fees that are expected to be introduced during the regulatory control period be recovered through the B-factor in the revenue cap formulae.[17]
- In regard to alternative control services:
    - Jemena proposed the price cap formulae for services provided on a quoted basis include a margin.[18]

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11 NER, cl. 6.18.2(b)(7).

12 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, p. 172; CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Jemena, *Attachment 07-01 - Price control mechanisms*, December 2020, pp. v-vi; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

13 CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Powercor, *Revised regulatory proposal 2021–26,* December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

14 CitiPower, *Revised regulatory proposal 2021–26* December 2020, p. 62; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

15 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, pp. 173-174.

16 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, p. 173; CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

17 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, p. 173; CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Jemena, *Attachment 07-01 - Price control mechanisms*, December 2020, p.2 Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26,* December 2020, p. 58.

18 Jemena, *Attachment 07-01 - Price control mechanisms*, December 2020, pp. 9-10.

- AusNet Services proposed the price cap formulae for services provided on a quoted basis include a tax component to be consistent with tax approaches for standard control services.[19]

14.3 Assessment approach

Our assessment approach is unchanged from that set out in our draft decision.[20]

14.4 Reasons for final decision on standard control services

The following sets out the reasons for our final decision on the control mechanism formulae for standard control services. This reasoning and responses to the Victorian distributors' revised proposals are provided in the relevant control mechanism formula parameters.

14.4.1 Application of control mechanism formulae

14.4.1.1 Timing change from calendar to financial regulatory years

In 2021, AusNet Services, CitiPower, Jemena, Powercor, and United Energy (the Victorian distributors) will transition the timing of their regulatory years from calendar years to financial years (see our Decision on the six-month extension).[21] This change will create uniformity in the timing of regulatory years across the electricity distribution network service providers in the National Electricity Market (NEM). [22]

Where required, our final decision has updated the definitions of the control mechanism formulae to facilitate the transition.

14.4.1.2 Total allowable revenue

The Victorian distributors' annual total allowable revenue (TAR) for standard control services is determined by the revenue cap formula in Figure 14.1.

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19 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, pp. 190-191.

20 AER, *AusNet Services distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 8-10.

21 AER, *Six-month extension - AusNet Services variation decision*, October 2020; AER, *Six-month extension - CitiPower variation decision*, October 2020; AER, *Six-month extension - Jemena variation decision*, October 2020; AER, *Six-month extension - Powercor variation decision*, October 2020; AER, *Six-month extension - United Energy variation decision*, October 2020.

22 AER, *Six-month extension – AusNet Services variation decision*, October 2020, p. 3; AER, *Six-month extension – CitiPower variation decision*, October 2020, p. 3; AER, *Six-month extension – Jemena variation decision*, October 2020, p. 3; AER, *Six-month extension – Powercor variation decision*, October 2020, p. 3; AER, *Six-month extension – United Energy variation decision*, October 2020, p. 3.

14.4.1.3 Intra-period adjustment to the weighted average cost of capital

Under the CPI-X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. The TAR is updated annually by an X factor which is designed to measure the real rate of change and is applied to reduce revenue variations between years (a revenue smoothing mechanism). The X factor itself is updated annually to incorporate updates to the trailing average cost of debt through the weighted average cost of capital.

Further discussion on this adjustment can be found in:

- Attachment 3—Rate of return—which discusses the trailing cost of debt update, and
- Attachment 1—Annual revenue requirement—which discusses the X factors.

14.4.1.4 Incentive scheme adjustments (I-factor)

The I-factor parameter makes adjustments to the allowed revenue relating to a service provider's performance against relevant incentive schemes.

For the Victorian distributors the annual adjustments relate to incentive scheme payments (rewards or penalties) due to their performance against the service target performance incentive scheme (STPIS), CSIS[23], demand management innovation allowance (DMIA)[24], demand management incentive scheme (DMIS) and f-factor incentive scheme.

For the avoidance of doubt, the I-factor does not incorporate incentive scheme payments already accounted for in our regulatory determination building blocks (such as the capital expenditure sharing scheme or efficiency benefit sharing scheme).

Service target performance incentive scheme (S-factor)

As set out in our draft decision, the Victorian distributors will be subject to the new STPIS guideline for the 2021–26 regulatory control period.[25]

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[23] Jemena has chosen not to apply for the CSIS.

[24] 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.

[25] AER, *Electricity distribution service providers: Service target performance incentive scheme*, November 2018; AER, *Draft decision - AusNet Services distribution determination 2021–26 - Attachment 10 - Service target performance incentive scheme*, September 2020, p. 4; AER, *Draft decision - CitiPower distribution determination 2021–26 - Attachment 10 - Service target performance incentive scheme*, September 2020, p. 4; AER, *Draft decision - Jemena distribution determination 2021–26 - Attachment 10 - Service target performance incentive scheme*, September 2020, p. 4; AER, *Draft decision - Powercor distribution determination 2021–26 - Attachment 10 - Service target performance incentive scheme*, September 2020, p. 4; AER, *Draft decision - United Energy distribution determination 2021–26 - Attachment 10 - Service target performance incentive scheme*, September 2020, p. 4.

Under the new STPIS guideline, STPIS payments will be applied through the revenue cap as monetary amounts added to or subtracted from the annual revenue (in line with other incentive schemes).[26] In previous control periods, the STPIS payments were applied as a percentage adjustment to annual revenue.[27]

STPIS payments are typically applied to revenue on a two-year lag. The two-year lag occurs because the Victorian distributors typically submit their compliance reports in the year (year t-1) following the year of performance (year t-2). STPIS payments are then made the in the following year (year t).

For example, a distributor will submit its compliance report in 2023–24 (year t-1) for its performance against the STPIS in 2022–23 (year t-2). STPIS payments are made through the revenue cap for prices that apply in 2024–25 (year t).

Given this lag, there is a transitional phase in the 2021–26 regulatory control period. In years 1 and 2 of the regulatory control period, the STPIS payments 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 STPIS 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.

The change in STPIS payment method also requires a change in the way the STPIS payments are determined. Previously, STPIS payments were applied as a percentage adjustment to the forthcoming adjusted annual smoothed revenue requirement (year t) as calculated in annual pricing proposals each year.

However, the new guideline determines that the STPIS monetary payments are based on the revenue relevant to the year for which STPIS performance is measured. On this basis, the STPIS payments are determined using the adjusted annual smoothed revenue requirement from year t-2.

For example, the STPIS payment in 2024–25 (year t) will be for performance against the STPIS in 2022–23 (year t-2), and the adjusted annual smoothed revenue requirement for 2022–23 (year t-2) is used to calculate the STPIS payment.[28]

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

- For the first year of the 2021–26 regulatory control period (year t=1 or 2021–22), the STPIS payments are expected to include any adjustments relating

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

[27] AER, *Electricity distribution service providers: Service target performance incentive scheme*, November 2009.

[28] The adjusted annual smoothed revenue requirement in year t=1 is equal to the annual smoothed revenue requirement set in the PTRM. This applies to year t=1 only.

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 (year t=2 or 2022–23), the STPIS payments are 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 payments are expected to revert to including any adjustments relating to year t-2 (e.g. 2021–22 outcomes are applied in 2023–24).

Customer service incentive scheme (H-factor)

We have updated the I-factor definition in the control mechanism formulae to include provision for incentive scheme payments (rewards or penalties) relating to AusNet Services', CitiPower's, Powercor's and United Energy's performance against the CSIS.

AusNet Services, CitiPower, Powercor and United Energy decided to apply the CSIS for the 2021–26 regulatory control period following our publication of the final CSIS in July 2020.[29] In accordance with the CSIS, the four Victorian distributors proposed the I-factor include the annual adjustments relating to performance against the CSIS.[30] [31]

We are able to update this aspect of the control mechanism formulae in our final decision as the F&A paper stated that the definition of the I-factor would be decided in the distribution determination.[32]

The first CSIS payments will occur in the third year of the regulatory control period (2023–24) because the payments are recovered through revenues on a two-year lag from the year of performance against the CSIS. The two-year lag will mean there are no CSIS payments in the first and second years of the regulatory control period.

Jemena has decided not to apply the CSIS for the 2021–26 regulatory control period.[33] See Attachment 12 – Customer service incentive scheme for discussion on the CSIS.

Demand management innovation allowance and incentive scheme

As set out in our draft decisions, the new demand management innovation allowance mechanism (DMIAM) and DMIS will replace the DMIA applied to Victorian distributors from 1 July 2021.[34]

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29 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, pp. 142-143.

30 CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

31 AusNet Services did not explicitly propose the CSIS be included in the I-factor, however we note that AusNet Services' January proposal included the H-factor in the I-factor definition (AusNet Services, *Regulatory Proposal 2021–26 Part III,* January 2020, p.269*)*.

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

33 Jemena, *2021–26 Revised Regulatory Proposal*, December 2020, p. 28.

To close out the DMIA we will determine and apply any carryover amount from underspending the allowance as a deduction from the distributor's revenue requirement in the 2021–26 regulatory control period.[35]

As a consequence, the I-factor include a component to adjust revenues for the DMIA carryover amount. This adjustment will occur in year 2 of the 2021–26 regulatory control period.

A similar adjustment will be required in year 2 of the 2026–31 regulatory control period for carryover amounts relating to the DMIAM for the 2021–26 regulatory control period.

Consistent with the STPIS and CSIS, payments relating to the new DMIS will occur on a two-year lag from the year of performance and applied in year t.

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

- For the first year of the 2021–26 regulatory control period (year t=1 or 2021–22), DMIS payments are expected to include any adjustments 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 (year t=2 or 2022–23), DMIS payments 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), DMIS payments are expected to revert to including any adjustments relating to year t-2 (e.g. 2021–22 outcomes are applied in 2023–24).

f-factor incentive scheme (f-factor)

The fire start (f-factor) incentive scheme 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.[36] We have made an f-factor scheme determination for each of the Victorian distributors under the F-Factor Scheme

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[34] 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; AER, *Draft decision - AusNet Services distribution determination 2021–26 - Attachment 11 - DMIS and DMIAM*, September 2020, p. 3; AER, *Draft decision - CitiPower distribution determination 2021–26 - Attachment 11 - DMIS and DMIAM*, September 2020, p. 3; AER, *Draft decision - Jemena distribution determination 2021–26 - Attachment 11 - DMIS and DMIAM*, September 2020, p. 3; AER, *Draft decision - Powercor distribution determination 2021–26 - Attachment 11 - DMIS and DMIAM*, September 2020, p. 3; AER, *Draft decision - United Energy distribution determination 2021–26 - Attachment 11 - DMIS and DMIAM*, September 2020, p. 3.

[35] AER, *Final decision: CitiPower distribution determination 2016 to 2020, Attachment 12 – Demand management incentive scheme*, May 2016; AER, *Demand management incentive scheme: Jemena, CitiPower, Powercor, SP AusNet and United Energy*, April 2009, p. 8–9.

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

Order in respect of the 2021–26 regulatory control period. Discussion on our f-factor scheme determinations is set out in the Overview chapter.

The f-factor incentive scheme previously operated 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 transition to regulatory years on a financial year basis, the f-factor will be better aligned and operate on a three-year lag in the 2021–26 regulatory control period (e.g. 2018–19 performance will be applied as an adjustment to the 2021–22 revenue allowance). The three-year lag reflects that smaller timed lags (e.g. a two-year lag) are not feasible due to the required timeframes for determining the f-factor adjustment. This three-year lag is provided under the Victorian F-Factor Scheme Amendment Order 2020, which amended the F-factor scheme Order 2016.[37]

CitiPower, Powercor, and United Energy expressed concern that applying the f-factor on a three-year lag on a permanent basis would dilute incentives.[38] 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.

Unlike the other scheme payments, transitional adjustments are not required for the f-factor due to the timing of moving to a three-year lag at the same time as the transition from calendar to financial years.

14.4.1.5 Annual adjustments (B-factor)

In accordance with the F&A, the annual adjustment factors to be included in the B-factor are decided in our distribution determination.[39]

The B-factor parameter makes adjustments to the revenue cap 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 Essential Service Commission Victoria (ESCV) licence fees.[40]

Unders and overs account

Our final decision is 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 in accordance with the method in Appendix A.

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37 Victoria Government Gazette S 549, 27 October 2020, p. 30 - http://www.gazette.vic.gov.au/gazette/Gazettes2020/GG2020S549.pdf.

38 CitiPower, Powercor, United Energy, *Correspondence on price control formula,* 5 December 2019,.

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

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

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).

Appendix A sets out that the unders and overs account for the first two years of the 2021–26 regulatory control period will incorporate an additional year to account for:

- the transition to regulatory years on a financial year basis, and
- prices for the first half of 2021 included no adjustments for DUoS under or over recovery amounts.

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

The under or over-recovery adjustment in year t will be adjusted by six months of the approved weighted average cost of capital (WACC) to reflect the time value of money of this adjustment. This reflects that the balance would generally be adjusted for twelve months of WACC if it was carried forward, and that the under or over-recoveries that arise within the year are adjusted by six months of WACC.

The WACC applied in the unders and overs account will be sourced from the annual return on debt updates provided by the AER and adjusted for actual inflation.[41] This is to be known as the adjusted nominal WACC.

Presentation of adjustments in the unders and overs account

In the unders and overs account, the sign of the true-up should be the reverse of the sign of the opening balance. This treatment is to demonstrate that the purpose true-up is to offset the opening balance. For clarity, if a distributor has under recovered its allowable revenue prior to year t, this balance will be negative. Therefore the true-up will be presented as a positive amount to allow the distributor to bring the balance of the unders and overs account to zero.[42]

As the unders and overs account determines the true-up amount to be included in the B-factor for determining the TAR, the B-factor in the unders and overs account is expected to be zero where there are no defined annual adjustments, or equal to the sum of those defined annual adjustments (see below further components of B-factor)).

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41 If circumstances require, alternative adjustments for an appropriate cost of capital may be applied following consultation between the AER and relevant distributor(s).

42 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.

Licence fees (L-factor)

Our final decision B-factor includes an L-factor adjustment to allow the Victorian distributors to recover the licence fees they are charged by the ESCV. The operation of the L-factor is set out in section 14.4.5.

As ESCV licence fees are applied on a financial year basis there is no transitional treatment to be considered. These ESCV fees are applied on a two-year lag.

Energy Safe Victoria (ESV) levies

In their revised proposals, the Victorian distributors proposed the Energy Safe Victoria (ESV) levies also be recovered through the B-factor, in line with the current treatment of ESC licence fees.[43]

However, on 25 February 2021, CitiPower, Powercor and United Energy requested the AER to determine that the scheme established by section 8 of the Electricity Safety Act 1998 (Vic) is a jurisdictional scheme.[44] Under the scheme, known as the ESV Levy Scheme, the Victorian distributors must pay levies to ESV in respect of its reasonable costs and expenses, as determined by the Victorian Minister.[45]

On 19 March 2021, we determined the ESV Levy Scheme to be a jurisdictional scheme which applies to all Victorian distributors.

The Victorian distributors are required under the distribution determinations to report to the AER the recovery of the ESV Levy Scheme amounts and on adjustments to be made to pricing proposals for over or under recovery, as set out in section 14.4.3. As a result, the ESV Levy Scheme becomes an approved jurisdictional scheme for the Victorian distributors, and the ESV levies are no longer part of the distribution revenues.

Further consideration of the ESV levies is covered in Attachment 6 – Operating expenditure.

Australian Energy Market Operator fees

The Victorian distributors also proposed that AEMO fees that may commence within the 2021–26 regulatory control period be recovered through the B-factor.[46] This is in

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43 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, p. 173; CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Jemena, *Attachment 05-01 - Operating expenditure*, December 2020, pp. 30-31; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26* December 2020, p. 58.

44 CitiPower, Powercor and United Energy, *Request for jurisdictional scheme determination*, February 2021.

45 Electricity Safety Act 1998 (Vic), Section 8.

46 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, p. 173; CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 62; Jemena, *Attachment 07-01 - Price control mechanisms*, December 2020, pp. 2–4; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

response to AEMO's draft report on Electricity Fee Structure which proposed to introduce electricity participant fees for distributors from 1 July 2023.[47]

However, on 26 March 2021, AEMO published its final report on Electricity Fee Structure which determined that electricity distributors will not be charged participant fees for the next fee period. AEMO will monitor the distributors' involvement with AEMO's systems and processes throughout the next fee period and review its position if required.[48]

As a result of AEMO's final report there is no need to include these fees in the B-factor. We note AusNet Services updated revised proposal proposed the recovery of potential AEMO fees as an opex step change.[49] If an AEMO fee is introduced in future, we consider the costs be treated consistently across all distributors to the extent possible.

Smoothing of material COVID-19 under-recoveries (P-factor)

Our final decision is to allow CitiPower to smooth its recovery of under-recovered distribution revenues in 2020 due to significantly reduced electricity consumption caused by the COVID-19 pandemic. We have not made provision for smoothing of under or over recovered revenues for the other Victorian distributors as their distribution revenues in 2020 were not materially impacted.

The total amount to be smoothed will be determined in CitiPower's 2021–22 pricing proposal and recovered in equal amounts over the remaining four years of the regulatory control period (2022–26) to reduce price impacts for customers. These amounts will be subject to adjustments to reflect the time value of money in line with those made in the unders and overs account.

We typically do not allow distributors to defer or smooth recovery of revenues into future years. In our experience, the risks involved (such as a snowballing effect of continued and increased under recoveries) outweigh the benefit of smoothing the impact, as the impact can then be exacerbated (larger price shocks).

However, we consider that in exceptional circumstances that deferrals or smoothing of revenue recovery can be allowed. In making these decisions, we take into consideration the impacts to both the distributors and, importantly, customers.

In 2020, Victorian electricity consumption changed as a result of the response to the exceptional circumstances created by the COVID-19 pandemic. This was due to state wide restrictions which had economic and social changes, including large numbers of the population working from home and business closures.

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47 AEMO, *Draft Report and Determination, Electricity Fee Structures*, November 2020.

48 AEMO, *Final Report and Determination, Electricity Fee Structures*, March 2021, pp. 5, 26.

49 AER, *Final decision, AusNet Services distribution determination 2021–26, Attachment 6, Operating expenditure, section 6.4.3 - AEMO fees*, April 2021.

Of the Victorian distributors, CitiPower was most impacted as its network is primarily the Melbourne central business district, and therefore energy consumption was affected by office and business closures.

In their revised proposals, CitiPower, Powercor, and United Energy proposed that distributors be allowed to defer recovery of under recovered revenues in 2020 due to the COVID-19 pandemic by up to four years to assist in smoothing the impact.[50] CitiPower's revised proposal expected an under-recovery of 5 per cent of its distribution revenue in 2020.[51]

To better understand these impacts, we issued information requests to the Victorian distributors seeking best estimates of their under or over recovery of revenues in 2020. Our analysis of the Victorian distributors' responses showed that only CitiPower's customers would incur substantive price increases should the recovery of under/over recovered revenue be passed through to customers in just one year.

In undertaking our analysis, we took into consideration other factors such as impacts and/or offsetting amounts regarding recovery of previous under or over recovered designated pricing proposal charges or jurisdictional schemes revenues.

As a result, our final decision is to allow CitiPower to smooth the recovery of it's under recovered distribution revenues over the regulatory control period as follows:

- The smoothing will only apply to distribution revenue. Under-recoveries experienced in other accounts are expected to be immaterial or offset by other factors.
- CitiPower will propose the total amount to be recovered in future years in its 2021–22 pricing proposal for the AER's approval. The amount proposed will be calculated as the difference between actual revenue and the total allowable revenue set for 2020, inclusive of relevant unders/overs adjustments for that year.
- The total amount to be recovered will be set as four equal amounts over the remaining four years of the regulatory control period (2022–26).
- The amounts to be recovered in the remaining years will be indexed using the WACC (see Section 14.4.5 for formulae), including a half year WACC in 2020 that is usually applied in the unders/overs account (and any relevant adjustments to consider the 2021 six-month extension period).

We will consider the proposed smoothing and compliance with requirements set in the determination at the time of reviewing the 2021–22 pricing proposal. No additional

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50 CitiPower, *Revised regulatory proposal 2021–26,* December 2020, p. 62; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 72; United Energy, *Revised regulatory proposal 2021–26*, December 2020, p. 58.

51 CitiPower, *Revised regulatory proposal 2021–26*, December 2020, p. 31.

adjustments or smoothing of these under-recovered revenues will be allowed over the remaining four years of the regulatory control period.[52]

Deliberate under-recovered revenue

If a distributor chooses, in its own interests, to under-recover revenue, then this is to be considered a deliberate under-recovery. These types of under-recoveries will be forgone by the distributor and not recovered in future years. We have made provision for the treatment of deliberate under-recoveries in the unders and overs account in Appendix A of this attachment.

Our approach for the treatment of deliberate under-recovered revenue was set out in our F&A,[53] and is consistent with our recent regulatory determinations for distributors in other NEM jurisdictions.

Deliberate under-recoveries are in contrast to those that arise due to variations between forecast of a services offered and actual quantities achieved (whether natural or set through some mechanism or clause in the tariff structure statements). The impact on revenues (under or over recovery) from variations between forecasts and actual quantities is accounted for in the unders and overs accounts. The treatment of these types of under and over recoveries ensure distributors never recover more or less revenue over the long term in net present terms.

Furthermore, we do not intend the treatment of intentional under-recoveries to impede distributors from proposing dynamic charging structures in tariff structure statements.

Treatment of AusNet Services' waiving of critical peak demand charges at the request of customers

In response to our draft decision, AusNet Services noted at times, at the request of a customer, it waives critical peak demand charges where the customer has been unable to respond to a critical peak demand event for reasons out of their control (such as a force majeure event).[54] In these instances, AusNet Services has not recovered the revenues it would otherwise be allowed.

AusNet Services noted the practice to waive critical peak demand charges in these instances are consistent with its tariff structure statement and proposed the revenues it otherwise would have recovered not be treated as a deliberate under recovery.[55]

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52 The calculation of the amount to be smoothed and subsequent adjustments in remaining years will be calculated through the mechanisms set by the AER in the Victorian Tariff Approval Model.

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

54 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, pp. 173-174; AusNet Services, *Response to information request 74 - Q1, 2 and 4*, 11 February 2021.

55 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, pp. 173-174.

We agree with AusNet Services that this practice is consistent with its approved tariff structure statement and that the revenues it otherwise would have recovered not be treated as deliberate under recovered revenues.

We observe the difference in revenue is due to how the charges are calculated rather than a deliberate decision to under recover revenue. Specifically, AusNet Services excludes the specific day, at the request of the customer, in determining the critical peak demand charges and revenue.[56] So, for example, instead of using the average peak demand based on 5 days it calculates it based on 4 days.

In response to our information request, AusNet Services noted these requests are low frequency (three, over the 2016–20 regulatory control period) and relate to low values (a total of less than $70,000).[57] In making our decision, we have taken into consideration the low frequency of requests and low value impacts. We will continue to monitor the treatment and impacts of this practice over the 2021–26 regulatory control period to be reviewed for AusNet Services next distribution determination.

14.4.1.6 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.

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).

In the first year (2021–22) of the 2021–26 regulatory control period, the C factor will include an adjustment to true-up the allowed revenue amounts we set for the six-month extension period. We used a placeholder WACC to determine the allowed revenues for the six-month extension period. Now that the updated WACC has been determined for this period using the averaging periods nominated by the DNSPs and approved by the AER, an adjustment is required to account for the differences between the placeholder and updated WACCs. The true-up for the placeholder WACC is discussed further in Attachment 3 – Rate of return.

The true-up adjustment for the six-month extension period relates to revenues recovered in the six-month extension period, being 1 January 2021 - 30 June 2021. The true-up adjustment will be applied to revenues in the 2021–22 year. Therefore, the adjustment amount will be indexed by the relevant half year WACC to account for the time-value of money between these periods.

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56 AusNet Services, *Response to information request 74 - Q1, 2 and 4*, 11 February 2021.

57 AusNet Services, *Response to information request 74 - Q3a*, 11 February 2021; AusNet Services, *Response to information request 74 - Q3b*, 17 February 2021.

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.

14.4.1.7 Calculation of movements in the consumer price index

We will apply the annual movement between the Australian Bureau of Statistics' (ABS) published December quarter data to calculate the change in CPI for the control mechanism formula.

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.[58]

Historically, the Victorian distributors have used June CPI, which is what was included in our F&A for the Victorian distributors.[59] Due to the change to regulatory years on a financial year basis, we consider a material change in circumstances has occurred, warranting a departure from the F&A.

As the Victorian distributors' regulatory years will be consistent with the rest of the NEM, we consider the approach to determining CPI movements should also be consistent. The December quarter data is the latest CPI data available at the time the Victorian distributors submit their annual pricing proposals during the 2021–26 regulatory control period.

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

14.4.2 Reporting on designated pricing proposal charges

We must decide how the Victorian distributors will report on the recovery of designated pricing proposal charges[60] for each year of the 2021–26 regulatory control period and on the adjustments to be made to account for under or over recovery of those charges.[61]

We apply an under and over recovery mechanism to facilitate this reporting. This approach is similar to the DUoS revenue under and over recovery mechanism and is

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

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

60 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.

61 NER, cl. 6.12.1 (19).

consistent with the requirements of the National Electricity Rules (NER).[62] The operation of this method is detailed in Appendix C of this attachment.

14.4.3 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 on the adjustments to be made to account for under or over recovery of those charges.[63]

Our draft decision jurisdictional scheme amounts under and over recovery mechanism approach is consistent with the requirements of the NER.[64] It is also consistent with the approach applied to electricity distributors in other jurisdictions. The operation of this method is detailed in Appendix D of this attachment.

14.4.4 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 F of this attachment.

14.4.5 Control mechanism formulae for standard control services

Our final decision control mechanism formulae must be as set out in the F&A unless we consider that a material change in circumstances justifies departing from that approach.[65] Figure 14.1 sets out the revenue cap formula for distribution services.

For standard control services, the NER require the control mechanism be of the prospective CPI–X form (or some incentive-based variant).[66]

As discussed in our draft decision, we have amended the control mechanism formulae from that in the F&A to account for recent changes to the STPIS.[67] Namely, the change

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

63 NER, cl. 6.12.1 (20).

64 NER, cl. 6.18.7A.

65 NER, cl. 6.12.3(c1).

66 NER, cl. 6.2.6(a).

67 AER, *Draft decision - AusNet Services distribution determination 2021–26 - Attachment 14 - Control mechanisms* September 2020, pp. 10-11; AER, *Draft decision - CitiPower distribution determination 2021–26 - Attachment 14 - Control mechanisms,* September 2020, pp. 10-11; AER, *Draft decision - Jemena distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 10-11; AER, *Draft decision - Powercor distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 10-11; AER, *Draft decision -*

will see the annual STPIS adjustments be applied as a fixed monetary amount rather than a percentage adjustment as has been the most recent application.

Figure 14.1 Revenue cap formula[68]

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:

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.

AAR_t is the adjusted annual smoothed revenue requirement 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 f-factor incentive scheme 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[69] [70] (S-factor) in relation to:

United Energy distribution determination 2021–26 - Attachment 14 - Control mechanisms, September 2020, pp. 10-11.

68 All parameters are in nominal terms unless otherwise specified.

69 The service target performance incentive scheme (STPIS) version 2.0 applies for the 2021–26 regulatory control period. The first payments relating to STPIS version 2.0 will occur in 2023/24. See *AER, Electricity distribution network Service Providers - Service target performance incentive scheme (Version 2.0)*, November 2018. In years

- 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).[71]

- the CSIS (H-factor) in relation to financial year t-2[72]
- 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).[73]
- any amounts required to true-up the demand management innovation allowance (DMIA) in relation to the 2016–20 regulatory control period[74] to be applied in regulatory year t=2 only[75]
- any other related incentive schemes as applicable[76] 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.

2021/22 and 2022/23, the payments relating to STPIS will be translated into a monetary amount for application under the I factor.

70 The STPIS 2.0 guideline uses the annual smoothed revenue AR(t-2) in the calculation of the s-factor, however AR is only applicable to revenue in the first year of the regulatory control period when revenue is sourced from the PTRM. AR(t-2) will apply to the s-factor calculations in year t=3, as this refers to the first year revenue. In other years where STPIS 2.0 applies (in this regulatory control period, years t=4 and 5), AAR(t-2) will be used to ensure the correct revenue is used, inclusive of actual CPI movements.

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

72 As the CSIS is a new scheme in the 2021–26 regulatory control period, no transitionary approach is required.

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

74 The DMIA measurement will be extended to incorporate the 2021 six-month extension period.

75 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.

76 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).

$Opening\ Balance_t$ 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 as approved by the AER for the relevant year.

- licence fee charges incurred by the Victorian businesses, charged by the Essential Services Commission Victoria (ESCV). The recovery of these 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 licence fees paid by the distributor to the ESCV relating to regulatory year t-2.

In year t=1 (i.e. 2021–22), the t-1 period will be the six-month extension period with the nominal WACC reflecting only the first six months of 2021. To index the licence fee charges for a full year, the nominal WACC for the t-2 period will be included in the calculation using the following method:

$$L_{2019\text{-}20} \times (1 + WACC_{2021\text{-}22}) \times (1 + WACC_{2020\text{-}21}) \times (1 + WACC_{2019\text{-}20})^{0.5}$$

- in the case of CitiPower, an adjustment to smooth distribution revenues being under-recovered in 2020 as a result of COVID-19 impacts.[77] These adjustments relate to 2020 under-recovered revenue that is smoothed over a number of years, and will therefore be indexed by an appropriate amount of interest, calculated using the following method:

$$P_t \times (1 + WACC_t)^{0.5} \times (1 + WACC_{t-1}) \times \ldots \times (1 + WACC_{HY21}) \times (1 + WACC_{2020})^{0.5}$$

where:

P_t is the annual adjustment amount for the 2022–26 years to smooth out the under-recovery for 2020, as approved in the 2021–22 pricing proposal.

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.

[77] Further explanation can be found in Section 14.4.1.5.

ΔCPI_t is the annual percentage change in the ABS consumer price index (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 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

For each regulatory year after the first year of a regulatory control period, the Victorian distributors are subject to side constraints which limits the annual movements in revenue that can be recovered from a tariff class.

The specific requirement is that the expected weighted average revenue to be raised from a tariff class must not exceed the corresponding expected weighted average revenue for the preceding year by more than the permissible percentage.[79] 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.[80]

The NER states that recovery of certain revenues, such as cost pass through amounts, are to be disregarded in deciding whether the permissible percentage has been exceeded.[81] Therefore, we adjust the permissible percentage by the annual movement in such revenues to remove (disregard) their impact for determining compliance with the side constraints.

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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.

79 NER, cl. 6.18.6.

80 NER, cl. 6.18.6(c).

81 NER, cl. 6.18.6(d).

Figure 14.2 Side constraints formula[82]

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.

t is the regulatory year.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[83] 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

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82 All parameters are in nominal terms unless otherwise specified.

83 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 relevant year. If X>0, then X will be set equal to zero for the purposes of the side constraint formula.

I_t' is the annual percentage change in the sum of incentive scheme adjustments described in Figure 14.1 applied in 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.

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.

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 Reasons for final decision on alternative control services

The following sets out the reasons for our final decision on the control mechanism formulae for alternative control services. This reasoning is provided in relation to the relevant control mechanism formula parameters.

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.[84]

As noted, the forms of the control mechanisms that will apply to a distribution determination and the formulae that give effect to those control mechanisms are considered during the F&A stage.[85] We have limited discretion to depart from the control mechanisms set out in the F&A paper.[86] For example, we can only depart from the formulae if there has been a material change in circumstance.

In their initial proposals, the Victorian distributors proposed formulae for alternative control services for the 2021–26 regulatory control period that generally reflected the F&A paper, with the exception of the control mechanism for price-capped services

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

85 AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, pp. 54–73.

86 NER, cl. 6.12.3(c) and (c1).

provided on a quoted basis.[87] The Victorian distributors proposed adjustments to this quoted price cap formula to incorporate a tax element, or a tax element and a margin element. [88]

Our draft decision did not accept the inclusion of tax and margin elements on the basis the Victorian distributors had not provided sufficient information to demonstrate that a material change in circumstance justified varying the formulae set in the F&A.[89] [90]

For our final decision, we do not consider the Victorian distributors have provided any further information that would substantiate a material change in circumstance has occurred to depart from the binding formulae set in the F&A. Our final decision is to maintain our draft decision, and not include a tax or margin element in the quoted services formula.

14.5.1 Application of the control mechanism formulae for type 5 and 6 (inc. smart metering) services

Consistent with our final F&A, our final decision revenue cap formula that will apply to the Victorian distributors' type 5 and 6 (inc. smart metering) services is below.[91]

In the first two years (2021–22, 2022–23) of the 2021–26 regulatory control period, the unders and overs account for type 5 and 6 (inc. smart metering) services will include an additional year (year t-3) adjustment to accommodate the transition to regulatory years on a financial year basis.

In addition, in the first year (2021–22) of the 2021–26 regulatory control period, the C factor will include an adjustment to true-up the allowed revenue amounts we set for the six-month extension period. We used a placeholder WACC to determine the allowed revenues for the six-month extension period. Now that the updated WACC has been determined for this period, an adjustment is required to account for the

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87 AusNet Services, *Regulatory Proposal 2021–26 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.

88 AusNet Services, *Regulatory Proposal 2021–26 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.

89 NER, cl. 6.12.3(c1).

90 AER, *Draft decision - AusNet Services distribution determination 2021–26 - Attachment 14 - Control mechanisms* September 2020, pp. 33-36; AER, *Draft decision - CitiPower distribution determination 2021–26 - Attachment 14 - Control mechanisms,* September 2020, pp. 33-36; AER, *Draft decision - Jemena distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 33-36; AER, *Draft decision - Powercor distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 33-36; AER, *Draft decision - United Energy distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 33-36.

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

differences between the placeholder and actual WACCs. This is the same approach applied for standard control services (see section 14.4.1.6).

The true-up amount is set out in Attachment 16 – Alternative control services. The true-up for the placeholder WACC is discussed further in Attachment 3 – Rate of return.

The true-up adjustment for the six-month extension period relates to revenues recovered in the six-month extension period, being 1 January 2021 – 30 June 2021. The true-up adjustment will be applied to revenues in the 2021–22 year. Therefore, the adjustment amount will be indexed by the relevant half year WACC to account for the time-value of money between these periods.

We have also adjusted the calculation of the annual movement in CPI to reflect the change to financial years. The approach to calculate CPI movements are is set out in section 14.4.1.7. The application of this calculation is set out in Figure 14.3.

We have also maintained our draft decision corrections to the revenue cap formula.

Our F&A incorrectly stated 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 2016–20 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

$$TARM_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^i q_t^i \qquad i = 1,\ldots,n \text{ and } t = 1, 2\ldots,5$$

$$TARM_t = AR_t + T_t + B_t + C_t \qquad t = 1, 2...,5$$

$$AR_t = AR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t) \qquad t = 2, 3, 4, 5$$

where:

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

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

q_t^i 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 Victorian AMI roll-out between 2009 and 2015. 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 as approved by the AER for the relevant year.

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[92] 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

[92] 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 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

Our final decision is that side constraints should apply to the prices for each metering service, for each regulatory year after the first year of the 2021–26 regulatory control period. Our final decision side constraints formula is set out in Figure 14.4.

We have determined the side constraint consistent with the approach defined by the NER for standard control services. That is, the annual permissible percentage increase is the greater of CPI–X plus 2 per cent or CPI plus 2 per cent. 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.[93]

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).

We note that there is no requirement in the NER for a side constraint on any alternative control service, however 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 Victorian distributors' 2016–20 regulatory control period. The F&A did not address side constraints for type 5 and 6 (inc. smart metering) services, however applying this side constraint mechanism is not inconsistent with the F&A.

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

Figure 14.4 Side constraints formula[94]

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.

t is the regulatory year.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[95] 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.

T_t is the annual percentage change from the sum of the annual adjustment factors for year t relating to the Victorian AMI roll-out between 2009 and 2015. There are no adjustments expected for the 2021–26 regulatory control period, and therefore the T-factor will have a value of 0.

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94 All parameters are in nominal terms unless otherwise specified.

95 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.

$B_t^{'}$ 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.

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 Application of the control mechanism formulae for alternative control services other than type 5 and 6 (inc. smart metering) services

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

14.5.2.1 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 set out in Figure 14.5.[96]

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

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

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

Where:

$\bar{p}_t^i$ is the cap on 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.

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

p_t^i is the price of service i in year t.

$\bar{p}_{t-1}^i$ 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[97] 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.

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.

14.5.2.2 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 set out in Figure 14.6 below.[98]

Quoted services – billing transparency

Our final decision is to introduce requirements around transparency of billing for quoted services. When charging for quoted services:

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97 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.

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

- The Victorian distributors must provide itemised invoices to the customer or the service recipient. The itemised invoices must show the major cost components. At a minimum, invoices must contain information on the cost components to demonstrate compliance with the control mechanism formula for quoted services (see Figure 14.6).
- The charges must be consistent with good industry practice in terms of the resource requirements.

We have made this decision 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.[99] This will aid in achieving consistency between regulatory arrangements for similar services across all jurisdictions.[100]

Quoted services formula – margin component

Our final decision does not accept the inclusion of a margin component in the quoted services price cap formula. We do not consider a material change in circumstances has occurred since the F&A that allows us to consider a margin component in the quoted services price control formula.

In their initial proposals, AusNet Services[101] and Jemena[102] proposed a margin component be included in the cost build-up for quoted ancillary network services. However, we did not accept the inclusion of margin in our draft decision as we were not satisfied there had been a material change in circumstances since the F&A that would allow us to consider changing the quoted services formula.[103]

In response, AusNet Services accepted our draft decision to not include a margin component.[104] However, Jemena did not accept our draft decision.[105] Jemena reasoned that including a margin component is consistent with the AER's determinations for TasNetworks and SA Power Networks, and is supported in the consultancy report provided by Marsden Jacob for the TasNetworks draft decision.

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99 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.

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

101 AusNet Services, *Regulatory Proposal 2021–26 Part IV*, January 2020, pp. 59-60.

102 Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, p. 11.

103 AER, *Draft decision - AusNet Services distribution determination 2021–26 - Attachment 14 - Control mechanisms* September 2020, pp. 33-34; AER, *Draft decision - CitiPower distribution determination 2021–26 - Attachment 14 - Control mechanisms,* September 2020, pp. 33-34; AER, *Draft decision - Jemena distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 33-34; AER, *Draft decision - Powercor distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 33-34; AER, *Draft decision - United Energy distribution determination 2021–26 - Attachment 14 - Control mechanisms*, September 2020, pp. 33-34.

104 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, p. 174.

105 Jemena, *Attachment 07-01 - Price control mechanisms*, December 2020, pp. 9-10.

In support of its proposal, Jemena also stated that:

- the circumstances they face are identical to all other distributors, including NER requirements and timing obligations, decisions made, and materiality of the issue
- the substance of the issue should be considered rather than an administrative timing issue, and
- an explicit margin reflects the principle of competitive neutrality, assists in promoting development of competition, and assists in achieving consistency across all jurisdictions.

As set out in our TasNetworks and SA Power Networks distribution determinations, we considered a material change in circumstance allowed us to consider including a margin in the quoted services price cap formula after publication of the F&A.[106] We do not consider a material change in circumstance has been provided to us in regard to the Victorian distributors.

As raised by Jemena, we agree that consistency across distributors and jurisdictions is desirable where appropriate. However, we consider consistency itself is not a material change in circumstances, particularly considering that only two of the nine determinations we made in the last two years included a margin component.

We also agree that including an explicit margin may better promote a competitive environment. However, we have not been provided evidence that would suggest there has been a material change in the development of competition for these services that would warrant including a margin. As it stands, there is little competition for these services which has been the environment for these services for some time.

Jemena is correct, the Marsden Jacob labour rates we use as the upper bound of efficient labour input rates for quoted service prices includes a margin. We do not consider that aspect in itself is a material change in circumstances. In fact, we would need to consider whether to exclude the margin in the Marsden Jacob labour rates to avoid any double recovery of the margins.

As a result, we do not consider Jemena has provided sufficient reasoning that suggest that a material change in circumstances apply that would permit a departure from what is set in the F&A.

For this component to be considered in a future determination, we recommend the Victorian distributors raise the issue in the F&A process, supported by evidence of the potential for a competitive market that would warrant the inclusion of a margin. Additionally, any margin component would need to be removed from the benchmark labour rates that we use in our determination.

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[106] AER, *TasNetworks draft decision attachment 13 - Control mechanisms*, September 2018, pp. 20-21; AER, *SA Power Network draft decision attachment 13 - Control mechanisms*, October 2019, p. 20.

Quoted services formula – tax component

Our final decision does not accept the inclusion of a tax component in the quoted services price cap formula. We do not consider a material change in circumstances has occurred since the F&A that allows us to consider a margin component in the quoted services price control formula.

In their initial proposals, the Victorian distributors proposed a tax component to be included in the cost build-up for quoted ancillary network services.[107] However, we did not accept the inclusion of tax in our draft decision as we were not satisfied there had been a material change in circumstances since the F&A that would allow us to consider changing the quoted services formula.

In its revised proposal, AusNet Services did not accept our draft decision to not include the tax component of the quoted services formula.[108] AusNet Services reasoned the tax component should be included to establish parity with standard control services, and to ensure consistency with the Marsden Jacob report used for our draft decision.

As stated in our draft decision and above, we have limited discretion to depart from the control mechanisms set out in the F&A paper.[109] We can only depart from the formulae if we consider there has been a material change in circumstance.

For our final decision, we do not consider AusNet Services have provided any further reasoning that supports a material change in circumstances having occurred.

In response to AusNet Services revised proposal, we note:

- There is no requirement for the basis of the control mechanism for alternative control services to be on parity with standard control services.[110]
- The Marsden Jacob report relates to the labour rates we use as the upper bound of efficient labour input rates for provision of alternative control services. Within this context, the Marsden Jacob report refers to tax only in relation to payroll tax, and the tax implicit in allowances for margins within the overhead rates. We therefore consider it implicit that the labour rates we approve already includes provision for this tax component of labour.

For this component to be considered in a future determination, we recommend the Victorian distributors raise the issue in the F&A process, supported by evidence as to the need to include a tax component.

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107 Jemena, *Attachment 07-07 - Price control mechanisms*, January 2020, pp. 9-11; AusNet Services, *Regulatory Proposal 2021–26 Part IV*, January 2020, pp. 59-60; 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.

108 AusNet Services, *Revised Regulatory Proposal 2021–26*, December 2020, pp. 190-191.

109 NER, cl. 6.12.3(c) and (c1).

110 NER, cl. 6.2.6.

14.5.3 New services introduced during the regulatory control period

During the 2021–26 regulatory control period, we will allow the Victorian distributors to introduce new services in limited circumstances. Our assessment of new services will include consideration of the extent stakeholders have transparency over the costs of the service as well as the likely benefits to customers from the service.

We understand there are times where a distributor cannot foresee a specific new service at the time of the regulatory determination. This is especially relevant in public lighting where new technologies are emerging, including more advanced light-emitting diode (LED) lamps and the integration of smart devices in public lighting infrastructure.

We appreciate there may be benefits in introducing new services within a regulatory control period in limited circumstances, such as customers having access to more efficient or cheaper lighting. However, when a new service is being introduced customers should benefit from the protections offered by the regulatory framework where possible, such as the ability to assess the costs.

Where new services are to be introduced that clearly fall within one of the established service groupings, such as public lighting, a quoted price approach is to be adopted with the price to be based on a relevant service within that same service grouping.[111] For example, the price for a new type of public lighting would be based on a relevant public lighting service.

Prices for new services will be considered as a part of the annual pricing process.

- The Victorian distributors must advise us of any new alternative control services to be introduced within the regulatory control period
- Prior to submitting their annual pricing proposal, the Victorian distributors must submit to the AER:
    - a detailed description of the service along with how the new service will be charged, and
    - the proposed quoted price setting out each cost component consistent with Figure 14.6 below.

The AER will consider the proposal for inclusion in the relevant annual pricing proposal.

This is consistent with our F&A, and regulatory determinations across all NEM jurisdictions.

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

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[112] 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.

$Contractor\ Services$ 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.

[112] 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 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.[113]
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 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 14.1. In general:

- Amounts provided for the most recently completed regulatory year (t–2) must be audited.[114]
- 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.
- Amounts for the next regulatory year (t) will be regarded as a forecast.

[113] If circumstances require, alternative adjustments for an appropriate cost of capital may be applied following consultation between the AER and relevant distributor(s).

[114] 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.

- 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.[115] 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[116]
- 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.

As set out in section 14.4.1.5, our final decision is to allow CitiPower to smooth its recovery of under-recovered distribution revenues in 2020 due to significantly reduced electricity consumption caused by the COVID-19 pandemic. We have not made provision for smoothing of under or over recovered revenues for the other Victorian distributors as their distribution revenues in 2020 were not materially impacted.

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

[116] While the 2020 revenue is expected to be known in time for 2021–22 pricing, we have allowed an extra year for this true-up to allow for any issues that may arise in reporting 2020 revenues.

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)	40 089	41 283	44 263
+ Incentive scheme amounts (I_t) [a]	1 026	34	36
+ Cost pass through amounts (C_t)	1 824	0	0
+ Annual adjustments (B_t - under/over recovery adjustment)[b]	100	110	130
(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
COVID-19 adjustment	0	0	0
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 the regulatory year and are therefore expected to equal the sum of the remaining annual adjustments under B_t, as set out in Section 14.4.5.

(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.[117]

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.[118]
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 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 14.2. In general:

- Amounts provided for the most recently completed regulatory year (t–2) must be audited.[119]
- 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.

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117 NER, cl. 6.18.2(b)(7).

118 If circumstances require, alternative adjustments for an appropriate cost of capital may be applied following consultation between the AER and relevant distributor(s).

119 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.[120]

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[121]
- 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.

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

[121] While the 2020 revenue is expected to be known in time for 2021–22 pricing, we have allowed an extra year for this true-up to allow for any issues that may arise in reporting 2020 revenues.

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
+ Cost pass through amount (C_t)	1 824	0	0
+ AMI-OIC (T_t)	0	0	0
+ Annual adjustments (B_t - under/over recovery adjustment)[b]	0	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[122] 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.[123]

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.[124]
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.[125] 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.[126]

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[122] 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.

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

[124] If circumstances require, alternative adjustments for an appropriate cost of capital may be applied following consultation between the AER and relevant distributor(s).

[125] 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.

[126] 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[127]
- 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.[128] 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.

[127] While the 2020 revenue is expected to be known in time for 2021–22 pricing, we have allowed an extra year for this true-up to allow for any issues that may arise in reporting 2020 revenues.

[128] 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[129] unders and overs account

This Appendix applies to the following jurisdictional schemes for Victorian distribution businesses:

- ESV levy scheme[130]
- Electricity Industry Amendment (Premium Solar Feed-in Tariff) Act 2009.[131]

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.[132]

The recovery of jurisdictional scheme amounts for each of these schemes is to be reported through the unders and overs account as separate line items, as demonstrated in Table 14.4.

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.[133]
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 approved nominal WACC.
5. The total sum of items 1–4 to derive the closing balance for each year.

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[129] 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.

[130] AER, *Determination - Request for the ESV Levy Scheme to be determined a jurisdictional scheme*, March 2021.

[131] NER, cl. 6.18.7A(e)(1)(iv).

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

[133] If circumstances require, alternative adjustments for an appropriate cost of capital may be applied following consultation between the AER and relevant distributor(s).

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.[134] Amounts for the next regulatory year (t) will be regarded as a forecast. Table 14.4 demonstrates how ESV levies are to be incorporated, being considered a jurisdictional scheme by the AER.

In exceptional circumstances, the jurisdictional scheme amounts unders and overs account can accommodate additional years—such as year t–3.[135]

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[136]
- 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

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134 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.

135 Any amounts provided for additional years prior to t-2 must be audited.

136 While the 2020 revenue is expected to be known in time for 2021–22 pricing, we have allowed an extra year for this true-up to allow for any issues that may arise in reporting 2020 revenues.

zero (i.e. a negative amount) to maintain strict compliance with the NER.[137] 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.

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.

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

E Annual pricing proposals

In line with our approach to annual pricing proposals for the Victorian distributors in previous regulatory periods, the AER will provide a Tariff Approval Model (TAM) for the Victorian distributors to use in submitting pricing proposals.

At least two weeks prior to annual pricing submissions being due we will provide the business with a pre-filled TAM to be used in the pricing proposal. This pre-filled TAM will include annual adjustments, revenue and cost true-up amounts from regulatory information notices or other sources, CPI and annual return on debt updates, and other components known by the AER. Pre-filling this data allows for the AER to verify inputs prior to the short timelines allowed within the pricing approval process.

The TAM to be used for the 2021–26 regulatory control period will include the escalation of price caps for ancillary network services and metering exit fees. This will ensure that price caps are escalated in the appropriate manner using the approved price cap formulae. It will also provide simplicity and consistency for AER review processes, as well as for stakeholders. The prices for public lighting services will be calculated through the AER Victorian public lighting model, updated each year for actual inflation.

The Victorian distributors will be required to input quantities and prices, and estimates required for unders/overs accounts, as well as any other inputs indicated by the AER in the TAM. The Victorian distributors will also provide information on indicative prices for future years. Where the Victorian distributors disagree with an input provided by the AER, or change any element of the TAM in their proposal, we require the business to indicate this in its pricing proposal, and provide supporting reasoning for the change.

In their pricing proposals, the Victorian distributors should also:

- provide a confidentiality template
- provide public versions of any confidential models for publication
- use version numbers in filenames for easy identification of revision by stakeholders (in the format of v1, v2, v3, etc.)
- provide details on methodologies for any forecasts provided (e.g. consumption forecasts)
- supporting information for any TSS requirements (e.g. standalone vs avoidable cost models or calculations).

F Rounding of inputs in annual pricing proposals

The following sets out our final 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 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
ABS	Australian Bureau of Statistics
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CESS	capital expenditure sharing scheme
CPI	consumer price index
CSIS	customer service incentive schemes
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
distributor	distribution network service provider
DPPC	designated pricing proposal charges
DUoS	distribution use of system
ESCV	Essential Services Commission Victoria
ESV	Energy Safe Victoria
EBSS	efficiency benefit sharing scheme
F&A	framework and approach
MRP	market risk premium
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RIN	regulatory information notice

Shortened form	Extended form
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
STPIS	service target performance incentive scheme
TAM	Tariff Approval Model
TAR	total allowable revenue
WACC	weighted average cost of capital