FINAL DECISION

Power and Water
Distribution Determination
2019 to 2024

Attachment 13
Control mechanisms

April 2019

AUSTRALIAN
ENERGY
REGULATOR

Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Power and Water Corporation for the 2019–2024 regulatory control period. It should be read with all other parts of the final determination.

The final determination includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Return on debt transition

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CPI	consumer price index
distributor	distribution network service provider
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
DPPC	designated pricing proposal charges
DUoS	distribution use of system
F&A	framework and approach
NT NER or the rules	National Electricity Rules As in force in the Northern Territory
NSP	network service provider
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
STPIS	service target performance incentive scheme
TAR	total allowable revenue
WACC	weighted average cost of capital

13 Control mechanisms

A control mechanism imposes limits over the prices of both direct control services and alternative control services and/or the revenues that a distribution network service provider can recover from customers.

Power and Water accepted our draft decision on control mechanism formulas. However, we have identified amendments to be applied to our control mechanism formulas. Specifically, this attachment sets out our final decision on the control mechanism formulas to apply to Power and Water, including changes to the side constraint formula to include adjustments for incentive schemes (as identified by Endeavour Energy in its revised proposal).[1] We consider that this amendment is also appropriate for Power and Water.[2]

13.1 Final decision

Our final decision is the same as our draft decision, except that we have also decided to include variables representing incentive schemes in the side constraint formula.

13.2 Assessment approach

Our assessment approach is unchanged from the description set out in our draft decision.

13.3 Reasons for final decision for side constraints

In their revised proposal, Endeavour Energy noted that the side constraint formula does not include I-factor adjustments that represent incentive schemes. Endeavour Energy proposed that the side constraint formula be updated to include adjustments for these factors relating to incentive schemes, as calculated in the revenue cap control mechanism.[3]

We agree with Endeavour Energy's proposal that adjustments for the incentive schemes, as represented by the I-factor in the revenue cap control mechanism, should be included in the side constraints formula. This adjustment reflects the NER.[4] Figure 13.1 sets out the revised side constraints formula.

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[1]   Endeavour Energy, *Revised regulatory proposal 01 July 2019 – 30 June 2024*, January 2019, p. 28.

[2]   NER, cl. 6.2.5(c)(4).

[3]   Endeavour Energy, *Revised regulatory proposal 01 July 2019 – 30 June 2024*, January 2019, p. 28.

[4]   NER, cl. 6.18.6(d)(1).

Figure 13.1 Side Constraint formula[5]

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

where:

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

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

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

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[6] from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

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

divided by

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

minus one.

For example, for 2020-21, year t-2 is the December quarter 2018 and year t-1 is the December quarter 2019.

X_t is the X factor for each year of the 2019-24 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the rate of return instrument,[7] applied for the relevant year. If X>0, then X will be set equal to zero for the purposes of the side constraint formula.

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[5]   All parameters are in nominal terms unless otherwise specified.

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

[7]   AER, *2018 Rate of Return Instrument*, December 2018.

I'_t is the annual percentage change from the sum of incentive schemes adjustments in year t relating to approved demand management incentive scheme amounts from year t-2.[8]

B'_t is the annual percentage change from the sum of annual adjustment factors for year t and includes the true-up for any under or over recovery of actual revenue collected through DUoS charges calculated using the method under the revenue cap formula.[9]

C'_t is the annual percentage change from the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

With the exception of the CPI and the X factor, the percentage for each of the other factors can be calculated by dividing the incremental revenues (as used in the total annual revenue formula) for each factor by the expected revenues for the regulatory year t-1 (based on the prices in year t-1 multiplied by the forecast quantities for year t).

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[8]   If the DMIS was not in force or no incentives were accrued in year t-2, this parameter will be taken to be 0. Our subsequent distribution determination for Power and Water will include a final carryover from the demand management innovation allowance mechanism (Mechanism). The Mechanism will result in a lump-sum carryover from the 2019-24 regulatory control period being deducted from/added to the allowed revenue in the second regulatory year of the subsequent regulatory control period.

[9]   AER, *Power and Water Corporation draft decision 2019-2024 - Attachment 13*, September 2018, pp. 14-15.