



FINAL DECISION
Essential Energy distribution
determination
2015–16 to 2018–19

Attachment 14 – Control
mechanism

April 2015

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Note

This attachment forms part of the AER's final decision on Essential Energy'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

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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

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
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 and 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 Essential Energy'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 Essential Energy 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 Essential Energy must report to us on its recovery of designated pricing proposal charges and jurisdictional scheme amounts.³
- the procedures Essential Energy must apply for assigning or reassigning retail customers to tariff classes.⁴

14.1 Final decision

Our final decision for Essential Energy is as follows:

- the control mechanism for standard control services provided by Essential Energy 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 Essential Energy tariff class must be consistent with the formula in Figure 14.2 below.

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).

- Essential Energy must demonstrate compliance with the control mechanism for standard control services in accordance with appendix A of this attachment.
- Essential Energy 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
- Essential Energy 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 Essential Energy must apply for assigning retail customers to tariff classes or reassigning retail customers from one tariff class to another.

14.2 Essential Energy's revised proposal

Essential Energy 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:

- 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

In determining the control mechanism for standard control services, we considered 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 Essential Energy's standard control services in the 2015–19 regulatory control period.

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 Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 3.

⁹ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, 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.

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 total annual revenue (TAR) for distribution services.¹⁵ Figure 14.1 contains the formula that gives effect to the revenue cap.¹⁶

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 issues relating to the WACC and its annual updating. The revenue attachment details issues relating to 'X-factors'.

¹² AER, *Draft decision: Essential Energy 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).

¹⁷ AER, *Draft decision: Essential Energy distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanisms*, November 2014, p. 9.

Incentive Adjustment

Essential Energy 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 Essential Energy 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. Essential Energy 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 DMIS attachment 12, we will not apply the D-factor in the 2015–19 regulatory control period. To close out the D-factor scheme, Essential Energy will recover the remaining expenditure arising from the scheme through its annual pricing proposal for 2015–16. As we set out in section 14.5.3, Essential Energy will recover this expenditure through the B factor in the formula for the control mechanism and side constraint.

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

¹⁸ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 5.

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: Essential Energy distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanisms*, November 2014, p. 10.

²¹ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 5.

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

²³ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 10.

We consider it is appropriate to maintain consistency between regulatory control periods.²⁴ Essential Energy 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 Essential Energy’s original proposal (to recover D-factor amounts through the annual pricing proposals).²⁶

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, Essential Energy 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.²⁷

Essential Energy 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.²⁸ Essential Energy submitted 'tolerance limits' should only apply to the DUoS unders and overs account to limit price volatility.²⁹ 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

Essential Energy will recover DUoS charges from distribution customers through its pricing proposal. Essential Energy’s revised proposal broadly agreed with the draft

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 Essential Energy, *Regulatory proposal: Attachment 9.2: Application and demonstration of compliance with control mechanism for standard and alternative control services*, May 2014, p. 4.

²⁷ AER, *Draft decision: Essential Energy distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanisms*, November 2014, pp. 13–14.

²⁸ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, pp. 5–8.

²⁹ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, pp. 5–8.

decision but outlined a number of implementation issues that would improve its operation.³⁰

Essential Energy suggested the control mechanism formula needs to explicitly include any balance in the DUoS unders and overs account.³¹ Queensland distributor Ergon Energy made a similar proposal.³² We agree with Essential Energy in principle, although we did not adopt Essential Energy's suggestions regarding the control mechanism formula. The requirement for Essential Energy 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.

Essential Energy disputed the draft decision, which did not apply interest on the opening balance and the under/over recovery amounts in year t. Essential Energy stated the draft decision approach would result in Essential Energy earning more or less than its annual revenue entitlement in present value terms.³³

We agree with Essential Energy'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.³⁴ We have incorporated these changes into appendices A, B and C of this attachment.

Essential Energy maintained its position that a tolerance limit should apply to the DUoS unders and overs account. Essential Energy stated the proposed tolerance limit would restrict unstable prices.³⁵ We discuss this issue in the section below.

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. Essential Energy stated that appropriately designed tolerance limits:

³⁰ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, pp. 5–8.

³¹ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, pp. 4–5.

³² Ergon Energy, *Submission on the Draft decisions: NSW and ACT distribution determinations 2015–16 to 2018–19*, 13 February 2015, p. 37.

³³ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 8.

³⁴ AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, pp. 462–463.

³⁵ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, pp. 6–7.

...ensure that in the event of a material over/under recovery of DUOS revenue that Essential Energy 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.³⁶

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.³⁷

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 efficient costs of providing those services.³⁸ It is also not consistent with the requirement that tariffs minimise distortions to price signals for efficient usage.³⁹

IPART and 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).⁴⁰ 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).⁴¹ The issue of under recovery continued when the ACCC assumed regulation of State Water's Murray-Darling Basin Valleys for the 2014–17 period.⁴² 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.⁴³ As we noted above, the NER emphasise that electricity distributors'

³⁶ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 7.

³⁷ 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.

³⁸ NER, cl 6.18.5(a).

³⁹ NER, cl 6.18.5(g)(3).

⁴⁰ 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.

⁴¹ 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.

⁴² ACCC, *Final decision on State Water pricing application: 2014–15 — 2016–17*, June 2014, pp. 11–13.

⁴³ Water Charge (Infrastructure) Rules 2010, rule 37(2)

tariffs should reflect efficient costs.⁴⁴ 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. The move to cost reflective tariffs is now underway following the AEMC change to the distribution pricing rules in 2014.⁴⁵

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.

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.⁴⁶ This may require negotiation between regulator and distributor during the pricing approval process. There is also the risk, 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.

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.⁴⁷

⁴⁴ NER, cl 6.18.5(e) to 6.18.5(g).

⁴⁵ See: <http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements> (accessed 18 February 2015).

⁴⁶ Essential Energy 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 TAR. For more details, see Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 7.

⁴⁷ NER, cl 6.12.1(19) and 6.18.7.

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.

14.5.1 Reporting on jurisdictional scheme amounts

Jurisdictional schemes amounts are those Essential Energy must pay pursuant to NSW government requirements.⁴⁸ We must decide how Essential Energy 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.⁴⁹

We approve Essential Energy's method of reporting on jurisdictional scheme amounts. It is consistent with the current reporting method, which we previously approved.⁵⁰ See appendix C for the under and over recovery mechanism for jurisdictional schemes.

14.5.2 Side constraints

In its revised regulatory proposal, Essential Energy disagreed with aspects of the draft decision side constraint formula.⁵¹ In particular, Essential Energy 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
- requires that the percentage increase in the weighted average revenue in year t is both ' \leq ' and ' $=$ ' the permissible percentage.⁵²

We agree with Essential Energy 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

Essential Energy's pricing proposals must submit to the AER proposed tariffs and charging parameters. Essential Energy's revenues for standard control services must be consistent with the total annual revenue formula in Figure 14.1, plus any unders and

⁴⁸ 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.

⁴⁹ NER, cl. 6.12.1 (20).

⁵⁰ AER, *Essential Energy: Placeholder determination for the transitional regulatory control period 2014-15*, April 2014, p. 5.

⁵¹ Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, pp. 8–10.

⁵² Essential Energy, *Revised regulatory proposal: Attachment 10.1: Control mechanism for standard control services*, January 2015, p. 9.

overs adjustment needed to move the balance of its DUoS unders and overs account to zero.

Figure 14.1 Revenue cap formula

1. $TAR_t \geq \sum_{i=1}^n \sum_{j=1}^m p_t^{ij} q_t^{ij}$ $i=1, \dots, n$ and $j=1, \dots, m$ and $t=1, \dots, 5$
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 revenue requirement in the Post Tax Revenue Model 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
- the D-factor amounts we approve for 2013–14 (applies to Essential Energy’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.⁵³ S_t for 2015–16 and 2016–17 are set at zero.

⁵³ 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.

Side constraints

Essential Energy 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.⁵⁴

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.

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

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 Essential Energy's pricing proposal for the regulatory year 2015–16).

⁵⁴ NER, cl. 6.18.6

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.⁵⁵ 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).

⁵⁵ 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.

A DUoS unders and overs account

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

Essential Energy 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.

Essential Energy must provide details of calculations in the format set out in Table 14.1. Amounts provided for the most recently completed regulatory year (t-2) must be audited. Amounts provided for the current regulatory year (t-1) will be regarded as an estimate. Amounts provided for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of DUoS charges, Essential Energy 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 14.1 Example calculation of DUoS unders and overs account (\$000, nominal)

	Year t-2 (actual)	Year t-1 (estimate)	Year t (forecast)
Revenue from DUoS charges	46,779	37,297	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) Essential Energy 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, Essential Energy must maintain an unders and overs account for designated pricing proposal charges in its annual pricing proposal under clause 6.18.2(b)(6).⁵⁶

Essential Energy 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 Essential Energy 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.

Essential Energy must provide details of calculations in the format set out in Table 14.2. 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, Essential Energy 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 14.2 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

⁵⁶ NER, cl. 6.12.1(19).

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, Essential Energy must maintain a jurisdictional scheme unders and overs account in its annual pricing proposal under clause 6.18.2(b)(6A) of the NER.

Essential Energy 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 Essential Energy 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 14.3 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, Essential Energy 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 14.3 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	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.⁵⁷

Our decision on the principles that Essential Energy is to adhere to in assigning and re-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.⁵⁸ In particular, we did not approve Essential Energy's proposed procedure for assigning retail customers to tariff classes. We required Essential Energy to amend its procedure to allow retail customers additional protection when they object to being assigned and/or re-assigned to a particular of tariff class.⁵⁹

We maintained this approach for the final decision.

D.2 Reasons for final decision

We accept Essential Energy's submission that a customer's retailer should be the central point of contact for a connected customer. However, we still consider that the procedures should include the AER as a dispute resolution body.

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

Our draft decision considered that Essential Energy should be obligated to notify retail customers in the event that their tariff class is reassigned by the distributor. After discussions and consultation with the NSW distributors, retailers and reviewing their submissions we accept Essential Energy's proposal to notify customers' retailers regarding tariff class reassignments.⁶⁰

⁵⁷ NER, cl 6.12.1(17).

⁵⁸ AER, *Draft decision: Essential Energy 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, pp.33–34.

⁵⁹ AER, *Draft decision: Essential Energy distribution determination 2015–16 to 2018–19: Attachment 14: Control mechanism for standard control services*, November 2014, p. 36.

⁶⁰ 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.

We accept that notifying both the retail customer and the retailer may impose an unwarranted 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 the distributor. As such, correspondence about network tariff class changes may cause confusion to the retail customer about their retail electricity bill.⁶¹

D.2.2 AER as dispute resolution body

Our draft decision included the AER as a dispute resolution body via the dispute resolution process available under Part 10 of the NEL.

Essential Energy's submission considered that section 7 of its revised tariff assignment methodology is consistent with our requirements under the National Energy Retail Law and note that it does not remove the customer's right to access the other forms of dispute resolution contained in parts b and c of the AER's draft decision.⁶²

We do not accept this proposition because a retail customer would not have sufficient knowledge that they have the right to approach the AER to resolve a dispute. Furthermore, our procedures recognise the Ombudsman as the dispute resolution body only to the extent that it has jurisdiction over such matters. In the absence of jurisdiction over such matters, the customer's right to dispute resolution under Part 10 of the NEL is recognised in clause 7(c) of the procedure.

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

Assignment of existing customers to tariff classes at the commencement of the next regulatory control period

1. Each customer who was a customer of Essential Energy immediately prior to 1 July 2015, and who continues to be a customer of Essential Energy as at 1 July 2015, will be taken to be "assigned" to the tariff class which Essential Energy was charging that customer immediately prior to 1 July 2015.

Assignment of new customers to a tariff class during the next regulatory control period

⁶¹ 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.

⁶² Essential Energy, *AER Reference No: AER Essential 051*, March 2015, p. 1.

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

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

5. Essential Energy will review an existing customer's assigned tariff and, following that review, may reassign the existing customer to a another tariff in the following situations:
 - (a) Essential Energy receives a request from the customer's retailer to review the tariff to which the existing customer is assigned; or
 - (b) Essential Energy believes that an existing customer's load characteristics or connection characteristics (or both) have changed such that it is no longer appropriate for that customer to be assigned to the tariff class to which the customer is currently assigned or, a customer no longer has the same or materially similar load or connection characteristics as other customers on the customer's existing tariff, then Essential Energy may reassign that customer to another tariff class.

Notification of proposed assignments and reassignments

6. Essential Energy will notify the customer's retailer of tariff assignments or reassignments in accordance with:
 - (a) When a request is received under 5(a) above, Essential Energy will notify the customer's retailer in writing of its decision, and if the decision is not to change the tariff or to assign a tariff other than that proposed by the retailer, the reasons for the decision; or

- (b) When the customer's tariff is reviewed under 5(b) above, Essential Energy will notify the customer's retailer in writing of the tariff class to which the customer has been assigned or reassigned, prior to the assignment or reassignment occurring.
7. A notice under paragraph 6 above must include advice informing the retailer that they may request further information from Essential Energy and that the retailer or retail customer may object to the proposed reassignment. This notice must specifically include reference to Essential Energy's published procedure for customer complaints and dispute resolution.
 8. If, in response to a notice issued in accordance with section 7 above, Essential Energy receives a request for further information from a retailer or retail customer, then it must provide such information within a reasonable timeframe. If Essential Energy reasonably claims confidentiality over any of the information requested by the retailer or retail customer, then it is not required to provide that information to the retailer or retail customer. If the retailer or retail customer disagrees with such confidentiality claims, he or she may have resort to the complaints and dispute resolution procedure, referred to in section 7 above (as modified for a confidentiality dispute).
 9. If, in response to a notice issued in accordance with paragraph 7 above, a retailer or retail customer makes an objection to Essential Energy about the proposed assignment or reassignment, Essential Energy must reconsider the proposed assignment or reassignment. In doing so Essential Energy must take into consideration the factors in paragraphs 3 and 4 above, and notify the retailer or retail customer in writing of its decision and the reasons for that decision.
 10. If a retailer or retail customer's objection to a tariff class assignment or reassignment is upheld, in accordance with Essential Energy's published procedure for customer complaints and dispute resolution then any adjustment which needs to be made to tariffs will be done by Essential Energy as part of the next annual review of charges.

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

11. Where the charging parameters for a particular tariff result in a basis of charge that varies according to the customer's usage or load profile, Essential Energy will set out in its pricing proposal a method of how it will review and assess the basis on which a customer is charged.