AUSTRALIAN ENERGY
REGULATOR

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Our Ref: D19/162081
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6 November 2019

Tony Narvaez
Managing Director
AusNet Services
Locked Bag 14051
MELBOURNE VIC 8001

Dear ~~Mr Narvaez~~ Tony

Re: Victorian Distribution Reset Timing – Proposed interim measure

I am writing to you in light of recent information from the Victorian Government Department of Environment, Land, Water & Planning (DELWP).

The Victorian Government has recently written to you noting it now has policy approval for the changes to upcoming regulatory control periods for electricity distributors (and future gas access arrangement reviews). However, the delay in obtaining this approval has impacted the AER's intention to conduct consultation on the means of operationalising these changes before your regulatory proposals are due on 31 January 2020.

The AER is cognisant of the need for regulatory certainty for distributors and wishes to provide advice on the approaches to the various building blocks relevant to the extended period (1 January 2021 to 30 June 2021). We consider that this should allow you to complete your regulatory proposals ahead of submitting them to the AER on 31 January 2020.

As such, we recommend as an interim measure, a simple trended-forward methodology for establishing most building blocks and applying the 2018 Rate of Return Instrument. This will enable each distributor to specify the relevant inputs to be included in its roll forward models (RFMs) and post-tax revenue models (PTRMs) for the six month extension period as part of its 2021–26 reset regulatory proposals to the AER.

Under this measure the building block inputs for 1 January 2021 to 30 June 2021 using the amended ½ year PTRM would be treated as follows:

- Opex: the previous year's allowance trended forward (by the relevant rate of change), then halved.
- Capex: the previous year's allowance halved.

- Opening regulatory asset base (RAB) as at 1 January 2021, based on actual capex/latest estimates for 2016–20, using the standard 5 year RFM for that period.
- Depreciation of capex is based on existing asset classes/lives/methods. For depreciation of existing assets at 1 January 2021, the distributor is to use the depreciation model approved for the current regulatory control period adjusted to reflect the ½ year.
- No revenue adjustments for 2016–20 efficiency benefit sharing scheme (EBSS)/capital expenditure sharing scheme (CESS) calculations—these would be deferred to begin from 1 July 2021.
- Rate of return based on the 2018 Rate of Return Instrument, reflecting the agreed implementation method (provided via email on 4 October 2019).
- Corporate income tax is based on the approach used for the current regulatory control period, except for gamma, which is to be based on the 2018 Rate of Return Instrument.

For 1 January 2021 to 30 June 2021, we propose that in relation to the incentive schemes and tax approach:

- EBSS would apply
- CESS would not apply
- Service target performance incentive scheme (STPIS) would apply; and
- 2018 tax review changes would not apply.

Save for the application of the 2018 Rate of Return Instrument, this approach treats the period of 1 January 2021 to 30 June 2021 as an extension of the current regulatory control period, consistent with the Victorian Government's current stated policy intention.

For completeness, I note that the total revenues for the period 1 July 2021 to 30 June 2026 are to be established using the following models:

- Amended 5.5 year RFM (based on extending the standard 5 year RFM above) to establish the opening RAB as at 1 July 2021.
- A depreciation model that continues the year-by-year tracking approach approved in the current regulatory control period for calculating the depreciation schedules of existing assets at 1 July 2021.
- The standard 5 year PTRM, which now incorporates the findings of the 2018 tax review.

The AER recommends that the use of the 'trended-forward placeholders' for 1 January to 30 June 2021 could be referenced in the main (full 5 year) regulatory proposal, where necessary. However, in treating the 6 month period as 'supplemental', this material might be best placed as an appendix to the regulatory proposal so it is clear to stakeholders who may wish to comment on this approach in their submissions to the proposals. All material would be submitted to the AER by 31 January 2020 in line with our previous advice (via letter of 30 May 2019).

The AER notes the use of 'trended-forward placeholders' is a simple and pragmatic approach. It aims to reduce the complexity of the process for determining a price path for the extended (six month) period and aligns with the policy intent of the Victorian Government. Notwithstanding, the AER will still need to finalise its position on these placeholders by August/September 2020 to enable distributors to submit tariff proposals to give effect to the application of the Rate of Return Instrument on 1 January 2021. Further, the AER will make a decision on whether the placeholders should be trued up post 1 July 2021 tariffs as part of its regulatory determination, initially in its draft decision and, having considered all views, in its final decision due in April 2021.

The AER intends to place a copy of this letter on its website for the information of stakeholders and consumers. Please contact Chris Pattas, General Manager, Networks (Distribution) on 03 9290 1470 if you would like to discuss this matter further.

Yours sincerely

Clare Savage
Chair
Australian Energy Regulator

Sent by email on: 06.11.2019

Cc: Charlotte Eddy, Manager Economic Regulation, AusNet Services