FINAL DECISION
Ausgrid distribution determination 2015−16 to 2018−19

Attachment 14 – Control mechanisms

April 2015

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

AER reference: 52294

Note

This attachment forms part of the AER's final decision on Ausgrid's revenue proposal 2015–19. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Annual revenue requirement

Attachment 2 - Regulatory asset base

Attachment 3 - Rate of return

Attachment 4 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency benefit sharing scheme

Attachment 10 - Capital expenditure sharing scheme

Attachment 11 - Service target performance incentive scheme

Attachment 12 - Demand management incentive scheme

Attachment 13 - Classification of services

Attachment 14 - Control mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

Attachment 17 - Negotiated services framework and criteria

Attachment 18 - Connection methodology

Attachment 19 - Pricing methodology

Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	aggregate service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
CPI-X	consumer price index minus X
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
expenditure assessment guideline	expenditure forecast assessment guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base

RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TAR	total annual revenue
WACC	weighted average cost of capital

14 Control mechanism for standard control services

The control mechanism imposes limits over the prices of direct control services, and/or the revenue from these services. For standard control services, the National Electricity Rules (NER) state the control mechanism must be of the prospective CPI–X form (or some incentive-based variant).[1]

This attachment sets out the final formulae for Ausgrid's control mechanism, the revenue cap, for the 2015–19 regulatory control period. It discusses:

- how we will apply the revenue cap.
- how we will determine compliance with the control mechanism.
- the mechanism through which Ausgrid will recover distribution use of system (DUoS) charges—including adjustments for revenue under or over recovery—in the 2015–19 regulatory control period.[2]
- how Ausgrid must report to us on its recovery of designated pricing proposal charges and jurisdictional scheme amounts.[3]
- the procedures Ausgrid must apply for assigning or reassigning retail customers to tariff classes.[4]

14.1 Final decision

Our final decision for Ausgrid is as follows:

- the control mechanism for standard control services provided by Ausgrid is a revenue cap.[5]
- section 14.5.3 contains the formula that gives effect to the control mechanism for standard control services.[6] The revenue cap for any given regulatory year is the total annual revenue (TAR) (for distribution services) for that regulatory year (calculated using the formula in Figure 14.1) plus any adjustment required to move the DUoS unders and overs account to zero.
- the side constraints applying to the price movements of each Ausgrid tariff class must be consistent with the formula in Ausgrid must demonstrate in its pricing

---

1 NER, cl 6.2.6(a).
2 NER, cl 6.12.1(11) and 6.12.1(13).
3 NER, cl 6.12.1(19) and 6.12.1(20).
4 NER, cl 6.12.1(17).
5 AER, *Stage 1 framework and approach paper: Ausgrid, Endeavour Energy and Essential Energy: Transitional regulatory control period 1 July 2014 to 30 June 2015, Subsequent regulatory control period 1 July 2015 to 30 June 2019*, March 2013, p. 43.
6 NER, cl 6.12.1(11).

proposal that proposed DUoS prices for the next year (t) will meet the side constraints formula in Figure 14.2 for each tariff class.

- Figure 14.2 below.
- Ausgrid must demonstrate compliance with the control mechanism for standard control services in accordance with appendix A of this attachment.
- Ausgrid must submit as part of its annual pricing proposal, a record of the amount of revenue recovered from designated pricing proposal charges and associated payments in accordance with appendix B of this attachment.[7]
- Ausgrid must report to us its jurisdictional scheme amounts recovery in accordance with appendix C of this attachment.
- appendix D of this attachment specifies the procedures Ausgrid must apply for assigning retail customers to tariff classes or reassigning retail customers from one tariff class to another.

14.2 Ausgrid's revised proposal

Ausgrid broadly considered that the AER's draft decision on the control mechanism for standard control services is appropriate.[8] It disagreed with particular aspects of the draft decision, including:

- recovery of emergency recoverable works (E-factor)
- application of tolerance limits
- the treatment of interest charge for year t in the unders and overs accounts.[9]

14.3 AER's assessment approach

Our stage 1 F&A decided the control mechanism for standard control services would be a revenue cap. The basis must be of the prospective CPI–X form (or some incentive-based variant).[10] We also stated we would finalise particular aspects of the control mechanism during the distribution determination process.[11]

---

7 We referred to this as the 'TUoS unders and overs account' in previous distribution determinations. In this final decision, we use the term 'designated pricing proposal charges' to reflect the wording of the NER (cl 6.12.1(19)).

8 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019*, 20 January 2015, p. 213–214.

9 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015.

10 AER, *Stage 1 Framework and approach paper Ausgrid, Endeavour Energy and Essential Energy*, March 2013, p. 43.

11 AER, *Stage 1 Framework and approach paper Ausgrid, Endeavour Energy and Essential Energy*, March 2013, p. 56–57.

In determining the control mechanism for standard control services, we considered the factors in clause 6.2.5(c) of the NER for each revenue adjustment mechanism and its application. This approach:

- satisfies the requirements of the NER
- confirms our decision in the stage 1 F&A to apply a revenue cap for Ausgrid's standard control services in the 2015–19 regulatory control period.

14.3.1 Inter-relationships

In the draft decision, we stated the B-factor should account for:

- approved pass through amounts
- residual metering asset costs from alternative control exit fees.[12]

In this final decision, the transfer of meters will be classified as an alternative control service not a standard control service (see alternative control services attachment 16). Hence, the B-factor in the control mechanism formula does not include residual metering asset costs (see Figure 14.1).

14.4 Reasons for final decision

Our stage 1 F&A deliberately set out a generic formula to give effect to the control mechanism for standard control services.[13] The NER requires our stage 1 F&A to include a formula for the control mechanism.[14] The control formula requires parameters that we complete in our final distribution determination. This final decision clarifies our position regarding the control formula and its respective parameters.

14.5 Application of the revenue cap

Total annual revenue

In this final decision, the revenue cap for any given regulatory year is the TAR for distribution services.[15] Figure 14.1 contains the formula that gives effect to the revenue cap.[16]

---

12 AER, *Draft decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanisms*, November 2014, pp. 13–14.

13 AER, *Stage 1 framework and approach paper: Ausgrid, Endeavour Energy and Essential Energy: Transitional regulatory control period 1 July 2014 to 30 June 2015, Subsequent regulatory control period 1 July 2015 to 30 June 2019*, March 2013, p. 43.

14 NER, cl 6.8.1(b)(2)(ii) and 11.56.4(l)(1).

15 In the draft decision, we stated the revenue cap for any given regulatory year is the annual revenue requirement (ARR) for distribution services. 'Annual revenue requirement' is a defined term in the NER, however, and this definition is not consistent with the formula that gives effect to the revenue cap. This final decision uses 'total annual revenue' for clarity.

16 NER, cl 6.12.1(11).

Intra-period adjustment to WACC

As per the draft decision, we will revise the X factors to implement any changes to revenue resulting from updates to return on debt.[17]

The attachment on the cost of capital details the annual adjustment to the WACC. The revenue attachment details issues relating to 'X-factors'.

Incentive Adjustment

Ausgrid accepted our decision to apply an annual adjustment to revenue from distribution services due to the operation of an incentive scheme.[18] As the service standards attachment discusses, we will apply a Service Target Performance Incentive Scheme (S-factor) to Ausgrid in the 2015–19 regulatory control period.

Transitional Adjustment (T-factor)

In the stage 1 F&A we included the T-factor in our control formula. We intended this to allow for the true-up of the difference between the notional revenue requirement for the 2014–15 regulatory year in this decision and the placeholder revenue in our transitional decision.[19] In the draft decision, we considered the T-factor was no longer required.[20] Instead, the true-up would occur via the PTRM as part of the overall revenue smoothing process. Ausgrid agreed with this approach.[21] This final decision confirms our position. Refer to revenue attachment 1 for further details on the true-up.

Recovery of D factor amounts

In the 2009–14 regulatory control period, the AER applied the D-factor incentive scheme (as part of the DMIS) in the form that the Independent Pricing and Regulatory Tribunal (IPART) previously applied.[22] As we discuss in the demand management attachment 12, we will not apply the D-factor in the 2015–19 regulatory control period. To close out the D-factor scheme, Ausgrid will recover the remaining expenditure arising from the scheme through its annual pricing proposal for 2015–16. As we set out

---

17 AER, *Draft decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, p. 14.

18 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 4.

19 AER, *Stage 1 framework and approach paper: Ausgrid, Endeavour Energy and Essential Energy: Transitional regulatory control period 1 July 2014 to 30 June 2015, Subsequent regulatory control period 1 July 2015 to 30 June 2019*, March 2013, p. 56.

20 AER, *Draft decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, p. 10.

21 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 4.

22 AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 470.

in section 14.5.3, Ausgrid will recover this expenditure through the B-factor in the formula for the control mechanism and side constraint.

In its revised regulatory proposal, Ausgrid expressed concern that the draft decision was silent on how it will recover D-factor amounts in the 2015–19 regulatory control period. Ausgrid suggested it can recover the D-factor amounts through the X-factor or through the annual pricing proposals.[23]

We consider it is appropriate to maintain consistency between regulatory control periods.[24] Ausgrid recovered D-factor amounts through the annual pricing proposals in the 2009–14 regulatory control period; hence our decision to maintain this approach to close out the scheme.[25] It is also consistent with Ausgrid's original proposal (to recover D-factor amounts through the annual pricing proposals).[26]

Demand management and embedded generator connection incentive scheme

Ausgrid maintained its position to introduce a Demand Management Benefit Sharing Scheme. Ausgrid proposed expanding the B-factor to include revenues associated with this proposed scheme..[27]

In line with our draft decision, we will not apply such a scheme in the 2015–19 regulatory control period and will instead provide a demand management innovation allowance (see the DMIS attachment for a more detailed discussion).

Definition of the Consumer Price Index

We uphold the draft decision's definition of CPI in relation to revenue from Ausgrid's prescribed transmission services. This final decision defines the yearly change in CPI for Ausgrid's prescribed transmission services as:

> the annual percentage change in the Australian Bureau of Statistics (ABS) Consumer Price Index All Groups, Weighted Average of Eight Capital Cities from December in year t–2 to December in year t–1[28]

Ausgrid did not agree with the draft decision's CPI definition for prescribed transmission services. Ausgrid proposed to use the average of four quarterly indexes

---

23 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 12–13.

24 NER, cl 6.2.5(c)(3) and (4).

25 AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, pp. 62–63.

26 Ausgrid, *Regulatory proposal: Attachment 9.02: Application and demonstration of compliance with control mechanisms for standard and alternative control services*, May 2014, p. 3.

27 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 5.

28 See Figure 14.3.

to calculate the annual change in CPI (similar to the definition in Figure 14.1).[29] Ausgrid stated its CPI formula for prescribed transmission services better measures the inflationary impacts throughout the year, and is more stable given it is less dependent on a single index.[30]

We do not agree with Ausgrid's CPI formula for prescribed transmission services because it is inconsistent with our current CPI definition. As its revised regulatory proposal noted, Ausgrid provides its transmission revenue requirement to TransGrid, who sets TUoS tariffs in NSW.[31] The draft decision's definition of CPI for Ausgrid's transmission services is consistent with the definition we apply to TransGrid. Inconsistent application of inflation will result in tariffs that do not match the expected revenues. This mismatch would require a further calculation to be undertaken to account for the difference. In our view this would create unnecessary complexity in the control mechanisms. This mismatch can be eliminated through consistent CPI application.

We also note Ausgrid applied the two CPI definitions for its distribution and transmission services in the 2009–14 regulatory control period.[32]

Recovery of Emergency Recoverable Works Costs (E-factor)

In its revised regulatory proposal, Ausgrid maintained its original proposal to include an E-factor in the control mechanism formula. This would enable Ausgrid to recover costs associated with emergency works where the responsible party is not known, or where it cannot otherwise recover costs.[33] As with the draft decision, we do not approve Ausgrid's proposal to include an E-factor in the revenue cap formula. The costs associated with the E-factor are already compensated for in the opex allowance. Although not definitive, we observe that Endeavour Energy did not seek the inclusion of an E-factor in the revenue cap formula. Essential Energy included the E-factor in its regulatory proposal but did not contest our draft decision not to include one.[34]

---

29 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 3.

30 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 3–4, 14–15.

31 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 13–14, 16.

32 AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14, 28 April 2009*, pp. 62–64.

33 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 4; Ausgrid, *Regulatory proposal: Attachment 9.02: Application and demonstration of compliance with control mechanisms for standard and alternative control services*, May 2014, p. 4.

34 Essential Energy, *Regulatory proposal: Attachment 9.2: Application and demonstration of compliance with control mechanism for standard and alternative control services*, 30 May 2014, p. 6.

The most important reason for our decision is that our allowed base opex for Ausgrid already accounts for such expenditure.[35] Ausgrid stated it excluded such expenditure from its base opex though.[36]

Our final decision uses an efficient benchmark to establish Ausgrid's base opex as a substitute for Ausgrid's opex forecast (see the opex attachment 7 for a more detailed discussion). All distributors incur costs that are to some extent beyond their control, including emergency works where the responsible party is not known. The benchmark base opex we determined in this final decision captures such costs. To demonstrate, the category analysis RINs that all distributors provided to us include an 'emergency response' line item, which captures the costs for such emergency works. Our base opex, which incorporates such items, ensures distributors have a reasonable opportunity to recover at least their efficient costs of this activity. To add an E-factor in the control formula would result in double cost recovery, which violates the opex criteria and pricing principles.[37]

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

We have amended the definition of the B-factor since the draft decision. As with the draft decision, the B-factor amount will still account for approved pass through amounts. However, it will no longer account for residual metering asset costs (see the alternative control services attachment 16 for a more detailed discussion). As we discussed above, Ausgrid will recover the remaining expenditure arising from the D-factor scheme through the B-factor.

In the draft decision, we stated the B-factor should account for:

- approved pass through amounts
- residual metering asset costs from alternative control exit fees.[38]

Ausgrid broadly agreed with this approach. However, it was concerned with the requirement to apply tolerance limits on its recovery of residual metering asset costs from metering exit fees.[39] Ausgrid submitted 'tolerance limits' should only apply to the

---

35 AER, *Draft decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, pp. 9–10.

36 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 4.

37 NER, cl 6.5.6(c) and 6.18.5(g).

38 AER, *Draft decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, p. 16.

39 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 5.

DUoS unders and overs account to limit price volatility.[40] As we noted in section 14.3.1, the B-factor will no longer account for residual metering asset costs.

As we discuss below, we will not apply tolerance limits on the DUoS unders and overs account in the 2015–19 regulatory control period.

Under and over recovery mechanism for DUoS

Ausgrid will recover DUoS charges from distribution customers through its pricing proposal. Ausgrid's revised proposal broadly agreed with the draft decision but outlined a number of implementation issues that would improve its operation.[41]

Ausgrid suggested the control mechanism formula needs to explicitly include any balance in the DUoS unders and overs account.[42] Queensland distributor Ergon Energy made a similar proposal.[43] We agree with Ausgrid in principle, although we did not adopt Ausgrid's suggestions regarding the control mechanism formula. The requirement for Ausgrid to follow the control mechanism formula in conjunction with the DUoS unders and overs account achieves the same purpose (see section 14.5.3). This is consistent with our approach in previous distribution determinations.

Ausgrid disputed the draft decision, which did not apply interest on the opening balance and the under / over recovery amounts in year t. Ausgrid stated the draft decision approach would result in Ausgrid earning more or less than its annual revenue entitlement in present value terms.[44] We agree with Ausgrid's interpretation and will now apply interest in year t. We note this is consistent with the approach we adopted for the TUoS unders and overs account for the 2009–14 regulatory control period.[45] We have incorporated these changes in appendices A, B and C of this attachment.

---

40 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 5.

41 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 5–6.

42 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 6–7.

43 Ergon Energy, *Submission on the Draft decisions: NSW and ACT distribution determinations 2015–16 to 2018–19*, 13 February 2015, p. 37.

44 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 9–10.

45 AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, pp. 462–463.

Ausgrid maintained its position that a tolerance limit should apply to the DUoS unders and overs account. Ausgrid stated the proposed tolerance limit would restrict unstable prices.[46] We discuss this issue in the next section.

Tolerance limits

We will not apply tolerance limits to the DUoS unders and over accounts in the 2015–19 regulatory control period. We consider the risks of applying tolerance limits (delayed price shocks, and reduced cost reflectivity in prices) outweigh the benefits of potentially smoothing prices.

Applying tolerance limits potentially smooths price shocks from volume risk under a revenue cap and offers flexibility to attain price stability. Ausgrid stated that appropriately designed tolerance limits:

> …ensure that in the event of a material over/under recovery of DUOS revenue that Ausgrid has the flexibility to transition DUOS prices to achieve a zero balance of the DUOS unders and overs account over a reasonable time frame. In the case of a very large under/over recovery of DUOS revenue…it is in the long-term interest of customers for transitional DUOS pricing arrangement to extend over more than one regulatory control period as long as our customers have been consulted on the plan to address this issue.[47]

In practice, however, tolerance limits may result in under or over recoveries accumulating during the regulatory control period. This would leave a large end-of-period adjustment to eliminate or reduce the account balance accumulated during previous years. As a result, price shocks are merely delayed, not eliminated. This occurred in Queensland where consistent under-recovery in the 2010–15 regulatory control period led to an accumulated $500 million in the account balance. The Queensland distributors proposed recovering this amount over the next regulatory control period.[48]

Accumulating over or under recoveries that persist for multiple years may also distort the cost reflectiveness of tariffs and thus price signals to customers. For example, instead of tariffs falling for a particular customer class in a given year, they rise as the distributor draws down its accumulated balance. This is not consistent with the network pricing objective that the tariffs a distributor charges a retail customer should reflect the

---

46 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 7–9.

47 Ausgrid, *Revised regulatory proposal: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 8.

48 Energex, *Regulatory proposal: June 2015 to June 2020*, 31 October 2014, pp. 215–216; Ergon Energy, *Regulatory proposal: 2015 to 2020*, 31 October 2014, p. 25.

efficient costs of providing those services.[49] It is also not consistent with the requirement that tariffs minimise distortions to price signals for efficient usage.[50]

The IPART and more recently the ACCC experienced similar issues of delayed cost reflectivity in their determinations for the State Water Corporation of NSW. In past determinations, IPART set price caps for certain valleys having regard to the severe customer impact of full cost recovery (because of high prices in those valleys).[51] This resulted in prices for those valleys not recovering the revenue requirement in past years (although the NSW Government funded the shortfall through direct budgetary subsidies).[52] The issue of under recovery continued when the ACCC assumed regulation of State Water's Murray-Darling Basin Valleys for the 2014–17 period.[53] We note the different characteristics of the water and electricity sectors influence their regulatory regimes. For example, the ACCC must consider price stability in its annual tariff process for State Water.[54] As we noted above, the NER emphasise that electricity distributors' tariffs should reflect efficient costs.[55] Nevertheless, this example demonstrates the potential to delay cost reflective pricing when under (or over) recoveries of costs are allowed to accumulate.

Eliminating tolerance limits removes distortions to cost reflectivity that we discussed above. The move to cost reflective tariffs is now underway following the AEMC change to the distribution pricing rules in 2014.[56]

A drawback of not applying tolerance limits is the possibility of price shocks when the variance between the total annual revenue and actual revenue is large. However, in-built smoothing mechanisms from some sources of error can mitigate the variability in revenue stemming from a revenue cap. For example:

- under the STPIS, distributors can bank revenue adjustments resulting from the S-factor. Thus, there is no good reason for the S-factor payment to find their way into a tolerance limits account balance.
- consumption forecasts are a potential source of error. We can mitigate such errors by approving reasonable forecasts during the distribution determination and pricing proposal process. This process, along with requirements for greater consultation, put the onus on distributors to produce reasonable volume forecasts at the outset.

---

49 NER, cl 6.18.5(a).

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

51 IPART, *Review of bulk water charges for State Water Corporation from 1 July 2010 to 30 June 2014: Water: Final report*, June 2010, pp. 18, 150–151.

52 IPART, *Review of bulk water charges for State Water Corporation from 1 July 2010 to 30 June 2014: Water: Final report*, June 2010, pp. 110, 149–150.

53 ACCC, *Final decision on State Water pricing application: 2014–15 — 2016–17*, June 2014, pp. 11–13.

54 Water Charge (Infrastructure) Rules 2010, rule 37(2)

55 NER, cl 6.18.5(e) to 6.18.5(g).

56 See: http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements (accessed 18 February 2015).

While this was not a major factor in our decision, tolerance limits also increase administration costs for the regulator and distributors. Both parties must keep records annually to track its operation over the regulatory control period. Administration costs may become particularly high where distributors proposed discretion for recovering revenue associated with the tolerance limits.[57] This may require negotiation between regulator and distributor during the pricing approval process. There is also the added complexity and confusion, and associated costs, of different distributors proposing different mechanisms to recover such revenue. Eliminating tolerance limits also avoids these administration costs and potential confusion for customers.

Unders and overs in the 2014–15 transitional year

Ausgrid stated the draft decision did not address its suggestion regarding DUoS unders and overs for the transitional year 2014–15.[58] Ausgrid stated it would not be able to calculate an accurate DUoS unders and overs account for that year. The reason is Ausgrid's standard control DUoS revenue for 2014–15 included revenue from ancillary network services and unclassified services.

Ausgrid suggested deducting the approved revenue for ancillary network services and unclassified services in the bundled DUoS charges for 2014–15 from the total actual revenue for that year. In Ausgrid's illustrative example in Table 14.1, Ausgrid's approach results in a DUoS over-recovery of $30 in 2014–15. This is the difference between the AER approved DUoS revenue of $200 and the deemed actual DUoS revenue of $230 in 2014–15 ($280 minus $50).[59]

Table 14.1 Example calculation of over/under recovery in 2014–15

2014–15	Revenue used for calculation of bundled DUoS price	Actual revenue collected from charging bundled DUoS
Revenue approved by the AER as annual revenue requirement in the transitional determination	$200	
Additional revenue for certain alternative control services ACS and unclassified services	$50	
Total bundled revenue	$250	$280

[57] Ausgrid proposed to submit a medium-term plan to address the DUOS revenue overs and unders account in its annual pricing proposal if the over/under recovery of DUoS revenue is greater than +/- 5 per cent of the ARR. For more details, see Ausgrid, *Revised regulatory proposal: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 8.

[58] Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 5.

[59] Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 5.

Source: Ausgrid, Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services, 20 January 2015, p. 5.

Note: We amended Table 14.1 slightly from the example in Ausgrid's revised proposal after clarification discussions with Ausgrid staff (phone conversation between AER and Ausgrid staff, 6 March 2015). In particular, we moved the actual DUoS revenue of $280 to the last row.

We understand and appreciate Ausgrid suggested this approach for transparency purposes.[60] We consider Ausgrid's approach is reasonable in principle, as long as it is consistent with the requirements of this final decision. Revenue from all standard control services must conform with the control mechanism formula and associated DUoS unders and overs account (see section 14.5.3). This applies regardless of the composition of actual and approved revenues. Using Table 14.1, the key consideration is the difference between actual revenue from bundled DUoS and approved revenue from bundled DUoS ($280 minus $250). This derives an over-recovery of $30 for 2014–15. This result is consistent with Ausgrid's example.

Under and over recovery mechanism for designated pricing proposal charges

We will apply an under and over recovery mechanism for designated pricing proposal charges to smooth the impact of over and under recovery into tariffs year on year. Our reasons are the same for the DUoS under and over recovery as set out above and is consistent with the requirements of the NER.[61]

We based the unders and overs account for designated pricing proposal charges on the approach we used in the 2009–14 regulatory control period. See appendix B for the under and over recovery mechanism for designated pricing proposal charges.

Control mechanism for standard control (transmission) services

Ausgrid has prescribed transmission services and must apportion its revenue between its distribution and transmission services. Therefore we are required to make a decision on the revenue cap formula for Ausgrid's transmission revenue. We will apply the same revenue cap formula to Ausgrid for prescribed (transmission) standard control services as that in the 2009–14 regulatory control period.

Ausgrid's revised regulatory proposal stated the concern that:

> [a]s part of its pricing proposal, Ausgrid must submit to us proposed tariffs and charging parameters which lead to expected revenues consistent with the ARR(distribution Services) and MAR (transmission services) formulas set out

[60] Phone conversation between AER and Ausgrid staff, 6 March 2015.

[61] NER, cl 6.12.1(19) and 6.18.7.

below, plus any unders and overs adjustment needed to move the balance of its DUOS and TUOS account to zero.[62]

Ausgrid submitted it cannot account separately for its transmission revenue due to the application of the coordinating transmission network service provider provisions of the NER.[63]

We acknowledge TransGrid is the NSW co–coordinating network service provider. It is therefore appropriate for TransGrid to develop the price structure for Ausgrid's prescribed transmission services (see the pricing methodology attachment 19). We removed references to Ausgrid's MAR (transmission services) with reference to compliance with the control mechanism and side constraint formulas (see section 14.5.3).

14.5.1 Reporting on jurisdictional scheme amounts

Jurisdictional schemes amounts are those Ausgrid must pay pursuant to NSW government requirements.[64] We must decide how Ausgrid will report recovery of jurisdictional scheme amounts for each year of the regulatory control period and adjustments necessary in subsequent pricing proposals to account for over or under recovery of those charges.[65]

We approve Ausgrid's method of reporting on jurisdictional scheme amounts. It is consistent with the current reporting method, which we previously approved.[66] See appendix C for the under and over recovery mechanism for jurisdictional schemes.

14.5.2 Side Constraints

In its revised regulatory proposal, Ausgrid disagreed with aspects of the draft decision side constraint formula.[67] In particular, Ausgrid stated the side constraint formula in the draft decision:

- is not consistent with the definition of 'permissible percentage' in clause 6.18.6(c) of the NER

---

62 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 14.

63 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 13.

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

65 NER, cl. 6.12.1 (20).

66 AER, *Ausgrid: Placeholder determination for the transitional regulatory control period 2014-15*, April 2014, p. 4.

67 Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, pp. 11–12.

- includes a parameter relating to the TUoS unders and overs account, which is not appropriate to the side constraints
- requires that the percentage increase in the weighted average revenue in year t is both '≤' and '=' the permissible percentage
- contains a different CPI definition to the revenue cap formula.[68]

We agree with Ausgrid and amended the specifications of the side constraint to reflect these observations (see Figure 14.2). We also replaced the 'PT_t' parameter with 'B_t' to be consistent with the revenue cap formula (see Figure 14.1).

14.5.3 Control mechanism formulas

Prescribed (Distribution) services

Ausgrid's pricing proposals must submit to the AER proposed tariffs and charging parameters. Ausgrid's revenues for standard control services must be consistent with the total annual revenue formula in Figure 14.1, plus any unders and overs adjustment needed to move the balance of its DUoS unders and overs account to zero.

Figure 14.1 Revenue cap formula

1. $TAR_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} \, q_t^{ij}$ i=1,...,n and j=1,...,m and t=1,...,5
2. $TAR_t = AR_t \pm B_t$
3. $AR_t = AR_{t-1}(1 + \Delta CPI_t)(1 - X_t)(1 + S_t)$

Where:

TAR_t is total annual revenue in year t.

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

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

AR_t is the annual smoothed expected revenue for year t. For the 2015–16 regulatory year, AR_{t-1} is the annual smoothed expected revenue in the Post Tax Revenue Model for 2014–15.

B_t is:

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

[68] Ausgrid, *Revised regulatory proposal and preliminary submission: 1 July 2014–30 June 2019: Attachment 9.01: Application and demonstration of compliance with control mechanism for standard control services*, 20 January 2015, p. 11.

- the D-factor amounts we approve for 2013–14 (applies to Ausgrid's pricing proposal for the regulatory year 2015–16).

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

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

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

S_t is the STPIS factor sum of the raw s-factors for all reliability of supply and customer service parameters (as applicable) to be applied in year t.[69] S_t for 2015–16 and 2016–17 are set at zero.

Side constraints

Ausgrid must demonstrate in its pricing proposal that proposed DUoS prices for the next year (t) will meet the side constraints formula in Figure 14.2 for each tariff class.[70]

Figure 14.2 Side constraints

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

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

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

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

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

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

---

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

70 NER, cl. 6.18.6

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

X_t the smoothing factor determined in accordance with the PTRM as approved in the AER's final decision, and annually revised for the return on debt update in accordance with the formula specified in the return on debt appendix I calculated for the relevant year. If X>0, then X will be set equal to zero for the purposes of the side constraint formula.

B_t is:

- the approved pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER, plus
- the D-factor amounts we approve for 2013–14 (applies to Ausgrid's pricing proposal for the regulatory year 2015–16).

S_t is the STPIS factor sum of the raw s-factors for all reliability of supply and customer service parameters (as applicable) to be applied in year t.[71] S_t for 2015–16 and 2016–17 are set at zero.

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

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

Prescribed (transmission) services

In its pricing proposals, Ausgrid must demonstrate that revenues for its prescribed (transmission) services are consistent with the MAR formula in Figure 14.3.

Figure 14.3 Revenue cap formula for prescribed(transmission) services

$$MAR_t = AR_t \pm PT_t$$

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

Where:

MAR_t is the maximum allowable average revenue in year t.

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

AR_t is the annual smoothed expected revenue for year t. For the 2015–16 regulatory year, AR_{t-1} is the annual smoothed expected revenue in the Post Tax Revenue Model for 2014–15.

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

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

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

A DUoS unders and overs account

To demonstrate compliance with its distribution determination in the 2015–19 regulatory control period, Ausgrid must maintain a DUoS unders and overs account in its annual pricing proposal under clause 6.18.2(b)(7) of the NER.

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

1. opening balance for year t-2, year t-1 and year t;
2. an interest charge for one year on the opening balance for each regulatory year (t-2, t-1 and t). These adjustments are to be calculated using the approved nominal WACC.
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 of items 1–4 to derive the closing balance for each year.

Ausgrid must provide details of calculations in the format set out in Table 14.2. All of Amounts provided for the most recently completed regulatory year (t-2) must be audited. Amounts provided for the current regulatory year (t-1) will be regarded as an estimate. Amounts provided for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of DUoS charges, Ausgrid is to achieve an expected zero balance on their DUoS unders and overs accounts in each forecast year in its annual pricing proposals in the 2015–19 regulatory control period.

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

Table 14.2 Example calculation of DUoS unders and overs account ($000, nominal)

	Year t–2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from DUoS charges	46,779	37,297	59,575
Less TAR for the relevant year	43,039	43,012	59,927
Smooth revenues (ARt)	43,039	43,010	59,913
Approved pass throughs (pass through)	0	2	14
Under/over recovery for regulatory year	3,740	-5,715	-352

DUoS unders and overs account			
Nominal WACC (per cent)	8.79	8.79	8.06
Opening balance	1,737	5,791	339
Interest on opening balance	153	509	27
Under/over recovery for regulatory year	3,740	-5,715	-352
Interest on under/over recovery for regulatory year	161	-246	-14
Closing balance	5,791	339	0 [a]

Notes: (a) Ausgrid must achieve an expected zero balance on their DUoS unders and overs accounts in each forecast year in its annual pricing proposals in the 2015–19 regulatory control period.

B Unders and overs account for designated pricing proposal charges

To demonstrate compliance with its distribution determination in the 2015–19 regulatory control period, Ausgrid must maintain an unders and overs account for designated pricing proposal charges in its annual pricing proposal under clause 6.18.2(b)(6) of the NER.

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

1. opening balance for year t-2, year t-1 and year t;
2. an interest charge for one year on the opening balance for each regulatory year (t-2, t-1 and t). These adjustments are to be calculated using the approved nominal WACC.
3. the amount of revenue recovered from designated pricing proposal charges in respect of that year, less the amounts of designated pricing proposal related payments made by Ausgrid in respect of that year;
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 of items 1–4 to derive the closing balance for each year.

Ausgrid must provide details of calculations in the format set out in Table 14.3. Amounts provided for the most recently completed regulatory year (t-2) must be audited. Amounts provided for the current regulatory year (t-1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

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

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

	Year t–2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from designated pricing proposal charges	40,077	34,944	36,607 [a]
Less total transmission related payments	34,365	38,734	39,200
Transmission charges to be paid to TNSP	33,793	38,000	38,400
Avoided TUOS payments	572	734	800

Under/over recovery for regulatory year	5,712	-3,790	-2,593
Unders and overs account for designated pricing proposal charges			
Nominal WACC (per cent)	8.28	8.28	8.28
Opening balance	0	5,944	2,492
Interest on opening balance	0	492	206
Under/over recovery for regulatory year	5,712	-3,790	-2,593
Interest on under/over recovery for regulatory year	232	-154	-105
Closing balance	5,944	2,492	0

Notes: (a) Forecast revenue from designated pricing proposal charges will be set to achieve an expected zero balance in the unders and overs account for designated pricing proposal charges for year t.

C Reporting on recovery of jurisdictional schemes

To demonstrate compliance with its distribution determination in the 2015–19 regulatory control period, Ausgrid must maintain a jurisdictional scheme unders and overs account in its annual pricing proposal under clause 6.18.2(b)(6A) of the NER.[72]

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

1. opening balance for year t-2, year t-1 and year t;
2. an interest charge for one year on the opening balance for each regulatory year (t-2, t-1 and t). These adjustments are to be calculated using the approved nominal WACC.
3. the amount of revenue recovered from jurisdictional scheme related charges applied in respect of that year, less the amounts of all jurisdictional scheme related payments made by Ausgrid in respect of that year;
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 of items 1–4 to derive the closing balance for each year.

Table 14.4 provides an example calculation of the jurisdictional schemes unders and overs account.

In proposing variations to the amount and structure of jurisdictional schemes charges for a given regulatory year t, Ausgrid is to achieve an expected zero balance on its jurisdictional schemes unders and overs accounts at the end of each regulatory year in the next regulatory control period.

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

	Year t–2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from jurisdictional schemes	19,777	23,121	26,881
Jurisdictional scheme 1 payments	14,159	13,954	13,961
Jurisdictional scheme 2 payments	6,113	7,005	

[72] NER, cl. 6.18.7A(a) to (c).

			14,680
Total payments form jurisdictional scheme	20,272	20,959	28,641
Over (under) recovery for financial year	-495	2162	-1760
Overs and unders account			
Annual rate of interest applicable to balances (per cent)	8.79	8.79	8.06
Opening balance	-	- 517	1,693
Interest on opening balance	-	- 45	136
Over/ under recovery for financial year	- 495	2,162	-1,760
Interest on over/ under recovery	- 22	93	-69
Closing balance	- 517	1,693	0

D Assigning retail customers to tariff classes

We are required to decide on the principles governing assignment or reassignment of retail customers to or between tariff classes.[73] Ausgrid proposed to assign retail customers into one of four classes of network users on the basis of the following factors namely:

- the nature of their network usage i.e. residential or business
- the nature of their metering i.e. metered or unmetered
- the voltage level as measured at their metering point e.g. low, high or sub-transmission voltage
- a forecast of the extent of their network usage e.g. level of annual consumption, maximum demand.[74]

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

D.1 AER's assessment approach

Our draft decision described our approach to assessing the principles governing assignment or reassignment of retail customers to tariff classes.[75] In particular, we did not approve Ausgrid's proposed procedure for assigning retail customers to tariff classes. We required Ausgrid to amend its procedure to allow retail customers additional protection when they object to being assigned and/or re-assigned to a particular tariff class.[76]

We maintained this approach for the final decision.

D.2 Reasons for final decision

We accept Ausgrid's revised procedure for assigning and reassigning retail customers to tariff classes because we consider that:

- notifications to customers regarding tariff assignments and reassignments should be made to customers' retailers rather than directly to customers
- Ausgrid's submission that a 20 per cent threshold to the application of the eligibility criteria for the Cost Reflective Network Price tariff class is reasonable.

---

73 NER, cl 6.12.1(17).

74 Ausgrid, *Distribution Subsequent regulatory proposal 2015-19, Attachment 9.01 Proposed Procedure for assigning customers to tariff classes*, June 2014, p. 3.

75 AER, *Draft decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, pp. 23–24.

76 Ausgrid, *Distribution Subsequent regulatory proposal 2015-19, Attachment 9.01 Proposed Procedure for assigning customers to tariff classes*, June 2014, p. 3.

These issues are now discussed it turn.

D.2.1 Approach of notifying retailers instead of the affected customer

Our draft decision considered that Ausgrid should be obligated to notify retail customers in the event that their tariff class is reassigned. After discussions and consultation with the NSW distributors, retailers and reviewing their submissions we accept Ausgrid's proposal to notify customers' retailers regarding tariff class reassignments.[77]

We accept Ausgrid's submission that notifying both the retail customer and the retailer may impose an additional cost on distributors. Further, notification sent by distributors to retail customers may also add a level of confusion. That is, the final bill paid by a retail customer will depend on the offer made by the retailer to that customer and not those applied by Ausgrid. As such, correspondence about network tariff class changes may cause confusion to the retail customer about their retail electricity bill.[78]

D.2.2 Eligibility criteria for the Cost Reflective Network Price tariff class

We accept Ausgrid's submission that a five per cent threshold to the application of the eligibility criteria for the Cost Reflective Network Price tariff class reassignment may be problematic. That is it may lead to a departure from cost reflective pricing, undermine efficient investment decisions or unacceptable price shocks.[79]

Further, Ausgrid submitted that it was reviewing the eligibility criteria applying to the Cost Reflective Network Price tariff class as part of annual pricing proposal for 2015–16. A key issue under consideration is whether to replace the extent of usage criteria with conditions based on the customer's connection characteristics. If this is implemented, the threshold applying to the Cost Reflective Network Price tariff class will no longer be applicable given that the extent of usage is no longer a relevant consideration.[80]

---

77 Ausgrid, *Revised regulatory proposal: Attachment 9.03: Proposed procedure for assigning or re-assignment of retail customers to tariff classes*, January 2015, pp. 2–6; Endeavour Energy, *Revised regulatory proposal: Attachment 9.02: Proposed procedure for assigning or re-assigning retail customers to tariff classes*, January 2015, pp. 2–4; Phone conference between AER staff Ausgrid and Endeavour Energy, 20 March 2015; Meeting between AER staff and Origin Energy; 23 March 2015; Phone conversation between AER staff and Essential Energy, 24 March 2015; Phone conversation between AER staff and EnergyAustralia, 24 March 2015; Phone conversation between AER staff and EnergyAustralia, March 2015.

78 Energy Australia, response to AER question regarding Proposed Procedure for Assigning or Re-Assignment of Retail Customers to Tariff Classes by Ausgrid, 23 March 2015.

79 Ausgrid, Revised regulatory proposal: Attachment 9.03 Proposed Procedure for Assigning or Re-Assignment of Retail Customers to Tariff Classes, January 2015, pp. 4–6; Ausgrid, Ausgrid's response to AER question Information request 060, March 2015, pp. 1–2.

80 Ausgrid, Ausgrid's response to AER question Information request 060, March 2015, p. 1.

D.3 Procedures for assigning or reassigning retail customers to tariff classes

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

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

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

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

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

2. If, after 1 July 2015, Ausgrid becomes aware that a person will become a retail customer of Ausgrid, then Ausgrid must determine the tariff class to which the new retail customer will be assigned.
3. In determining the tariff class to which a retail customer or potential retail customer will be assigned, or reassigned, in accordance with paragraphs 2 or 5 of these procedures, Ausgrid must take into account one or more of the following factors:[81]
    (a) the nature and extent of the retail customer's usage
    (b) the nature of the retail customer's connection to the network[82]
    (c) whether remotely-read interval metering or other similar metering technology has been installed at the retail customer's premises as a result of a regulatory obligation or requirement.
4. In addition to the requirements of paragraph 3 above, Ausgrid, when assigning or reassigning a retail customer to a tariff class, must ensure:
    (a) retail customers with similar connection and usage profiles are treated equally[83]
    (b) retail customers who have micro–generation facilities are not treated less favourably than retail customers with similar load profiles without such facilities.[84]

---

81 NER, cl 6.18.4(a)(i).
82 The AER interprets 'nature' to include the installation of any technology capable of supporting time based tariffs.
83 NER, cl 6.18.4(2).
84 NER, cl 6.18.4(3).

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

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

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

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

    ii. If an existing retail customer has increased their annual energy consumption above 40 GWh or recorded a maximum demand in excess of 10 MVA in the previous calendar year prior to the network price change then Ausgrid will reassign this retail customer to a new tariff class for the purposes of the annual pricing proposal unless Ausgrid has reasons to believe that this reassignment is unreasonable in the circumstances, such as in the case where the reduction in the extent of network usage is expected to be temporary in nature.

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

    (i) existing retail customers to the Cost Reflective Network Price tariff class if their historical volume data over this period exceeds the eligibility criteria for this tariff class by 20 per cent i.e. 48 GWH pa or 12 MW.

    (ii) existing retail customers from the Cost Reflective Network Price tariff class to another tariff class if their historical volume data over this period falls below the eligibility criteria for this tariff class by more than 20 per cent i.e. 32 GWh pa or 8 MW.

    iv. Ausgrid will have discretion over whether it is economically desirable to assign retail customers to the Cost Reflective Network Price tariff class

that satisfy the eligibility criteria, but lie within the ±20 per cent tolerance of the eligibility criteria for this tariff class.[85]

7. If the voltage of the supply to the premise as measured at the metering point changes then the existing retail customer will be reassigned to the appropriate tariff class for the purposes of the next annual pricing proposal process commencing on 1 July.
8. Ausgrid may take into account other relevant information in determining whether a retail customer's tariff class remains appropriate.
9. Ausgrid may reassign a retail customer to another tariff class if the existing retail customer's load characteristics or connection characteristics (or both) have changed such that it is no longer appropriate for that retail customer to be assigned to the tariff class to which the retail customer is currently assigned. Or a retail customer no longer has the same or materially similar load or connection characteristics as other retail customers on the retail customer's existing tariff class, then it may reassign that retail customer to another tariff class. In determining the tariff class to which a retail customer will be reassigned, Ausgrid must take into account paragraphs 3 and 4 above.

Notice of proposed assignments and reassignments and rights of objection

10. Ausgrid must notify the retail customer's retailer in writing or through appropriate B2B processes prior to the reassignment occurring. The obligation to notify a retail customer's retailer does not apply if the retail customer has agreed with its retailer and Ausgrid that its network charges are to be billed by Ausgrid directly to the retail customer, in which case Ausgrid must notify the retail customer directly.
11. A notice under paragraph 10 above must include advice informing the retail customer that they may request further information from Ausgrid and that the retail customer may object to the proposed reassignment. This notice must specifically include:
    (a) either a copy of Ausgrid's internal procedures for reviewing objections or complaints of this type or the link to where such information is available on the Ausgrid's website
    (b) that if any objection is not satisfactorily resolved under Ausgrid's internal review process within a reasonable timeframe, then to the extent that the matter relates to a small retail customer and resolution of such disputes are within the jurisdiction of the NSW Energy and Water Ombudsman, the retail customer is entitled to escalate the matter to the ombudsman.

[85] Note that paragraph 6 is only applicable if the eligibility criteria for Ausgrid's CRNP tariff continue to be based on the extent of network usage (greater than 40 GWh pa or 10 MVA.

(c) that if the objection is not resolved to the satisfaction of the retail customer under the Ausgrid's internal review system or the ombudsman, then the retail customer is entitled to seek a decision of the AER via the dispute resolution process available under Part 10 of the NEL.

12. If, in response to a notice issued in accordance with paragraph 10 above, Ausgrid receives a request for further information from a retail customer, then it must provide such information within a reasonable timeframe. If Ausgrid reasonably claims confidentiality over any of the information requested by the retail customer, then it is not required to provide that information to the retail customer. If the retail customer disagrees with such confidentiality claims, he or she may have resort to the dispute resolution procedures referred to in section 11 (as modified for a confidentiality dispute).

13. If, in response to a notice issued in accordance with paragraph 10 above, a retail customer or their retailer makes an objection to Ausgrid about the proposed assignment or reassignment, Ausgrid must reconsider the proposed assignment or reassignment. In doing so Ausgrid must take into consideration the tariff assignment factors and notify the retail customer's retailer in writing of its decision and the reasons for that decision.

14. If an objection to a tariff class assignment or reassignment is upheld, then any adjustment which needs to be made to tariffs will be done by Ausgrid as part of the next annual review of tariffs.

15. If a retail customer objects to Ausgrid's tariff class assignment, Ausgrid must provide the information set out in paragraph 11 and adopt and comply with the arrangements set out in paragraphs 11, 12 and 13 in respect of requests for further information by the retail customer and resolution of the objection.

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

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