# DRAFT DECISION

## Power and Water Distribution Determination 2019 to 2024

## Overview

September 2018

AUSTRALIAN ENERGY REGULATOR

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# Invitation for submissions

Interested parties are invited to make submissions on our draft decision by 11 January 2019.

We will consider and respond to all submissions received by that date in our final determination.

Submissions should be sent to: NTPowerWater2019@aer.gov.au.

Alternatively, submissions can be sent to:

Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

(1) clearly identify the information that is the subject of the confidentiality claim

(2) provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the *ACCC/AER Information Policy* (June 2014), which is available on our website.[1]

[1] https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information

# Note

This overview forms part of the AER's draft decision on Power and Water's 2019–24 distribution determination. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

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Attachment 15 – Alternative control services

Attachment 16 – Negotiated services framework and criteria

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

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# Shortened forms

| Shortened form | Extended form |
|---|---|
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| ATO | Australian Tax Office |
| augex | augmentation expenditure |
| capex | capital expenditure |
| CCP | Consumer Challenge Panel |
| CCP 13 | Consumer Challenge Panel, sub-panel 13 |
| CESS | capital expenditure sharing scheme |
| CPI | consumer price index |
| DRP | debt risk premium |
| DMIAM | demand management innovation allowance mechanism |
| DMIS | demand management incentive scheme |
| distributor | distribution network service provider |
| DUoS | distribution use of system |
| EBSS | efficiency benefit sharing scheme |
| ECA | Energy Consumers Australia |
| Pricing Order | electricity pricing order |
| 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 |

| Shortened form | Extended form |
|---|---|
| NT NER or the rules | National Electricity Rules As in force in the Northern Territory |
| NSP | network service provider |
| opex | operating expenditure |
| PPI | partial performance indicators |
| Pricing Order | electricity pricing order |
| 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 |
| WACC | weighted average cost of capital |

# About this decision

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. We regulate energy networks in all jurisdictions except Western Australia. We set the amount of revenue that network businesses can recover from customers for using these networks.

The National Electricity Law and Rules (NEL and NT NER) provide the regulatory framework governing electricity transmission and distribution networks. Our work under this framework is guided by the National Electricity Objective (NEO):[2]

> …to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

Power and Water is the electricity distribution network service provider for the Northern Territory. It is important to note that this is the first determination being made for Power and Water under the NEL and NT NER. The current determination for the period 2014–19 was made by the Utilities Commission of the Northern Territory. We assumed responsibility for the economic regulation of Power and Water's electricity distribution services on 1 July 2015.

This draft decision provides Power and Water and its stakeholders with our draft findings based on the information Power and Water have supplied and the response to various questions we have posed. The draft decision sets out where we require Power and Water to provide more information or further justify their proposal so that we may reach a final decision in April 2019. We have provided Power and Water with some guidance on our draft findings and the business has indicated in many areas that further information and justification will be forthcoming. In other areas the business has submitted further information, however, not within a timeframe that has permitted us to take into account for this draft decision. We will be considering all information and stakeholder submissions put before us in arriving at our final decision.

On 31 January 2018, Power and Water submitted its regulatory proposal for the five years commencing 1 July 2019. Its proposal sets out the revenue it proposes to recover from customers for the provision of electricity distribution services, and the methodology it proposes to use to set its prices each year.

The key component of our distribution determination for Power and Water will be the total revenue it can recover from customers for the provision of common distribution services (or 'standard control services') –those used by most of Power and Water's

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[2] NEL, s. 7.

customers. This is our 'building block determination' (section 2), and will form the basis of Power and Water's distribution tariffs for the 2019–24 regulatory control period. Power and Water's Tariff Structure Statement (TSS) sets out the tariff structure through which it will recover its regulated revenue for standard control services from customers (section 4).

Power and Water also provides alternative control services, such as metering services, the costs of which are separately recovered from users of those services directly, through a capped price on the individual service.[3] We discuss Power and Water's alternative control services in attachment 15 to this draft decision.

Power and Water will now have the opportunity to submit a revised proposal in response to this draft decision by 29 November 2018. Submissions from interested stakeholders on both the draft decision and revised proposal are invited by 11 January 2019.

The decisions we make and the actions we take affect a wide range of individuals, businesses and organisations. Hearing from those affected by our work helps us make better decisions, provides greater transparency and predictability, and builds trust and confidence in the regulatory regime.

Throughout this review we will also have the benefit of advice from our Consumer Challenge Panel (CCP13).[4] The expert members of the CCP help us to make better regulatory decisions by providing input on issues of importance to consumers and bringing consumer perspectives to our processes.

The table below sets out the key milestones for our review of Power and Water's proposal:

| Milestone | Date |
|---|---|
| Power and Water submitted its proposal | 31 January 2018 |
| AER issues paper published | 28 March 2018 |
| Public forum on Power and Water's proposal held in Darwin | 12 April 2018 |
| Submissions on AER's issues paper Power and Water's proposal closed | 16 May 2018 |
| AER draft decision published | 27 September 2018 |
| Public forum on draft decision | 29 October 2018 |
| Power and Water submits revised proposal | 29 November 2018 |
| Submissions on draft decision and revised proposal due | 11 January 2019 |
| AER final decision to be published | April 2019 |

[3] AER, *Framework and Approach for Power and Water Corporation*, July 2017, pp. 41–43.

[4] Members of CCP13 are Andrew Nance and Mark Grenning. Member biographies are available on our website: https://www.aer.gov.au/about-us/consumer-challenge-panel

# 1 Our draft decision

Our draft decision allows Power and Water to recover $758.8 million ($nominal, smoothed) from its customers over the five years from 1 July 2019 to 30 June 2024. This compares to Power and Water's proposal for $927.9 million ($nominal, smoothed) in revenue. This is a decrease of $166.2 million ($2018–19) or 19.1 per cent in revenue allowed[5] in the 2014–19 regulatory control period. We estimate that this draft decision, if implemented, would result in:

- a 9.2 per cent nominal reduction in Power and Water's network tariffs over the 2019–24 regulatory control period. This equates to an average annual reduction of 1.9 per cent. This means that network tariffs on 1 July 2023 will be 9.2% lower than they are on 1 July 2018.
- A nominal reduction of 9.2 per cent in Power and Water's average annual electricity bill for residential customers in 2019–20 compared to the current, 2018–19 level. This is followed by average annual increases of 1.4 per cent over the remaining four years (2020–21 to 2023–24).

Pricing that is cost reflective and stable is one of the key themes Power and Water has identified in its proposal. In the lead up to submission of its proposal, Power and Water undertook the largest network focussed customer engagement program in its history, through the combination of consumer focus groups, customer interviews, deliberative forums and presentations to and feedback from its Customer Advisory Council. Through these, Power and Water identified a number of key themes:

- maintaining reliability and responsiveness levels for most customers and improving reliability for poor performing rural and urban areas
- support for demand charges for all customers who have a demand-capable meter and the move to cost reflective tariffs for large energy users

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[5] This is compared to the Ministerial Direction allowance. It is important to note that there were in affect two revenue allowances given to Power and Water in the current 2014–19 period –the initial allowance determined by the Utilities Commission in April 2014 and the lower allowance subsequently determined by the NT Government by Ministerial Direction. It is this lower revenue path that Power and Water recovered from customers during the 2014–19 regulatory control period. It should be noted that the Ministerial Direction revenue included metering services, which going forward will be recovered separately in alternative control services, so this is not a like for like comparison.

The Utilities Commission made its 2014 Network Price Determination under the Northern Territories Network Access Code on 24 April 2014. However, on 13 May and 6 June 2014, the Treasurer, as the Shareholding Minister of Power and Water, made a direction under the Government Owned Corporations Act 2001 (NT), reducing Power and Water's revenue path. There are a number of comparisons throughout Power and Water's proposal and this draft decision to the allowance made by the Utilities Commission and the Ministerial Direction allowance. In the most part we will be making comparisons to the Ministerial Direction allowance. Also see AER, *Issues Paper, Power and Water Corporation Distribution Determination 2019 to 2024*, March 2018, p. 13.

- supporting new technology, including the roll out of smart meters to all customers on a new and replacement basis.

Consumer engagement has been a central element of Power and Water's key themes, as reflected in its revenue proposal and is considered in further detail in section 1.4 below. Consumers expect value for money and there needs to be a high level of confidence that the regulatory framework under which Power and Water operates is serving the desired outcomes for consumers.

This is the first time that Power and Water has submitted a regulatory proposal, tariff structure statement and regulatory information notices to the AER. We recognise that Power and Water, and the Northern Territory energy market have undergone extensive changes in recent years, with:

- the disaggregation of the vertically integrated government owned business on 1 July 2014; and
- the progressive adoption of the national framework, which will continue up until the commencement of the regulatory control period on 1 July 2019.

Power and Water has undergone significant change in a relatively short period of time compared to network businesses in other jurisdictions. We understand the challenges that this creates for Power and Water, and we expect that Power and Water will be driven to make continuing improvements.

Our draft decision supports a number of the key themes expressed through Power and Water's regulatory proposal and reflecting input from its stakeholders. We have allowed expenditure for improving reliability for poor performing rural and urban areas and to enable the roll out of smart meters on a new and replacement basis. We are also supportive of Power and Water's implementation of more cost reflective tariffs.

Our draft decision allows a lower revenue compared to what has been proposed by Power and Water. We have identified a number of additional efficiencies that we consider Power and Water should realise during the 2019–24 regulatory control period. We have made reductions to Power and Water's rate of return on investments, and capital and operating expenditures. Our concerns with Power and Water's proposed forecast expenditures align with concerns expressed by some consumers.

We consider that Power and Water has made progress in enhancing the quality of its business planning, investment and operations. Power and Water has submitted a proposal that reflects the development of its business practices over recent years, and we commend Power and Water for achieving this milestone. Although the proposal had a number of good features, it lacked the underlying detail that we would expect in support of the claims made. Power and Water will need to continue to work on improving the quality of its supporting information.

We recognise Power and Water manages a small, remote but highly geographically dispersed network that is subject to a number of diverse environmental factors. While Power and Water has made progress towards improving the overall condition and performance of its network, work on enhancing its asset management practices should continue. This includes the quantification of risks that it seeks to address through network expenditure and embracing demand management as a core aspect of its

investment considerations. Our capex alternative, for example, considered a more targeted refurbishment of the Berrimah zone substation and a small non-network solution for the Wishart zone substation.

Power and Water's proposal recognised the business' past inefficiencies and that there is room for improvement as it continues its drive to reduce costs over time.[6] For this reason, Power and Water proposed a targeted reduction of $35.2 million ($2018–19), or 10 per cent, to its operating expenditure over the 2019–24 regulatory control period. Its proposal also included opex rate of change and step change increases.

Our draft decision with respect to opex is $33.4 million ($2018–19) or 9.8 per cent lower than Power and Water's proposal, resulting in savings to customers. We determined that Power and Water's revealed costs in 2016–17 do not reflect efficient costs. For this reason, we have not used Power and Water's 2016–17 opex as a starting point, even with its proposed efficiency factor, to forecast opex over the 2019–24 regulatory control period. We have forecast a lower rate of change reflecting lower estimates of price and output growth. We have forecast zero productivity growth consistent with Power and Water's proposal. However, we are reviewing our approach to forecasting productivity, and as a result our estimate of productivity growth may change in our final decision.[7] We consider the majority of Power and Water's step changes are not required and can be largely met by Power and Water's current resourcing and operational efficiencies not been reflected in Power and Water's opex forecast.

Based on the information provided, our draft decision reflects our view of the efficient level of operating expenditure required by a prudent operator.

Our draft decision is to not apply the EBSS in the 2019–24 regulatory control period. This is related to our decision to not use Power and Water's revealed opex to forecast opex over 2019–24. We consider Power and Water will face strong continuous incentives to make efficiency improvements without an EBSS.

## 1.1 What is driving revenue

The changing impact of inflation over time makes it difficult to compare revenue from one period to the next on a like-for-like basis. To do this we use 'real' values based on a common year (in this case 2018–19), which have been adjusted to remove the impact of inflation.

In real terms, our draft decision would allow 19.1 per cent less revenue than recovered from customers in the 2014–19 regulatory control period. As Figure 1 shows, this is recovered through a large reduction in revenue in the first year commencing 1 July 2019, followed by gradual increases per annum over the remaining four years.

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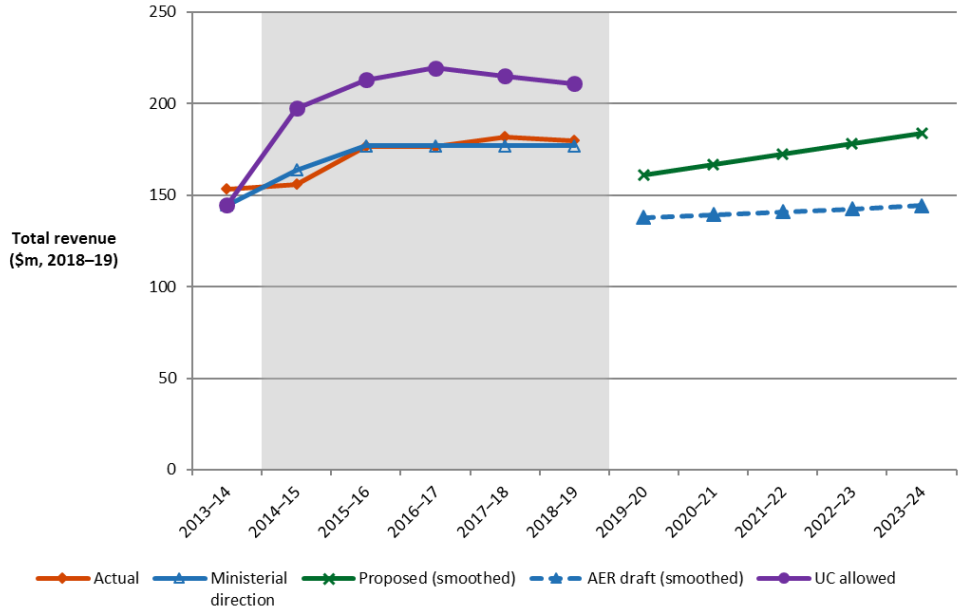
6 Power and Water, *Regulatory proposal*, 16 March 2018, p. 78.

7 See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-our-approach-to-forecasting-opex-productivity-growth-for-electricity-distributors.

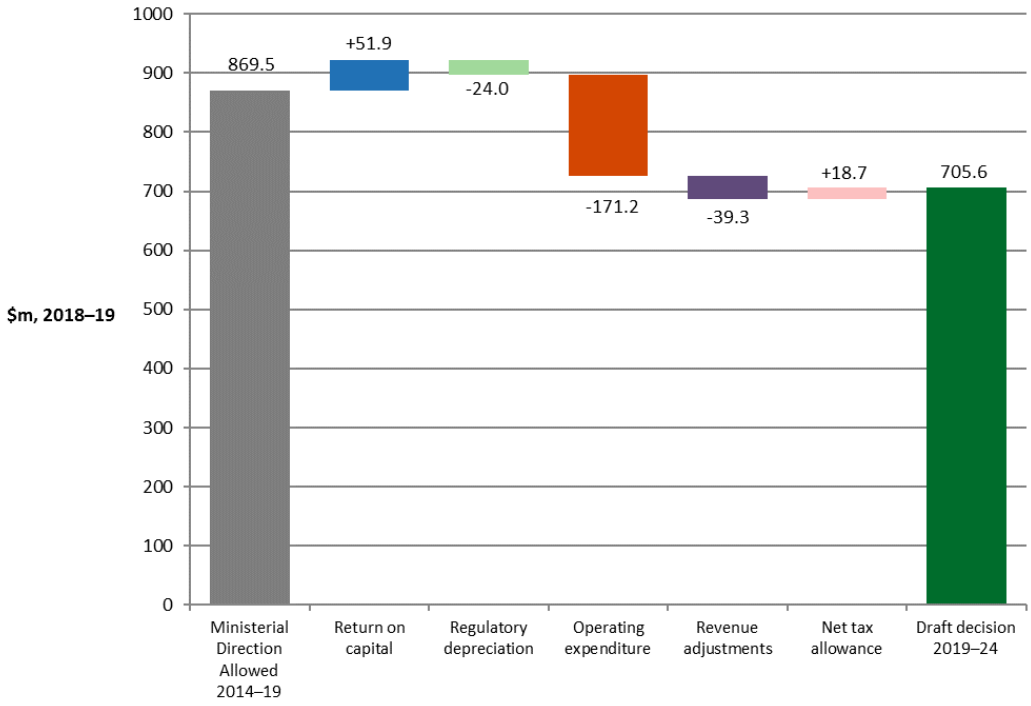
## Figure 1 Revenue over time ($million, 2018–19)




Source: AER analysis.

Figure 2 below highlights the key drivers of the decrease in Power and Water's revenues that would result from this draft decision, by reference to the revenue 'building blocks' that form the basis of our assessment. This figure shows a comparison of our draft decision against the allowances for the 2014–19 regulatory control period determined by Ministerial Direction– these are the key drivers of the change.

## Figure 2 Change in total revenue from 2014–19 to 2019–24 - Ministerial Direction approved allowance compared to AER draft decision ($m 2018–19)




Source: AER analysis.

There are a number of factors contributing to the change in revenue from period to period.

Power and Water's revenue for 2019–24 is being driven by:

- increases in capex
- a higher rate of return compared to that established by the Ministerial Direction
- reduction in regulatory depreciation
- opex reductions; this is a key driver for the reduction in revenue for the next period
- a negative revenue adjustment, which relates to the Utilities Commission's 2013 cost pass through determination carryover from the 2014–19 Network Price Determination made by the Utilities Commission.[8] The Utilities Commission total revenue requirement for the 2014–19 regulatory control period included an

[8] Utilities Commission, *2014 Network Price Determination; Final Determination, Part A - Statement of Reasons*, April 2014, pp. 139–140.

additional $42 million carried over for the cost pass through arising from the implementation of the Davies Review recommendations during the previous period[9]

- increases in corporate income tax, which is largely a result of the move to the post-tax revenue framework.[10]

## 1.2 Key differences between our draft decision and Power and Water's proposal

As we noted above, our draft decision does not reflect the full $927.9 in revenue ($nominal, smoothed) proposed by Power and Water, and instead allows a lower total revenue of $758.8 million. In a number of areas, the information provided has not justified that Power and Water's proposal is prudent and efficient.

These include:

- Power and Water's total forecast capex, which includes provision for a level of capital investment that we consider goes beyond what is efficient and prudent for the maintenance and operation of its network and given expected demand

  The lower capex forecast we have substituted for the purposes of this draft decision has resulted in a smaller projected increase in Power and Water's RAB over the 2019–24 regulatory control period, and a reduction in the regulatory depreciation allowance. We have estimated a capex forecast of $315.6 million (17.6 per cent reduction) compared to Power and Water's proposed capex of $383.0 million. This is driven by reductions in all categories of capex, including repex, augex, non-network expenditure, such as IT costs, and overheads (section 2.4)

- an additional $33.4 million ($2018–19) or 9.8 per cent in forecast opex savings. We consider Power and Water's revealed costs in 2016–17 do not reflect efficient costs and we have determined an alternative base year opex forecast. We have forecast lower price and output growth. We also consider the majority of Power and Water's step changes are not required (section 2.5)

- the rate of return, which is a large contributor to the difference between our draft decision and Power and Water's proposal (and therefore the return on capital). We have approved a rate of return of 5.22 per cent compared to Power and Water's proposed 6.62 per cent. This is because we have not incorporated Power and Water's proposed immediate transition to the trailing average approach for debt. Rather, we will commence a 10 year transition to the trailing average in the first year of Power and Water's 2019–24 regulatory control period. Our draft decision

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[9] Utilities Commission, *2014 Network Price Determination; Final Determination, Part B - Network Price Determination*, April 2014, p. 5.

[10] The change to the post-tax framework has resulted in a new tax building block and there is a corresponding lower post-tax rate of return compared to a pre-tax rate of return, all things being equal.

adopts the approach proposed in our draft 2018 rate of return guideline[11] to calculate a lower rate of return

Also reflecting our draft 2018 rate of return guideline, our draft decision adopts a value of imputation credits (gamma) of 0.5 compared to Power and Water's proposed 0.4, which has contributed to the reduction in the corporate income tax allowance relative to Power and Water's proposal (section 2.2)

- a $29.2 million ($nominal) reduction in the depreciation allowance (section 2.3)
- a $17.3 million ($nominal) reduction in the corporate income tax (section 2.6).

Before we make our final decision, Power and Water will have the opportunity to respond to these concerns in its revised proposal. We will also seek further submissions from stakeholders on both our draft decision and Power and Water's revised proposal.

We are also expecting further adjustments to Power and Water's mix of capex and opex as a result of the NT Government's recent announcement to fund undergrounding in Darwin in response to Cyclone Marcus.[12] It is anticipated that new undergrounded cables will displace overhead assets, impacting on the future replacement capex and on-going maintenance.

## 1.3 Expected impact of our draft decision on electricity bills

Power and Water's proposed charges are for the network[13] component of the electricity bill for NT. Power and Water's network charges make up about 44 per cent of the average household electricity bill, and 35 per cent for the average small business customer, in the NT.[14]

Each of the components in the electricity supply chain, as reflected in Figure 3 below, can affect the electricity charges that customers receive in their bills. The cost of the network components of the electricity supply chain are ultimately recovered in electricity retail charges.

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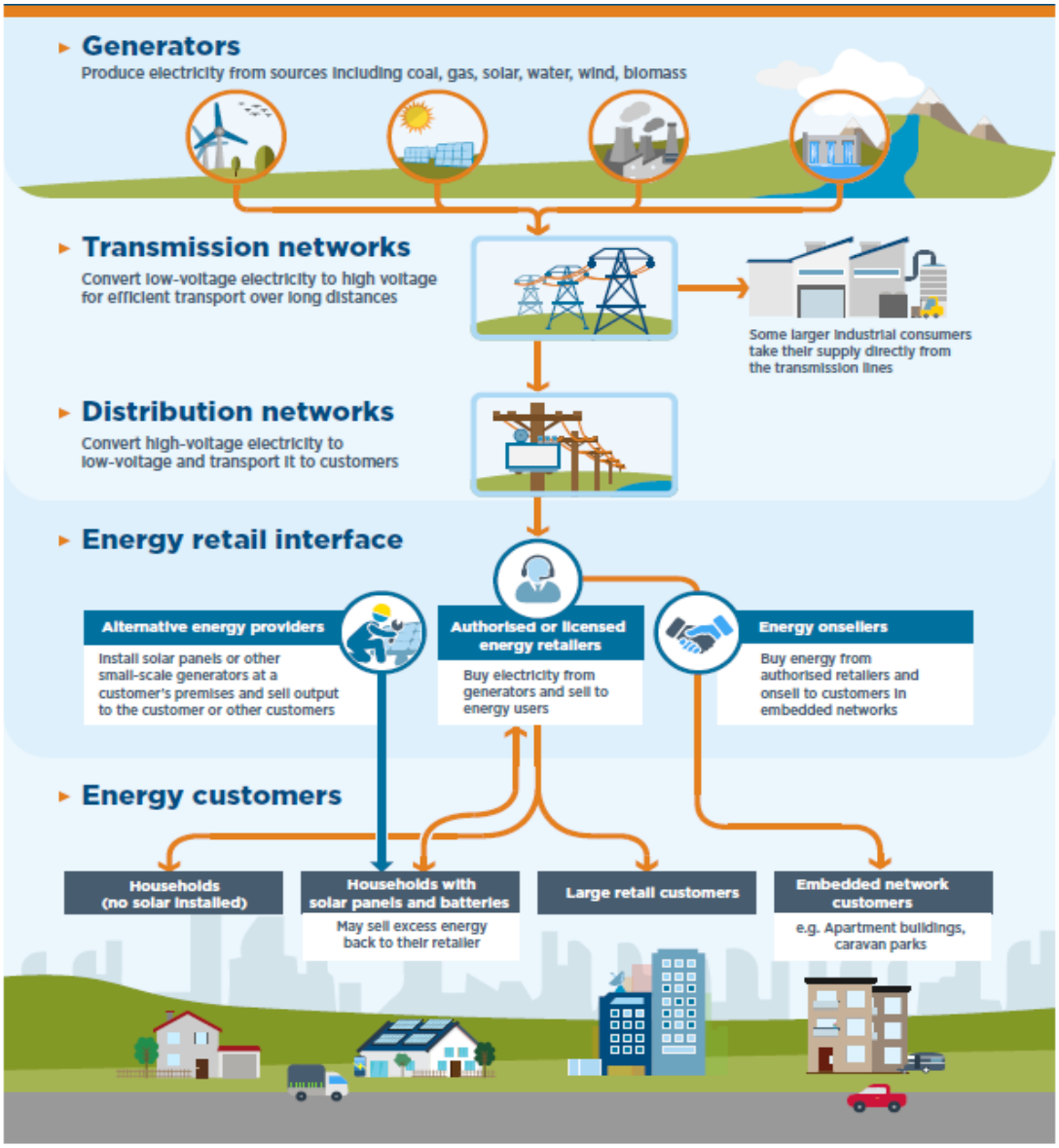
11 Consultation on our draft 2018 guideline is ongoing, and is expected to conclude in December 2018. Legislation currently before the South Australian House of Assembly will (if passed) make our final 2018 rate of return guideline binding on this and other decisions.

12 Planning and design work will commence immediately with $5 million, with construction works to commence in 2018/19 supported by additional funding of $10 million per annum. See Media Release, Nicole Mansion, Treasurer; Budget 2018: Undergrounding Power Back on Track, 27 April 2018.

13 All of Power and Water's electricity network is deemed to be distribution for the purposes of economic regulation. Darwin, Katherine, Tennant Creek, Alice Springs and the Darwin to Katherine 132kV power line represent the local distribution systems in the NT (See section 9 and schedule 2 of the *National Electricity (Northern Territory)(National Uniform) Legislation Act)*.

14 Power and Water, *Revenue Proposal Overview*, Attachment 01.1, p. 1.

## Figure 3 Electricity supply chain




Source: AER, State of the Energy Market, May 2017, p. 18.

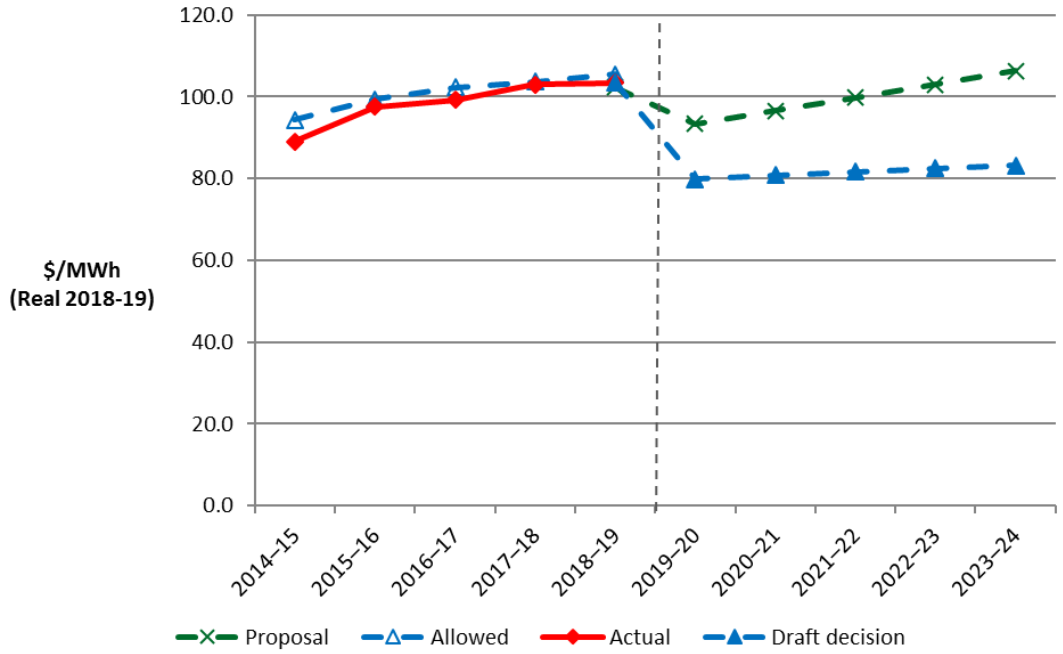
### *Distribution charges*

Figure 4 below shows the indicative average distribution charges over the period 2014–15 to 2023–24 in real dollar terms. These amounts are an approximation of distribution charges as they are simply Power and Water's forecast revenue divided by its forecast energy delivered (measured in MWh). Based on this, the indicative distribution charges are expected to decrease from an average of $98.4 per MWh[15]

[15] Distribution charges for 2014–19 are based on actual revenue.

over 2014–19 to an average of $81.6 per MWh over 2019–24. This is a 17.1 per cent decline in distribution charges between the two periods.

### Figure 4 Indicative distribution price path for NT ($/MWh, 2018–19)




Source: AER analysis.

#### *Potential bill impact*

We expect that, holding other components of bills constant, our draft decision will result in the average annual electricity bill for residential customers in the NT to decrease by about $102 or 4 per cent ($nominal) in 2023–24 compared to the current, 2018–19 level. This involves a $231 decrease in the first year of regulatory control period (2019–20) followed by gradual increases of around $32 for the remaining four years of the 2019–24 regulatory control period.

We note the majority of customers in the NT are subject to the government's Electricity Pricing Order (Pricing Order). This caps retail prices for customers using less than 750MWh of electricity per annum.[16] It is important to recognise that the customer impact of any changes to Power and Water's revenue as a result of our decision is constrained by the Pricing Order.

The Pricing Order stipulates a fixed charge and volume based tariff structure (including a time of use tariff) but does not account for demand based tariffs. The Pricing Order

[16] The fixed daily charge and the charge for the volume of electricity consumed is not to exceed the amount specified in the Pricing Order (See clauses 4 and 5). The Pricing Order can be found on the Utilities Commission's website at: http://www.utilicom.nt.gov.au/Electricity/pricing/Pages/Electricity-Retail-Pricing.aspx.

prevents price increases but does allow for prices to be set lower than prescribed. However, it is up to retailers to determine the price in accordance with the Pricing Order and pass on to customers any cost savings from lower network revenue determined for Power and Water. This means only a small number of large customers who are not covered by this retail price protection benefit most from our determination.

For large customers with an average annual electricity usage of around 1000 MWh per annum, we expect that the distribution component of the average annual electricity bill in 2023–24 to decrease by about $8199 ($nominal) from the 2018–19 level.[17]

Further detail on our draft decision impact on overall bills is set out in attachment 1.

## 1.4 Power and Water's consumer engagement

The NEO puts the long term interests of consumers at the centre of our decisions as a regulator and the way Power and Water operates its network. An important part of this is ensuring the regulatory proposals Power and Water puts to us for approval reflects the NEO, and that Power and Water has engaged with its consumers to determine how best to provide services that align with their long term interests.

Consumer engagement in this context is about Power and Water working openly and collaboratively with consumers and providing opportunities for their views and preferences to be heard and to influence Power and Water's decisions. In the regulatory process, stronger consumer engagement can help us test service providers' expenditure proposals, and can raise alternative views on matters such as service priorities, capital expenditure proposals and tariff structures.

Power and Water undertook a comprehensive engagement process in developing its regulatory proposal, commencing in February 2017. It's the largest network consumer engagement and research program in its history and included establishing a Customer Advisory Council (CAC)[18], undertaking focus groups, in-depth customer and stakeholder interviews, deliberative forums, a large energy users forum and tariff structure statement consultation.[19] This comes at a time of significant changes in the way that Power and Water manages its business and we acknowledge the challenges that this presents a business the size of Power and Water and the work it has done to get the business and customers engaged. Power and Water is on a good path to recognising the importance of consumer engagement and the value it delivers for the network business and customers. Power and Water's consumer engagement program represents a reasonable starting point to build on into the future.

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17 This equates to a 3.2 per cent decrease in the average large customer's total electricity bill over five years.

18 Power and Water's Consumer Advisory Council is made up of 14 consumer representative bodies and other stakeholders including: Central Australian Health Services, NT Chamber of Commerce, The GPT Group, St Vincent De Paul, NT Farmers Association, Charles Darwin University, Tenant Advice Council, Master Builders Association, Council on the Aging (COTA), Multicultural Council of Australia, Urban Development Institute, NT Airports, Environment Centre and Department of Defence.

19 PowerWater, *Engagement Overview; How we engaged, what we heard and how we are responding*, 31 January 2018.

We tasked CCP13 specifically with advising us on the effectiveness of Power and Water's engagement activities with consumers and how this was reflected in the development of its proposal. CCP13 attended a number of Power and Water's workshops and met on several occasions with Power and Water executives and staff. CCP13 also talked to a number of stakeholders who are represented on Power and Water's CAC and met with a number of large consumers.

We were particularly encouraged to see CCP13 confirm that:

- given Power and Water's circumstances, it undertook a comprehensive and well planned consumer engagement program[20]
- senior management of Power and Water were represented in a number of workshops and have shown commitment to engagement with consumers which bodes well for genuine consumer consciousness becoming part of the culture of Power and Water[21]
- Power and Water has demonstrated a desire to learn and improve on its consumer engagement approaches[22]
- Power and Water was also unique in the quality of information presented at its large customer workshop. Attendees at its large customer workshop were provided individually calculated information detailing the impacts of the new tariff options on their sites.

There are a number of areas in which we think further improvements in Power and Water's consumer engagement can be achieved. Although Power and Water published a draft customer overview of its TSS, following consultation with its CAC, it did not seek to consult on a broader preliminary revenue proposal covering its proposed capex, opex, rate of return and other aspects. We have found that this has proved to be a valuable aspect of the consumer engagement process, in helping to shape the businesses revenue proposals, in other jurisdictions.

The CCP13 also expressed concerns in Power and Water's engagement process:

- large users, who are not subject to the NT Pricing Order, are the only customers who might see an impact in their electricity bill because of Power and Water's revenue proposal. On this basis, it would have been better for Power and Water to engage over a longer period with more of these customers[23]

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[20] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period,* 16 May 2018, p. 26.

[21] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period,* 16 May 2018, p. 4.

[22] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period,* 16 May 2018, p. 26.

[23] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period*, 16 May 2018, p. 24.

- the need to continue the engagement beyond lodging the revenue proposal. There has been little engagement by Power and Water following lodgement of its revenue proposal in January 2018.[24] The key issue will be continuing to improve the knowledge and capability of consumer representatives, particularly as there is no ECA funding.

Consistent with CCP13's advice[25], we accept that Power and Water has undertaken a reasonable consumer engagement process and is reasonably informed of consumers interests and concerns in framing its revenue proposal.

[24] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period*, 16 May 2018, p. 17.

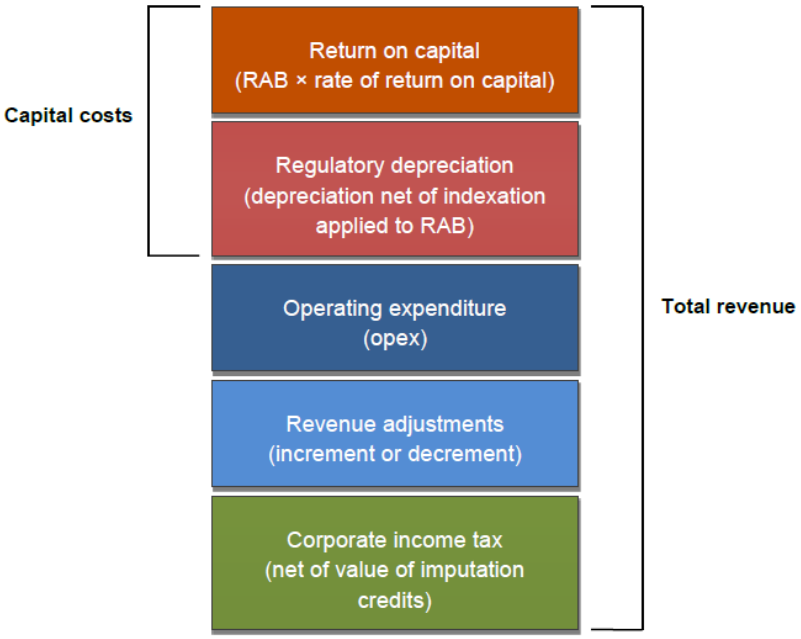
[25] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period, 16 May 2018*, p. 4.

# 2 Key components of our draft decision on revenue

The total revenue Power and Water has proposed reflects its forecast of the efficient cost of providing its distribution network services over the 2019–24 regulatory control period. Power and Water's proposal, and our assessment of it under the NEL and NER, are based on a 'building block' approach to determine a total revenue allowance (see Figure 5) which looks at five cost components:

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business) (section 2.2)
- depreciation of the RAB (or return of capital, to return the initial investment to investors over time) (section 2.3)
    - capex—the capital costs and expenditure incurred in the provision of network services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. The forecast capex approved in our decisions directly affects the size of the RAB and therefore the revenue generated from the return on capital and depreciation building blocks (section 2.4)
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services (section 2.5)
- revenue increments or decrements carried over from the previous regulatory control period, including the application of incentive schemes, such as the Capital Expenditure Sharing Scheme (CESS) and the Demand Management Innovation Allowance Mechanism (DMIAM) allowance for 2019–24 (See attachment 10 for further discussion on the DMIAM)
- the estimated cost of corporate income tax (section 2.6)

## Figure 5 The building block approach for determining total revenue




We use an incentive approach where, once regulated revenues are set for a five year period, networks who keep actual costs below the regulatory forecast of costs retain part of the benefit. This benchmark incentive framework is a foundation of our regulatory approach and promotes the delivery of the NEO. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

Our draft decision on Power and Water's revenues for the 2019–24 regulatory control period is set out in Table 2.1 below.

## Table 2.1 AER's draft decision on Power and Water's revenues for the 2019–24 regulatory control period ($million, nominal)

| | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | Total |
|---|---|---|---|---|---|---|
| Return on capital | 50.4 | 53.5 | 55.9 | 58.8 | 60.1 | 278.8 |
| Regulatory depreciation[a] | 18.6 | 23.3 | 26.2 | 30.4 | 33.3 | 131.8 |
| Operating expenditure[b] | 61.8 | 63.6 | 65.8 | 67.9 | 70.1 | 329.2 |
| Revenue adjustments[c] | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.3 |
| Net tax allowance | 3.9 | 4.0 | 4.1 | 4.1 | 4.1 | 20.1 |
| Annual revenue requirement (unsmoothed) | 134.7 | 144.5 | 152.0 | 161.3 | 167.7 | 760.3 |
| **Annual expected revenue (smoothed)** | **141.2** | **146.3** | **151.6** | **157.0** | **162.7** | **758.8** |
| X factor[d] | n/a[e] | –1.12% | –1.12% | –1.12% | –1.12% | n/a |

Source: AER analysis.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.

(b) Includes debt raising costs.

(c) Includes revenue adjustments from shared assets and demand management innovation allowance mechanism (DMIAM).

(d) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.

(e) Power and Water is not required to apply an X factor for 2019–20 because we set the 2019–20 expected revenue in this decision. The expected revenue for 2019–20 is around 23.3 per cent lower than the approved expected revenue for 2018–19 in real terms, or 21.5 per cent lower in nominal terms.

In the sections below, we discuss each component of our decision on Power and Water's revenue for 2019–24 in turn. Incentive schemes, including the EBSS and CESS are discussed in section 3. The tariff structure statement is discussed in section 4.

## 2.1 Regulatory asset base

The RAB accounts for the value of Power and Water's regulated assets over time. The size of the RAB—and therefore the revenue generated from the return on capital and return of capital building blocks—is directly affected by our assessment of capex.

Our draft decision is to determine an opening RAB value of $966.4 million ($nominal) as at 1 July 2019 for Power and Water. We roll forward this opening RAB value year-by-year by indexing it for inflation, adding new capex, and subtracting depreciation and other possible factors (for example, disposals or customer contributions).[26] This gives us a closing value of the RAB at the end of each year of the 2019–24 regulatory control period. The value of the RAB is then used to determine:

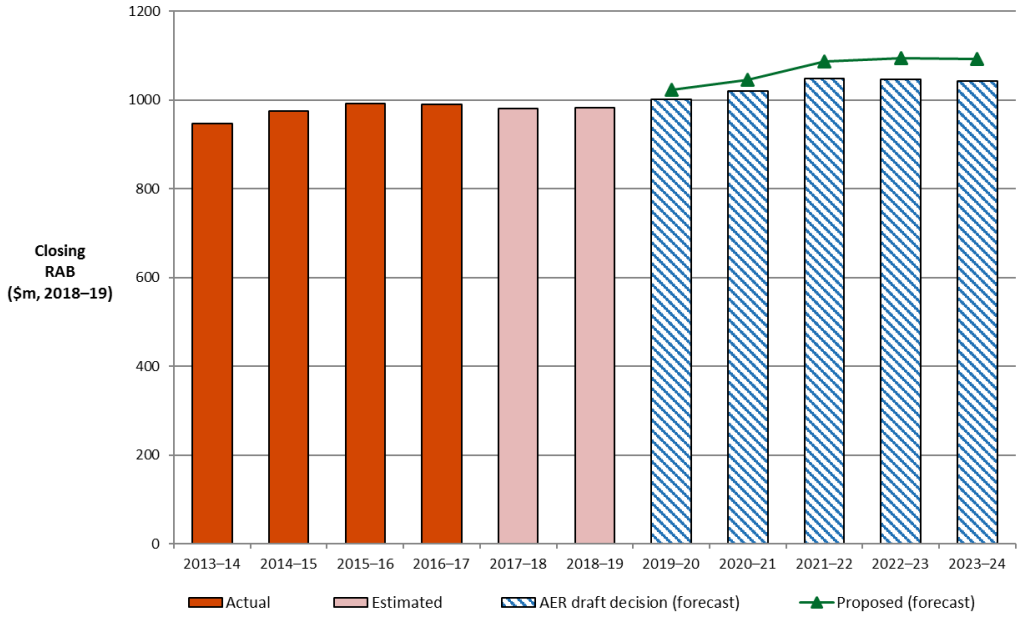
- the return on capital building block, which is the product of the RAB and our approved rate of return
- regulatory depreciation (or the return of capital, discussed further below in section 2.3).

RAB growth is a key issue for many stakeholders. CCP13 noted that significant expenditure in a low interest rate environment has the potential to trigger price rises in the future when interest rates inevitability return to a higher point.[27] Figure 6 shows growth in Power and Water's RAB. It has been largely stable in the 2014–19 regulatory control period, but forecast to grow slightly in the 2019–24 regulatory control period. This is driven by increased capex forecast in the 2019–24 period.

[26] The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

[27] Consumer Challenge Panel, CCP Sub-Panel No. 13, *Advice to the AER, Response to proposals from PWC for a revenue reset for the 2019–24 regulatory period,* 16 May 2018, p. 5.

## Figure 6 Projected RAB growth




Source: AER analysis.

Power and Water's proposal calculated its opening RAB as at 1 July 2019 and its closing RAB at 30 June 2024 in accordance with our RFM. Table 2.2 sets out our draft decision on the forecast RAB values for Power and Water over the 2019–24 regulatory control period.

## Table 2.2 AER's draft decision on Power and Water's RAB for the 2019–24 regulatory control period ($million, nominal)

| | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 |
|---|---|---|---|---|---|
| Opening RAB | 966.4 | 1026.0 | 1070.8 | 1127.2 | 1152.2 |
| Capital expenditure[a] | 78.3 | 68.1 | 82.6 | 55.4 | 58.9 |
| Inflation indexation on opening RAB | 23.7 | 25.1 | 26.2 | 27.6 | 28.2 |
| *Less*: straight-line depreciation | 42.3 | 48.4 | 52.4 | 58.0 | 61.5 |
| Closing RAB | 1026.0 | 1070.8 | 1127.2 | 1152.2 | 1177.8 |

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB for revenue modelling.

Further details regarding the roll forward of Power and Water's RAB is set out in attachment 2.

## 2.2 Rate of return and value of imputation credits

The return (the 'return on capital') each business is to receive on its RAB continues to be a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB.

We estimate the rate of return by combining the returns of the two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest on its loans and give a return on equity to investors.

A good estimate of the rate of return is necessary to promote efficient prices in the long term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and reliability may decline. Alternatively, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

Power and Water's proposal applied a rate of return of 6.62 per cent. This is a placeholder, to be updated with more recent data at key milestones throughout this review (this draft decision, Power and Water's revised proposal and our final decision).

We estimated our draft decision allowed rate of return using the approach set out in our draft 2018 rate of return guidelines. This reflects a departure from the current 2013 Guidelines.[28] After considering all the material submitted to us, we consider that this departure will, for the reasons set out in the draft 2018 Guidelines,[29] contribute to the achievement of the national electricity objective and allowed rate of return objective to the greatest degree.

Our draft decision rate of return is 5.22 per cent (nominal vanilla, indicative) for the first year of the 2019–24 regulatory control period. Power and Water has a lower rate of return compared to our draft determinations for TasNetworks and Evoenergy, which we have made a draft decision at the same time as this Power and Water draft decision. This is explained by the approach to debt and application of the trailing average in the circumstances of each business.

The reason for the difference between our allowed rate of return and Power and Water's proposal is we have commenced a 10 year transition to the trailing average for debt in the first year of the 2019–24 regulatory control period, rather than the immediate transition proposed by Power and Water. We consider that a revenue neutral transition between the on-the-day approach and trailing average approach is necessary to avoid windfall gains or losses which would not be consistent with the NEO. Power and Water's proposed approach is also backward looking and

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[28] Rule 6.5.2(qa) specifies the guidelines that apply in NT.

[29] AER, *Draft rate of return guidelines explanatory statement*, July 2018, p. 17.

retrospectively incorporates past estimates of the cost of debt. We consider that selection of a historical averaging period can introduce bias into outcomes.

Power and Water also adopted a value of imputation credits (gamma) of 0.4, consistent with our recent decisions. Our draft decision is to apply a gamma of 0.5 as reflected in our 2018 rate of return guideline draft decision. This has contributed to the reduction in the corporate income tax allowance relative to Power and Water's proposal (section 2.2 below).

Consultation on our draft 2018 guideline is ongoing, and is expected to conclude in December 2018. Legislation currently before the South Australian House of Assembly will (if passed) make our final 2018 rate of return guideline binding on this and other decisions.

## 2.3 Regulatory depreciation (return of capital)

In our draft decision, we include an allowance for the depreciation of Power and Water's asset base (otherwise referred to as return of capital). Regulated service providers invest in large sunk assets to provide electricity services to customers. While some of the cost of such assets may be recovered from customers upfront, a greater proportion is recovered over time. The depreciation allowance is used for this purpose.

In deciding whether to approve the regulatory depreciation allowance proposed by Power and Water, we make determinations on the indexation of the RAB and depreciation building blocks for Power and Water's 2019–24 regulatory control period.[30]

Our draft decision approves a regulatory depreciation allowance of $131.8 million ($nominal) for the 2019–24 regulatory control period. This is $29.2 million (18.1 per cent) lower than Power and Water's proposed value of $161.0 million ($nominal).

This reduction occurs mainly because of our changes to Power and Water's proposed year-by-year depreciation tracking model. We accept Power and Water's proposal to use the year-by-year tracking method for depreciating its existing assets consistent with the approach we approved in our recent decisions for other regulated businesses.[31] However, we made several amendments to the depreciation model to update inputs and correct modelling errors.

Our determinations on other components of Power and Water's proposal also affect the forecast regulatory depreciation allowance. Specifically, they relate to the opening

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30 NT NER, cll. 6.12.1, 6.4.3.

31 AER, *Final decision: ElectraNet transmission determination 2018-23,* attachment 5, April 2018, p. 7; AER, *Final decision: AusNet Services transmission determination 2017-22,* attachment 5, April 2017, p. 8; AER, *Draft decision: TasNetworks distribution determination 2017-19,* attachment 5, April 2017, pp. 18–21; AER, *Final decision: Jemena distribution determination 2016-20,* attachment 5, May 2016, pp. 11–13; AER, *Final decision: AusNet Services distribution determination 2016-20,* attachment 5, May 2016, pp. 10–14.

RAB as at 1 July 2019 (attachment 2), expected inflation rate (attachment 3) and forecast capital expenditure (attachment 5) and its effect on the projected RAB over the 2019–24 regulatory control period.[32]

Our draft decision on other aspects of Power and Water's regulatory depreciation is that we accept Power and Water's proposed asset classes and its straight-line depreciation method used to calculate the regulatory depreciation allowance. We also largely accept Power and Water's proposal to remap the approved asset classes by the Utilities Commission. We did not however, accept all of Power and Water's proposed standard asset lives, such as 'Property' and 'Equity raising costs'.

Table 2.3 shows our draft decision on Power and Water's depreciation allowance for the 2019–24 regulatory control period.

### Table 2.3 AER's draft decision on Power and Water's depreciation allowance for the 2019–24 period ($million, nominal)

| | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | Total |
|---|---|---|---|---|---|---|
| Straight-line depreciation | 42.3 | 48.4 | 52.4 | 58.0 | 61.5 | 262.7 |
| *Less:* inflation indexation on opening RAB | 23.7 | 25.1 | 26.2 | 27.6 | 28.2 | 130.9 |
| **Regulatory depreciation** | **18.6** | **23.3** | **26.2** | **30.4** | **33.3** | **131.8** |

Source: AER analysis.

Further detail on our draft decision regarding depreciation is set out in attachment 4.

## 2.4 Capital expenditure

Capital expenditure (capex) refers to the investment in assets to provide services. This investment mostly relates to assets with long lives and these costs are recovered over several regulatory periods. On an annual basis, however, the financing cost and depreciation associated with these assets are recovered (return of and on capital) as part of the building blocks that form part of Power and Water's total revenue requirement.

Our draft decision on Power and Water's revenue includes a substitute estimate of $315.6 million ($2018–19) in total forecast net capex for the 2019–24 regulatory control period.[33] This is $67.3 million (or 17.6 per cent) lower than Power and Water's

[32] Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2019–24 regulatory control period.

[33] Our alternative estimate includes adjustments that Power and Water has itself made to correct errors and reflect changes in approach since its initial proposal. These changes account for around $15 million ($2018–19) of the difference between Power and Water's initial capex proposal and our alternative estimate.

proposed value of $383.0 million. Table 2.4 shows our draft decision compared to Power and Water's forecast.

### Table 2.4 AER draft decision on total net capex ($million, 2018–19)

| | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | Total |
|---|---|---|---|---|---|---|
| Power and Water's proposal | 94.0 | 72.5 | 94.6 | 63.7 | 58.2 | 383.0 |
| AER draft decision | 74.7 | 64.0 | 75.8 | 49.6 | 51.5 | 315.6 |
| Difference | -19.3 | -8.4 | -18.8 | -14.1 | -6.7 | -67.3 |
| Percentage difference (%) | -20.5% | -11.6% | -19.9% | -22.1% | -11.6% | -17.6% |

Source: AER analysis.

Note: Numbers may not total due to rounding.

While Power and Water had some initial difficulty in preparing and providing the supporting documentation for its capex proposal, it put forward a reasonable proposal that reflects the development of their business practices over recent years. Power and Water engaged constructively with our review process, and has sought to provide additional information where requested in a timely way.

Our review has highlighted that Power and Water has an opportunity to further develop its risk management and asset management practices, and its ability to demonstrate the prudency and efficiency of investment proposals.

Figure 6 shows our capex draft decision compared to Power and Water's proposal, its past allowances and past actual expenditure.

## Figure 6 AER draft decision on total forecast capex ($million, 2018–19)


Source: Power and Water, Capex overview 2019-20 to 2023-24, 16 March 2018, p. 11 and pp. 13-14; and AER analysis.

We are cognisant that the NT government's undergrounding project for Darwin may have implications on Power and Water's proposed expenditure in the forecast period.[34] We have engaged with Power and Water on this matter. To the extent that Power and Water is able to reflect the impact of the undergrounding project on its forecast capex (and opex) for the 2019–24 regulatory control period, we invite Power and Water to do so in the revised regulatory proposal.

The key aspects of our draft decision on capex are highlighted below.

### *Replacement*

Our draft decision for Power and Water includes total forecast replacement capex of $129 million ($2018-19), which is 13 per cent lower than Power and Water's forecast repex of $148.6 million ($2018-29). We have included the majority of Power and Water's proposed repex proposal in our alternative estimate. However, in relation to Berrimah Zone Substation Replacement, Alice Springs poles' replacement and Darwin HV northern suburbs cable replacement, we have found that:

[34] The Northern Territory Government announced on 27 April its long-term program to recommence undergrounding power in Darwin Suburbs. The announcement occurred after Power and Water has submitted their initial regulatory proposal on the 30 January 2018, as such Power and Water did not incorporate the impact of this undergrounding program in their initial proposal.

- Power and Water's proposal to replace the Berrimah Zone Substation replacement with a greenfields solution is not the most efficient solution. Power and Water's proposal is one that replaces the current zone substation with an adjacent substation of smaller capacity. The reduced capacity of the preferred solution contributes to the potential need to augment the network to meet firm capacity in Wishart. We consider it more efficient to refurbish a number of assets identified within this program and target replacement based on condition, which would assist in deferring the need for augmentation at Wishart
- the Alice Springs corroded poles program proposed by Power and Water is likely to overstate the number of poles in need of refurbishment in the 2019–24 regulatory control period
- similarly, the Darwin northern suburbs HV cable replacement program is likely to overstate the volume of cables in need of replacement in the 2019-24 regulatory control period.

### *Growth (augex)*

Our draft decision for Power and Water includes total forecast augmentation capex of $35.9 million ($2018-19), which is 40.7 percent lower than Power and Water's forecast augex of $60.6 million ($2018-19). We have included the majority of Power and Water's proposed augex projects and programs in our alternative estimate of forecast augex, particularly where expenditure is driven by the need to maintain compliance with technical requirements, reliability and power quality obligations. However, in relation to the Wishart zone substation project and the fault level replacement project, we have found that:

- the scope and timing of the Wishart zone substation development is related to a repex project to replace the nearby Berrimah zone substation. We have provided an alternative repex solution which maintains the existing capacity at Berrimah and is therefore likely to reduce or defer the potential need for augmentation at Wishart. Further, uncertainty around forecast demand and the identification of a potentially viable and lower cost non-network solution do not support the need for major network augmentation in the Wishart area in the 2019–24 regulatory control period
- the fault level replacement program proposed by Power and Water is likely to overstate the number of switch gear units in need of replacement in the 2019–24 regulatory control period.

### *Demand forecasts*

We are satisfied that AEMO's forecasting methodology for maximum demand and customer connections, adopted by Power and Water in its proposal, is likely to be reasonable and unbiased. However, it is not clear that the proposed forecasts necessarily reflect a realistic expectation of demand because:

- the NT Treasury's latest (2018 Budget) forecasts of macroeconomic drivers such as GSP and population growth are lower than the 2017 forecasts used as inputs

- it is not clear that the demand forecasts fully account for the potential impact of the NT Government's 'Roadmap to Renewables' policy (report released 27 November 2017)
- Power and Water has not justified the timing and quantum of spot loads forecast to arise within and beyond the 2019–24 regulatory control period.

We expect Power and Water to update its maximum demand and customer connections forecasts and/or provide additional information to validate key inputs and assumptions as part of its revised proposal.

### *Connections and customer contributions*

We have made no specific adjustment to Power and Water's proposed customer connections capex, as we are satisfied that Power and Water's forecasting methodology is reasonable and likely to produce a prudent and efficient forecast. Our draft decision includes customer connections capex of $61.6 million ($2018–19), which is slightly lower than Power and Water's forecast due to our updated estimate of forecast labour cost growth in the 2019–24 regulatory control period. We note that Power and Water will revise its customer connections forecast to reflect updated assumptions and inputs for its revised proposal.

In relation to forecast customer contributions, we note that Power and Water updated its forecast after submission of its initial regulatory proposal to account for changes to its customer connections policy. We have included Power and Water's revised estimate of customer contributions of $49.0 million in our alternative estimate of forecast net capex.

### *Non-network - IT*

Our draft decision for Power and Water includes forecast non-network ICT expenditure of $25.7 million ($2018–19), which is 31.3 per cent lower than Power and Water's forecast of $37.5 million ($2018-19).

Power and Water's ICT capex proposal represented a substantial increase from historical levels of investment, particularly in the early years of the regulatory control period. While we recognise the need for Power and Water to update and invest in many of its key systems, Power and Water has not sufficiently demonstrated its capability to efficiently deliver the full proposed ICT capex program within the 2019–24 regulatory control period. Our alternative estimate allows for a modest increase in ICT capex, at a level which we consider can be efficiently delivered by Power and Water in the 2019–24 regulatory control period.

### *Non-network - other*

Our draft decision for Power and Water includes forecast non-network other capex of $54.8 million ($2018–19), which is 21.1 percent lower than Power and Water's forecast of $69.4 million ($2018-19). The reasons for this are that:

- Power and Water has not clearly justified the need for the proposed 19 Mile Depot and access road upgrade project in the 2019–24 regulatory control period
- Power and Water's approach to estimating the capitalised cost of fleet and property leases overstated the amount of capex that should be recognised for these lease arrangements in the 2019–24 regulatory control period. Power and Water has acknowledged this error, and provided a revised forecast for capitalised fleet and property lease costs which we have included in our alternative estimate of forecast non-network – other capex.

### *Overheads*

Our draft decision for Power and Water includes capitalised overheads of $58.4 million ($2018–19), which is 12.6 per cent lower than Power and Water's forecast of $66.9 million ($2018-19). While we accept Power and Water's approach to the capitalisation of overheads in accordance with its capitalisation policy and CAM, our alternative estimate:

- corrects for an error in the base year capitalised overheads figure used by Power and Water to forecast capitalised overheads
- applies a lower rate of change to forecast the growth in capitalised overheads over the 2019–24 regulatory control period.

Further detail on our draft decision regarding capex is set out in attachment 5.

## 2.5 Operating expenditure

Operating expenditure (opex) refers to the operating, maintenance and other non-capital expenses incurred in the provision of network services. Forecast opex for standard control services is one of the building blocks we use to determine a service provider's annual total revenue requirement.

Our draft decision on Power and Water's revenue includes $305.9 million ($2018–19) in total forecast opex for the 2019–24 regulatory control period. This is $33.4 million (9.8 per cent) lower than Power and Water's proposed total opex forecast of $339.3 million ($2018–19). Table 2.5 shows our decision compared to Power and Water's forecast.

**Table 2.5 AER draft decision on total opex ($million, 2018–19)**

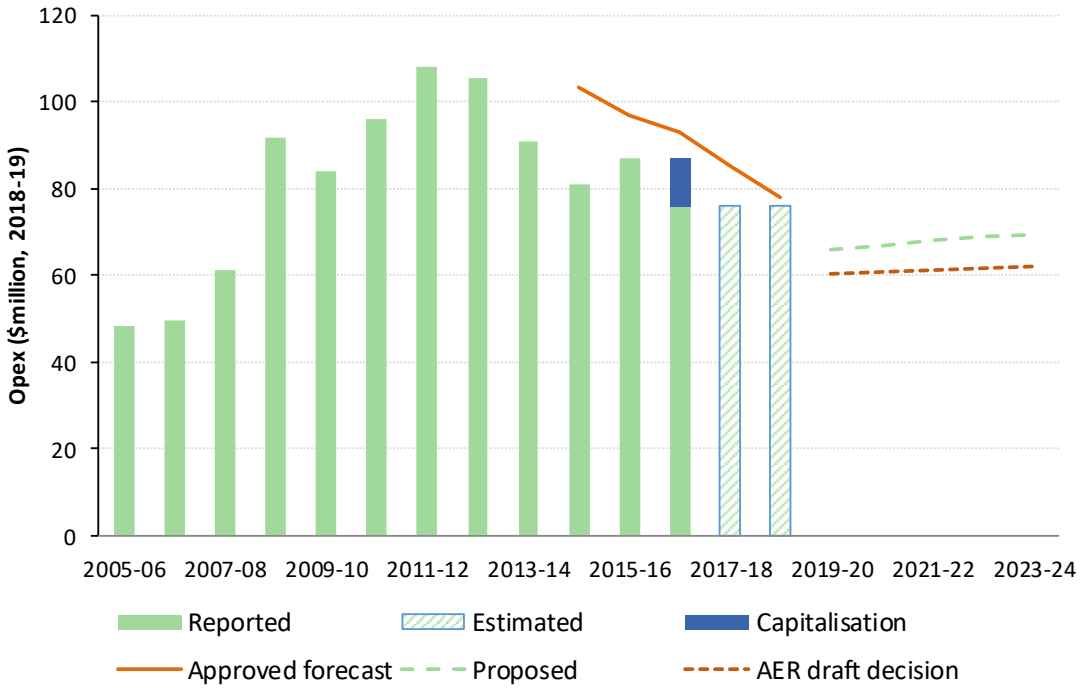
| | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | Total |
|---|---|---|---|---|---|---|
| Power and Water's proposed opex | 66.0 | 66.9 | 68.0 | 68.8 | 69.5 | 339.3 |
| AER draft decision | 60.3 | 60.6 | 61.2 | 61.7 | 62.1 | 305.9 |
| Difference | **-5.8** | **-6.3** | **-6.8** | **-7.1** | **-7.4** | **-33.4** |

Source: Power and Water, Revenue proposal, post tax revenue model (PTRM), 31 January 2018; AER analysis.

Note: Includes debt raising costs. Numbers may not add up to total due to rounding.

Figure 7 shows our opex decision compared to Power and Water's proposal, its past allowances approved by the Utilities Commission and past actual expenditure.

## Figure 7 AER draft decision on total forecast opex ($million, 2018–19)




Source: Power and Water, Regulatory accounts; Power and Water, Economic benchmarking RIN response; Utilities Commission NTRM; AER analysis.

Note: Includes debt raising costs.

Power and Water adopted our base–step–trend approach to forecast opex for the 2019–24 regulatory control period.[35] The 9.8 per cent difference between our forecast and Power and Water's proposal reflects our view of the efficient level of opex required by a prudent operator. A number of factors drive the difference. We included:

- a lower estimate of efficient base opex reflecting our bottom up review of the opex categories, resulting in a 13.8 per cent efficiency adjustment to base opex. This is higher than the 10 per cent top down adjustment to base opex Power and Water proposed.[36] We have undertaken a bottom up review reflecting Power and Water's poor relative benchmarking performance, its proposal which proposed efficiency adjustments and other previous reports
- a lower estimate of the rate of change reflecting:

[35] Power and Water, Regulatory proposal, 16 March 2018, p. 77.

[36] Power and Water's 10 per cent adjustment and our 13.8 per cent adjustment are not directly comparable as they are made off different bases. Power and Water's 10 per cent is taken off a lower base, after a $5.5 million adjustment for increased capitalisation has been made. On a consistent basis, Power and Water's $7.0 million efficiency adjustment is 9.3 per cent of base year opex.

- Deloitte Access Economics' (DAE) wage price index (WPI) forecast for the Northern Territory utilities industry. This is lower than the historical average of the South Australian utilities WPI from DAE and BIS Shrapnel that Power and Water used
- a lower rate of output growth relative to Power and Water's. We have derived output weights from the results of four of the models we presented in our 2017 annual benchmarking report. This is a refinement of our previous approach (and that adopted by Power and Water[37]) which used the weights from a single econometric model.[38]

- part of the guaranteed service level (GSL) payments step change, but we did not include proposed step changes for implementing the national connections process, metering type 7 compliance, operating a metering data management system (MDMS) and additional network planning resources.

For the rate of change, we have applied a zero productivity growth forecast.[39] This has been our standard approach to forecasting the productivity components of the rate of change. However, we are currently reviewing whether this remains appropriate. This review may change our approach going forward. As part of this review we will be looking to consult with all distributors and any other interested stakeholders. We will take the outcome of this review into consideration in our final decision.

In reaching our draft decision on opex we considered stakeholder submissions from the CCP13, the Electrical Trades Union of Australia (ETU), Jacana and an anonymous party, in response to Power and Water's proposal. Submissions questioned the efficiency of Power and Water's base opex, and the capitalisation of costs, which we have examined.

There are several aspects noted in our opex draft decision where either Power and Water has foreshadowed changes may be made in its revised proposal or where we consider Power and Water may wish to provide further information. This, amongst other things, may result in changes between the draft and final decisions.

We have set out the reasons for our draft decision on opex in greater detail in attachment 6.

## 2.6 Corporate income tax

Our draft decision includes a decision on the estimated cost of corporate income tax for Power and Water's 2019–24 regulatory control period as part of our revenue

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37 Power and Water, *Regulatory proposal*, 16 March 2018, p. 89.

38 We have derived weights from the results four economic benchmarking models — Cobb-Douglas stochastic frontier analysis, Cobb-Douglas least squares econometrics, translog least squares econometrics and opex multi-lateral partial factor productivity. We had previously relied solely on the results of our Cobb-Douglas stochastic frontier analysis model, which is the basis of Power and Water's proposal.

39 Using the outputs and weights from our stochastic frontier analysis Cobb-Douglas (SFACD) econometric model.

determination.[40] It enables Power and Water to recover the costs associated with the estimated corporate income tax payable during the regulatory control period.

In the current 2014–19 regulatory control period, Power and Water has been regulated under a pre-tax framework by the Utilities Commission. Under this framework, the allowance for tax is embedded in the return on equity requirement (and subsequently the rate of return). Therefore, the Utilities Commission did not determine a separate tax building block for Power and Water for that period. However, under the NT NER, the post-tax revenue model will be applied to Power and Water for the 2019–24 regulatory control period. One of the key steps of the transition from the pre-tax framework to the post-tax framework is to establish an opening TAB, which is required to estimate the tax depreciation. We have determined the opening TAB value as at 1 July 2019 to be $972.5 million ($nominal).

We determined an estimated cost of corporate income tax of $20.1 million ($nominal) for Power and Water over the 2019–24 regulatory control period. This is $17.3 million (or 46.2 per cent) lower than Power and Water's proposed value of $37.4 million.[41]

The majority of this reduction is due to our amendments to Power and Water's proposed return on capital (attachments 2 and 3) and the regulatory depreciation (attachment 4) building blocks. These building blocks affect total revenues, which in turn impacts the tax calculation.[42] Our decision to increase the value of imputation credits (gamma) to 0.50 from Power and Water's proposed 0.40 also results in a material contribution to this reduction (section 2.2).

We amended other proposed inputs for forecasting the cost of corporate income tax which further reduced the estimated tax allowance. These inputs are the opening tax asset base (TAB) as at 1 July 2019, standard tax asset lives and the remaining tax asset lives as at 1 July 2019 (attachment 7).

Table 2.6 shows our draft decision on Power and Water's corporate income tax allowance for the 2019–24 regulatory control period.

### Table 2.6 AER's draft decision on corporate income tax allowance for Power and Water ($million, nominal)

| | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | Total |
|---|---|---|---|---|---|---|
| Tax payable | 7.7 | 8.0 | 8.2 | 8.1 | 8.3 | 40.3 |
| *Less:* value of imputation credits | 3.9 | 4.0 | 4.1 | 4.1 | 4.1 | 20.1 |
| **Net corporate income tax allowance** | **3.9** | **4.0** | **4.1** | **4.1** | **4.1** | **20.1** |

Source: AER analysis.

[40] NT NER, cl. 6.4.3(a)(4).

[41] Power and Water, *SCS Post-tax Revenue Model*, Attachment 12.1, 16 March 2018 – PUBLIC.

[42] The changes affecting revenues are discussed in attachment 1.

For this draft decision, we have used our regulatory models (PTRM and RFM) to calculate the various components required to estimate Power and Water's cost of corporate income tax for the 2019–24 regulatory control period. Our assessment approach for this draft decision is discussed in attachment 7. We are currently undertaking a review of our regulatory tax approach (the tax review). As discussed in the initial report to the tax review published on 28 June 2018, we intend to apply any changes to our regulatory models arising from the tax review to the final decision for Power and Water's 2019–24 regulatory control period in April 2019.[43]

Further detail on our draft decision regarding corporate income tax is set out in attachment 7.

[43] AER, *Initial Report–Review of regulatory tax approach*, June 2018, pp. 4 and 5.

# 3 Incentive schemes

Incentive schemes are a component of incentive based regulation and complement our approach to assessing efficient costs. These schemes provide important balancing incentives under the revenue determination we've discussed in section 2, to encourage Power and Water to pursue expenditure efficiencies and demand side alternatives to capex and opex, while maintaining the reliability and overall performance of its network.

The incentive schemes that might apply to an electricity network as part of our decision are:

- the opex efficiency benefit sharing scheme (EBSS)
- the capital expenditure sharing scheme (CESS)
- the service target performance incentive scheme (STPIS)
- the demand management incentive scheme (DMIS) and demand management innovation allowance mechanism (DMIAM).

Once we make our decision on Power and Water's revenue cap, it has an incentive to provide services at the lowest possible cost, because its returns are determined by its actual costs of providing services. Our incentive schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. If networks reduce their costs to below our forecast of efficient costs, the savings are shared with their customers in future regulatory periods through the EBSS and CESS.

The DMIS) and DMIAM encourage businesses to pursue demand side alternatives to opex and capex. The incentive schemes encourage businesses to make efficient decisions on when and what type of expenditure to incur, and meet service reliability targets.

The incentive schemes that will apply to Power and Water for the 2019–24 regulatory control period are:

- the CESS
- DMIS and DMIAM.

We will not apply the STPIS to Power and Water in the next regulatory control period, due to the unavailability of reliable historic supply interruption data. However, we will be collecting relevant data during the course of the 2019–24 regulatory control period in order to establish suitable targets for the following regulatory control period. This is consistent with our Framework and Approach for Power and Water.[44] Power and

[44] AER, *Final framework and approach for Power and Water Corporation*, July 2017, pp. 44–45.

Water's performance under these schemes in the 2019–24 regulatory control period will be reflected in its annual pricing proposals throughout that period and its revenue proposal for the subsequent, 2024–29 regulatory control period.

Given our decision to not use revealed costs to forecast opex in 2019–24, and it is uncertain whether we will rely on revealed costs to forecast opex in the period starting 1 July 2024, our draft decision is to not apply the EBSS in the 2019–24 regulatory control period. This is because consumers would not share the benefits of any efficiency improvements if revealed opex is not used to forecast opex in the 2024-29 regulatory control period. We consider Power and Water will already face strong continuous incentives to make efficiency improvements without an EBSS.

We discuss our draft decisions on each incentive scheme further in attachments 8 to 11.

# 4 Tariff structure statement

Power and Water's 2019–24 proposal includes its first tariff structure statement (TSS).

The requirement on distributors to prepare a TSS arises from a significant process of reform to the NER governing distribution network pricing. The purpose of the reforms is to empower customers to make informed choices by:

- providing better price signals—tariffs that reflect what it costs to use electricity at different times so that customers can make informed decisions to better manage their bills
- transitioning to greater cost reflectivity—requiring distributors to explicitly consider the impacts of tariff changes on customers, and engaging with customers, customer representatives and retailers in developing network tariff proposals over time
- managing future expectations—providing guidance for retailers, customers and suppliers of services such as local generation, batteries and demand management by setting out the distributor's tariff approaches for the entire duration of the regulatory control period.

Among other matters, Power and Water's TSS must set out its proposed tariffs, structures and charging parameters for each proposed tariff, and the policies and procedures the distributor proposes to apply assigning customers to tariffs or reassigning customers from one tariff to another.[45]

Our decision in this determination is on the structure of tariffs that will form the basis of tariff proposals throughout the regulatory period. While an indicative pricing schedule must accompany the TSS, Power and Water's tariffs for the entire 2019–24 regulatory control period are not set as part of this determination.[46] Rather, tariffs for 2019–20 will be subject to a separate approval process that takes place in May 2019, after we make our final revenue determination in April 2019. Tariffs for the following four years will also be approved on an annual basis in May of each year.

Power and Water proposed some significant changes to its tariffs and tariff structures for the 2019–24 regulatory control period. We note that small customers—those consuming less than 750 MWh per annum—are protected by the NT Government's Pricing Order, which caps electricity retail prices. Power and Water considers the Pricing Order provides it the opportunity to accelerate network tariff reform. The main reforms Power and Water proposed include:

- a mandatory assignment policy

[45] NER, cl. 6.18.1A.

[46] NER, cl. 6.8.2(d1).

- a new demand tariff for small customers (Smart Meter LV consumer <750 MWh pa)
- amending the unmetered tariffs from flat consumption tariff to a demand-based tariff structure
- removal of the declining block structure from large customer tariffs
- individually calculated tariffs for large customers
- seasonal charging windows.

Our draft decision broadly supports the direction of these changes. However, in attachment 18 we have set out a series of changes to the proposed TSS that provide greater clarity on several aspects of Power and Water's tariff strategy, which are required before we can approve the TSS. These include amendments that would provide more certainty as to how Power and Water will set tariffs.

Advanced meters are an important element in pursing cost reflective network tariffs. Support for demand tariffs and new technology are key themes underpinning Power and Water's proposal.[47] Our draft determination has accepted Power and Water's proposal to install advanced meters, including remote communications capabilities for all new and replacement meters during the 2019–2024 regulatory control period. On balance, there appears to be value to customers in having Power and Water install smart meters on the network.

[47] This included support for demand charges for all customers who have a demand-capable meter and the move to cost reflective tariffs for large energy users, and supporting new technology, including the roll out of smart meters to all customers on a new and replacement basis. See Power and Water, *Regulatory Proposal*, 16 March 2018, p. 6.

# 5 The National Electricity Objective

The NEL requires us to make our decision in a manner that contributes, or is likely to contribute, to achieving the NEO.[48] The focus of the NEO is on promoting efficient investment in, and operation and use of, electricity services (rather than assets) in the long term interests of consumers.[49] This is not delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision.[50]

In general, we consider that the long-term interests of consumers are best served where consumers receive a reasonable level of safe and reliable service that they value at least cost in the long run.[51] A decision that places too much emphasis on short term considerations may not lead to the best overall outcomes for consumers once the longer term implications of that decision are taken into account. [52]

There may be a range of economically efficient decisions that we could make in a revenue determination, each with different implications for the long term interests of consumers.[53] A particular economically efficient outcome may nevertheless not be in the long term interests of consumers, depending on how prices are structured and risks allocated within the market. [54] There are also a range of outcomes that are unlikely to advance the NEO, or advance the NEO to the degree than others would. For example, we consider that:

- the long term interests of consumers would not be advanced if we encourage overinvestment which results in prices so high that consumers are unwilling or unable to efficiently use the network.[55] This could have significant longer term pricing implications for those consumers who continue to use network services.
- equally, the long-term interests of consumers would not be advanced if allowed revenues result in prices so low that investors do not invest to sufficiently maintain the appropriate quality and level of service, and where customers are making more use of the network than is sustainable.[56] This could create longer term problems in the network, and could have adverse consequences for safety, security and reliability of the network.

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48 NEL, section 16(1)

49 This is also the view of the Australian Energy Markets Commission (the AEMC). See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

50 Hansard, *SA House of Assembly,* 26 September 2013, p. 7173. See also the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 7–8.

51 Hansard, *SA House of Assembly,* 9 February 2005, p. 1452.

52 See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 6–7.

53 Re Michael: Ex parte Epic Energy [2002] WASCA 231 at [143].

54 See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

55 NEL, s. 7A(7).

56 NEL, s. 7A(6).

The legislative framework recognises the complexity of this task by providing us with significant discretion in many aspects of the decision-making process to make judgements on these matters.

## 5.1 Achieving the NEO to the greatest degree

Electricity determinations are complex decisions. In most cases, the provisions of the NER do not point to a single answer, either for our decision as a whole or in respect of particular components. They require us to exercise our regulatory judgement. For example, chapter 6 of the NER requires us to prepare forecasts, which are predictions about unknown future circumstances. Very often, there will be more than one plausible forecast,[57] and much debate amongst stakeholders about relevant costs. For certain components of our decision there may therefore be several plausible answers or several plausible point estimates.

When the constituent components of our decision are considered together, this means there will almost always be several potential, overall decisions. More than one of these may contribute to the achievement of the NEO. In these cases, our role is to make an overall decision that we are satisfied contributes to the achievement of the NEO to the greatest degree.[58]

We approach this from a practical perspective, accepting that it is not possible to consider every permutation specifically. Where there are choices to be made among several plausible alternatives, we have selected what we are satisfied would result in an overall decision that contributes to the achievement of the NEO to the greatest degree.

## 5.2 Interrelationships between constituent components

Examining constituent components in isolation ignores the importance of the interrelationships between components of the overall decision, and would not contribute to the achievement of the NEO. We have considered these interrelationships in our analysis of the constituent components of our draft decision in the relevant attachments. Examples include:

- underlying drivers and context which are likely to affect many constituent components of our decision. For example, forecast demand affects the efficient levels of capex and opex in the regulatory control period (see attachment 5 and 6).
- direct mathematical links between different components of a decision. For example, the level of gamma has an impact on the appropriate tax allowance; the benchmark efficient entity's debt to equity ratio has a direct effect on the cost of equity, the cost of debt, and the overall vanilla rate of return (see attachments 3 and 7).

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[57] AEMC, *Rule Determination: National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006,* (16 November 2006), p. 52.

[58] NEL, s. 16(1)(d).

- trade-offs between different components of revenue. For example, undertaking a particular capex project may affect the need for opex or vice versa (see attachments 5 and 6).

# A Constituent decisions

Our draft decision on Power and Water's distribution determination includes the following constituent components:[59]

## Constituent decision

In accordance with clause 6.12.1(1) of the NT NER, the AER's draft decision is that the following classification of services will apply to Power and Water for the 2019–24 regulatory control period (listed by service group):

- Standard control services include common distribution services, augmentation to the network and type 7 metering services
- Alternative control services includes type 1–6 metering services and ancillary network services (fee based and quoted services)
- Unregulated services include the rental of distribution assets to third parties.

Attachment 12 of the draft decision discusses classification of services.

In accordance with clause 6.12.1(2)(i) of the NT NER, the AER's draft decision is not to approve the annual revenue requirement set out in Power and Water's building block proposal. Our draft decision on Power and Water's annual revenue requirement for each year of the 2019–24 regulatory control period is set out in attachment 1 of the draft decision.

In accordance with clause 6.12.1(2)(ii) of the NT NER, the AER's draft decision is to approve Power and Water's proposal that the regulatory control period will commence on 1 July 2019. Also in accordance with clause 6.12.1(2)(ii) of the NT NER, the AER's draft decision is to approve Power and Water's proposal that the length of the regulatory control period will be 5 years from 1 July 2019 to 30 June 2024.

In accordance with clause 6.12.1(3)(ii) of the NT NER and acting in accordance with clause 6.5.7(d), the AER's draft decision is not to accept Power and Water's proposed total forecast net capital expenditure of $383.0 million ($2018–19). Our draft decision therefore includes a substitute estimate of Power and Water's total forecast net capex for the 2019–24 regulatory control period of $315.6 million ($2018–19). The reasons for our draft decision are set out in attachment 5 of the draft decision.

In accordance with clause 6.12.1(4)(ii) of the NT NER and acting in accordance with clause 6.5.6(d), the AER's draft decision is not to accept Power and Water's proposed total forecast operating expenditure inclusive of debt raising costs and exclusive of DMIA of $339.3 million ($2018-19). Our draft decision therefore includes a substitute estimate of Power and Water's total forecast opex for the 2019–24 regulatory control period of $305.9 million ($2018–19) including debt raising costs and exclusive of DMIAM. The reasons for out draft decision are set out in attachment 6 of the draft decision.

In accordance with clause 6.12.1(4A)(i) of the NER, the AER determines that there are no contingent

[59] NEL, s. 16(1)(c).

projects for the purposes of the distribution determination.

In accordance with clause 6.12.1(5) of the NT NER, the AER's draft decision is that the allowed rate or return for the 2019–20 regulatory year is 5.22 per cent (nominal vanilla), as set out in Attachment 3 of this draft decision. The rate of return for the remaining regulatory years 2020–24 will be updated annually because our decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.

In accordance with clause 6.12.1(5A) of the NT NER, the AER's draft decision is that the return on debt is to be estimated using a methodology referred to in clause 6.5.2(i)(2) and using the formula to be applied in accordance with clause 6.5.2(l). The methodology and formula are set out in Attachment 3 of this draft decision which is set out in attachment 3 of the draft decision.

In accordance with clause 6.12.1(5B) of the NT NER, the AER's draft decision on the value of imputation credits as referred to in clause 6.5.3 is to adopt a value of 0.5. This is discussed in section 2.2 of this draft decision overview.

In accordance with clause 6.12.1(6) of the NT NER, the AER's draft decision on Power and Water's regulatory asset base as at 1 July 2019 in accordance with clause 6.5.1 and schedule 6.2 is $966.4 million ($nominal). This is discussed in attachment 2 of the draft decision.

In accordance with clause 6.12.1(7) of the NT NER, the AER's draft decision is not to accept Power and Water's proposed corporate income tax of $37.4 million ($nominal). Our draft decision on Power and Water's corporate income tax is $20.1 million ($nominal). This is set out in attachment 7 of the draft decision.

In accordance with clause 6.12.1(8) of the NT NER, the AER's draft decision is to not approve the depreciation schedules submitted by Power and Water. Our draft decision substitute's alternative depreciation schedules in accordance with clause 6.5.5(b) and this is set out in attachment 4 of the draft decision.

In accordance with clause 6.12.1(9) of the NT NER, the AER makes the following draft decisions on how any applicable efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme, demand management incentive scheme or small-scale incentive scheme is to apply:

- The AER's draft decision is to not apply version 2 of the EBSS to Power and Water in the 2019–24 regulatory control period. This is set out in attachment 8 of the draft decision.
- We will apply the CESS as set out in version 1 of the Capital Expenditure Incentives Guideline to Power and Water in the 2019–24 regulatory control period. CESS is discussed in attachment 9 of the draft decision.
- We will not apply our Service Target Performance Incentive Scheme (STPIS) to Power and Water for the 2019–24 regulatory control period.
- The AER has determined to apply the Demand Management Incentive Scheme (DMIS) and the Demand Management Innovation Allowance Mechanism (DMIAM) for Power and Water in the 2019–24 regulatory control period. DMIS and DMIAM are discussed in attachment 11 of the draft decision.

In accordance with clause 6.12.1(10) of the NT NER, the AER's draft decision is that all appropriate amounts, values and inputs are as set out in this determination including attachments.

In accordance with clause 6.12.1(11) of the NT NER and our framework and approach paper, the

AER's draft decision on the form of control mechanisms (including the X factor) for standard control services is a revenue cap. The revenue cap for Power and Water for any given regulatory year is the total annual revenue calculated using the formula in attachment 13 plus any adjustment required to move the DUoS under/over account to zero. This is discussed at attachment 13 of the draft decision.

In accordance with clause 6.12.1(12) of the NT NER and our framework and approach paper, the AER's draft decision on the form of the control mechanism for alternative control services is to apply price caps for all services. This is discussed in attachment 13 of the draft decision.

In accordance with clause 6.12.1(13) of the NT NER, to demonstrate compliance with its distribution determination, the AER's draft decision is Power and Water must maintain a DUoS unders and overs account. It must provide information on this account to us in its annual pricing proposal. This is discussed in attachment 13 of the draft decision.

In accordance with clause 6.12.1(14) of the NT NER, the AER's draft decision is to apply the following nominated pass through events to apply to Power and Water for the 2019–24 regulatory control period in accordance with clause 6.5.10):

- terrorism event
- insurance cap event
- natural disaster event.

These events have the definitions set out in Attachment 14 of the draft decision.

In accordance with clause 6.12.1(14A) of the NT NER, the AER's draft decision is to not approve the tariff structure statement proposed by Power and Water. Our draft decision requires Power and Water to demonstrate reasonable consideration of the impact of the proposed increases in fixed charges on high voltage business customers. This is discussed in attachment 18 of the draft decision.

In accordance with clause 6.12.1(15) of the NT NER, the AER's draft decision is to apply the negotiating framework as proposed by Power and Water. The negotiating framework is set out in attachment 16 of the draft decision.

In accordance with clause 6.12.1(16) of the NT NER, the AER's draft decision is to apply the negotiated distribution services criteria published in February 2016 to Power and Water. This is set out in attachment 16 of the draft decision.

In accordance with clause 6.12.1(17) of the NT NER, the AER's draft decision on the policies and procedures for assigning retail customers to tariff classes for Power and Water is set out in attachment 13 of the draft decision.

In accordance with clause 6.12.1(18) of the NT NER, the AER's draft decision is that the depreciation approach based on forecast capex (forecast depreciation) is to be used to establish the RAB at the commencement of Power and Water' regulatory control period as at 1 July 2024. This is discussed in attachment 2 of the draft decision.

In accordance with clause 6.12.1(19) of the NT NER, the AER's draft decision on how Power and Water is to report to the AER on its recovery of designated pricing proposal charges is to set this out in its annual pricing proposal. The method to account for the under and over recovery of designated pricing proposal charges is discussed in attachment 13 of the draft decision.

In accordance with clause 6.12.1(20) of the NT NER, the AER's draft decision is to require Power and Water to maintain a jurisdictional scheme unders and overs account. It must provide information on

this account to us in its annual pricing proposal as set out in attachment 13 of the draft decision.

In accordance with clause 6.12.1(21) of the NT NER, the AER's draft decision is to modify the Power and Water' proposed connection policy as set out in attachment 17 of the draft decision.

# B List of submissions

We received six submissions in response to Power and Water's revenue proposal. These are listed below.

| Submission from | Date received |
|---|---|
| Anonymous | 16 May 2018 |
| Consumer Challenge Panel (CCP13) | 16 May 2018 |
| Electrical Trades Union | 16 May 2018 |
| Jacana Energy | 16 May 2018 |
| Local Government Association of NT | 16 May 2018 |
| Power and Water (A response to submissions) | 17 August 2018 |