



FINAL DECISION

AusNet Services

Six-month extension – variation decision

October 2020

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Note

This document is a variation decision for the 2016–20 regulatory control period, which has been extended by six months. This variation decision was prepared in parallel to the AER's draft determination that will apply to AusNet Services for the 2021–26 regulatory control period. Whilst it is not part of the determination, it should be read with all other parts of the draft decision.

This final decision includes the following attachments:

Six-month extension – variation decision

Attachment A – Control mechanism formulae

Attachment B – Rate of Return (Confidential)

Contents

Contents	1-2
1 Introduction.....	1-3
1.1 Victorian electricity distribution: Six-month extension.....	1-3
1.2 Our process.....	1-4
2 Our final decision for AusNet Services and reasons for this decision..	2-6
2.1 Annual revenue requirement	2-6
2.2 Regulatory asset base.....	2-10
2.3 Rate of return	2-12
2.3.1 Inflation forecasts.....	2-15
2.4 Regulatory depreciation.....	2-16
2.5 Operating expenditure.....	2-17
2.6 Capital expenditure.....	2-19
2.7 Corporate income tax	2-19
2.8 Efficiency benefit sharing scheme	2-20
2.9 Capital expenditure sharing scheme	2-21
2.10 Service target performance incentive scheme.....	2-21
2.11 Demand management incentive scheme.....	2-23
2.12 Control mechanisms	2-24
2.13 Pass through events.....	2-26
2.14 Alternative control services	2-26
2.15 Tariff structure statement.....	2-27
2.16 Victorian f-factor Incentive scheme	2-28
2.17 Submission of pricing proposal	2-28
A Constituent decisions	2-30
Shortened forms	2-32

1 Introduction

We, the Australian Energy Regulator (AER), are responsible for the economic regulation of electricity distribution systems in Australia, except for Western Australia.

AusNet Services is one of five distribution network service providers (distributors) in Victoria and is responsible for providing electricity distribution services across the east of Victoria, from the edge of Melbourne to the border with New South Wales. We regulate the revenues AusNet Services and other electricity distributors can recover from their customers.

The National Electricity Law and Rules (NEL and NER) provide the regulatory framework governing electricity networks. In regulating AusNet Services, we are guided by the National Electricity Objective (NEO), as set out in the NEL. The NEO is 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—

price, quality, safety, reliability and security of supply of electricity; and
the reliability, safety and security of the national electricity system.¹

We apply incentive regulation in making our decision on a distributor's revenue to promote economic efficiency. Incentive regulation encourages distributors to spend efficiently and to share the benefits of efficiency gains with consumers.

1.1 Victorian electricity distribution: Six-month extension

In April 2019, we were advised by the Victorian Minister for Energy, Environment and Climate Change of the intention to make changes to the timing of the Victorian electricity and gas network price resets to operate on a financial year basis.

This would allow network and retail price changes to take effect on 1 July and to bring Victoria into alignment with other National Electricity Market (NEM) states.

On 27 October 2020 the National Energy Legislation Amendment Act 2020 (Vic) (NELA Act) came into effect. The NELA Act amends the National Electricity (Victoria) Act 2005 (NEVA) to extend the current regulatory control period (1 January 2016 – 31 December 2020) by six months. Therefore, AusNet Services' next five year regulatory control period begins on 1 July 2021 and not on 1 January 2021.

On 27 October 2020, the Victorian Government published an Order in Council (Order) under section 16VE of the amended NEVA to give effect to the extension of the current regulatory control.

The trend forward approach

The Victorian Government's (the Government's) policy intention was that the six month period was to be treated as an extension of the current regulatory period (2016–20).

¹ NEL, s. 7.

Consistent with this approach, we wrote to distributors outlining a trend forward approach to determining inputs for allowed revenue for this six month period. The approach was also subject to the Government's intention for the 2018 Rate of Return Instrument (RoRI) to apply instead of the 2013 Rate of Return Guideline. This would allow the lower Weighted Average Cost of Capital (WACC) determined under the RoRI, to apply from 1 January 2021 instead of the commencement of the next regulatory control period on 1 July 2021. The Government's intention was that this would deliver lower prices for consumers earlier, rather than them having to wait until the new regulatory control period commenced.

The trend forward approach on key inputs was seen as pragmatic and reduced the complexity of the transition process (Box 1 below). Most inputs are rolled forward/trended forward, and other regulatory changes are not applied (i.e. outcomes from tax review and operating expenditure (opex) productivity review). The guidance issued by the AER in November 2019 applies the trend forward methodology for establishing most building blocks for determining the revenue the Victorian distributors can recover for provision of Standard Control Services (access and supply of electricity to customers) (SCS). The approach allowed each distributor to specify the relevant inputs to be included in its roll forward models (RFMs) and post-tax revenue models (PTRMs) for the six month period and submit these in conjunction with its 2021–26 regulatory reset proposal.

The Victorian Government's legislative amendments and associated Orders in Council give us the power to vary the 2016–20 distribution determinations and to apply the trend forward approach and the RoRI for the extension period of 1 January 2021 to 30 June 2021.

1.2 Our process

In November 2019, we provided distributors guidance on the approaches to the affected elements relevant to the six month extension (1 January 2021 to 30 June 2021).

In line with this guidance, AusNet Services submitted elements relevant to the six-month extension as part of its regulatory proposal for the 2021–26 regulatory control period on 31 January 2020.

The Order gives effect to the guidance.

Box 1 Summary of Trend Forward Approach

The AER recommended a simple trend-forward methodology for establishing most building blocks and applying the 2018 RoR Instrument. This enabled each distributor to specify the relevant inputs to be included in its roll forward models (RFMs) and post-tax revenue models (PTRMs) for the six month extension period as part of its 2021–26 reset regulatory proposals to the AER.

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

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

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

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

Save for the application of the 2018 Rate of Return Instrument, this approach treats the period of 1 January 2021 to 30 June 2021 as an extension of the current regulatory control period, consistent with the Victorian Government's current stated policy intention. The total revenues for the period 1 July 2021 to 30 June 2026 are to be established using the following models:

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

2 Our final decision for AusNet Services and reasons for this decision

Section 16VK of the amended NEVA provides that despite anything to the contrary in the NEL, the NER and a 2016-2020 distribution determination, the AER may vary the 2016–2020 distribution determination as the AER considers necessary as a consequence of the extension of the 2016-2020 regulatory control period. The Order also contain provisions that give effect to the extension of the 2016–2020 regulatory control period.

The following reflects our final decision to vary AusNet Services' 2016–20 Distribution Determination (variation decision), made in accordance with the section 16VK of the NEVA and the Order.

2.1 Annual revenue requirement

This section sets out our final decision on AusNet Services' annual revenue requirement (ARR) for the provision of SCS over the six-month extension period. Specifically, it sets out our final decision on the ARR for the six-month extension period, which is the sum of annual building block costs. We determine AusNet Services' ARR using a building block approach and the expected revenue for the six-month extension period is set equal to the ARR.²

We determine an ARR of \$296.1 million (\$ nominal) for AusNet Services over the six-month extension period. This is a reduction of \$12.1 million (\$ nominal) or 3.9 per cent to AusNet Services' proposed ARR of \$308.2 million (\$ nominal) for this period. This reflects the impact of our final decision on the various building block costs.

The changes we made to AusNet Services' proposed building blocks include (in nominal terms):

- a reduction in the return on capital of \$4.9 million or 4.5 per cent
- a reduction in the regulatory depreciation of \$3.8 million or 7.3 per cent
- a reduction in the opex forecast of \$2.3 million or 1.7 per cent
- a reduction in the revenue adjustments of \$0.6 million or 66.4 per cent³
- a reduction in the cost of corporate income tax of \$0.3 million or 5.8 per cent.

The expected revenue is set equal to the ARR of \$296.1 million.

Table 2.1 shows our final decision on the building block costs, the ARR, and expected revenue for the six-month extension period.

² This is because the revenue set in this decision is for a single period and so no revenue smoothing is employed.

³ This difference is for our removal of the revenue adjustment amounts for the efficiency benefit sharing scheme (EBSS) and shared assets and our amendment to the demand management innovation allowance mechanism (DMIAM).

Table 2.1 AER's final decision on AusNet Services' revenues for the six-month extension period (\$ million, nominal)

	HY2021 ^d
Return on capital	105.7
Regulatory depreciation ^a	48.6
Operating expenditure ^b	136.4
Revenue adjustments ^c	0.3
Cost of corporate income tax	5.1
Annual revenue requirement and expected revenue	296.1

Source: AER analysis.

- (a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening regulatory asset base (RAB).
- (b) Includes debt raising costs.
- (c) Revenue adjustments from the DMIAM.
- (d) This is for the six-month extension period of 1 January 2021 to 30 June 2021.

Expected impact of decision on electricity bills

The electricity bill for customers in AusNet Services' network reflects the combined cost of all the electricity supply chain components—wholesale energy generation, transmission, distribution, metering, and retail costs. This final decision primarily relates to the distribution charges for SCS, which represent approximately 34.0 per cent on average for residential customers' and 39.0 per cent on average for small business customers' electricity bill in AusNet Services' network area.⁴

We estimate the expected bill impact by varying the distribution charges in accordance with our final decision on revenue, while holding all other components constant.⁵ This approach isolates the effect of our final decision on the core distribution charges only. However, this does not imply that other components will remain unchanged across the regulatory control period.⁶

⁴ AusNet Services, *ASD - Workbook 7 - Bill Impacts 2022-26*, January 2020.

⁵ We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

⁶ It also assumes that actual energy consumption will equal the forecast adopted in our decision. Since AusNet Services operates under a revenue cap, changes in energy consumption will also affect electricity bills across the six-month extension period.

Our decision also covers charges for revenue-capped metering services (that form a part of ACS) and these costs are included in this estimated bill impact analysis.⁷ Other components of the electricity bill include wholesale electricity costs, retail costs and environmental policy costs.

To simplify and provide for a like-for-like comparison we have halved the bill estimate for the calendar year 2020. This allows us to effectively compare the average electricity bill for the six-month extension period in 2021 with the average six-month electricity bill in 2020.

Based on this approach, we expect that our final decision on the distribution component will decrease the average residential electricity bill in the six-month extension period by about \$27 (\$ nominal) or 3.2 per cent from the 2020 bill level.⁸ By comparison, had we accepted AusNet Services' proposal, the expected change in the distribution component would decrease the average residential electricity bill in the six-month extension period by about \$14 (\$ nominal) or 1.7 per cent from the 2020 bill level.⁹

Similarly, for an average small business customer, we expect that our final decision on the distribution component will decrease the average electricity bill in the six-month extension period by about \$169 (\$ nominal) or 4.3 per cent from the 2020 bill level.¹⁰ By comparison, had we accepted AusNet Services' proposal, the expected change in the distribution component would decrease the average small business electricity bill in the six-month extension period by about \$111 (\$ nominal) or 2.8 per cent from the 2020 bill level.¹¹

Our estimated impact is based on an average electricity usage for six months of around 2000 kWh for residential households and 10 000 kWh for small businesses.¹² Therefore, customers with different usage will experience different changes in their bills. We also note that there are other factors, such as wholesale, metering and retail costs, which affect electricity bills.

Table 2.2 shows our estimated impact of our final decision and AusNet Services' proposal on the average electricity bills for residential and small business customers in its network over the six-month extension period.

⁷ The metering costs referenced in the estimated bill impact analysis refer only to the revenue-capped type 5 and 6 (including smart metering) services, and do not include any other price-capped metering services. For more information on metering services, see Section 2.14 Alternative control services.

⁸ If we only consider SCS and exclude the metering component the decrease is \$32.

⁹ If we only consider SCS and exclude the metering component the decrease is \$22.

¹⁰ If we only consider SCS and exclude the metering component the decrease is \$174.

¹¹ If we only consider SCS and exclude the metering component the decrease is \$118.

¹² This equates to annual usage of 4000 kWh for residential households and 20000 kWh for small businesses. Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, pp. 72–73.

Table 2.2 Estimated impact of AusNet Services' proposal and AER's final decision on electricity bills for the six-month extension period (\$ nominal)

	2020 (halved) ^a	HY2021 ^b
AER final decision		
Residential bill	852 ^c	825
Period change ^e		-27 (-3.2%)
Standard control services		-32
Metering		5
Small business bill	3954 ^d	3785
Period change ^e		-169 (-4.3%)
Standard control services		-174
Metering		5
AusNet Services proposal		
Residential bill	852 ^c	838
Period change ^e		-14 (-1.7%)
Standard control services		-22
Metering		7
Small business bill	3954 ^d	3843
Period change ^e		-111 (-2.8%)
Standard control services		-118
Metering		7

Source: AER analysis; Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, p. 76.

- (a) This is for the period of 1 January 2020 to 31 December 2020, halved.
- (b) This is for the six-month extension period of 1 January 2021 to 30 June 2021.
- (c) Bill for CY2020 is half of the annual bill sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision* and based on the average annual consumption of 4000 kWh for residential customers in Victoria.
- (d) Bill for CY2020 is half of the annual bill sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision* and based on the average annual consumption of 20 000 kWh for small business customers in Victoria. Added to this amount is the metering cost per customer for half of 2020.
- (e) Period change amounts and percentages are indicative. They are derived by varying the distribution component of the CY2020 (halved) bill amounts in proportion to half-year expected revenue divided by forecast energy as provided by AusNet Services. Actual bill impacts will vary depending on electricity consumption and tariff class. Added to this amount is the metering cost per customer for half of 2020.

2.2 Regulatory asset base

Our final decision includes AusNet Services' opening regulatory asset base (RAB) value as at 1 January 2021. The value of the RAB substantially impacts AusNet Services' revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and return of capital (depreciation) components of the distribution determination.¹³ This final decision sets out the opening RAB as at 1 January 2021 based on actual/latest capital expenditure (capex) estimates for the 2016–20 regulatory control period, using the standard five year roll forward model (RFM) for that period.¹⁴

We determine an opening RAB value of \$4530.4 million as at 1 January 2021 for AusNet Services. This value is \$56.3 million (or 1.2 per cent) lower than AusNet Services' proposed opening RAB of \$4586.8 million (\$ nominal) as at 1 January 2021.¹⁵

To determine the opening RAB for AusNet Services as at 1 January 2021 we have rolled forward the RAB over the 2016–20 regulatory control period. In doing so, we reviewed the key inputs of AusNet Services' proposed RFM, such as actual inflation, rate of return, gross capex values,¹⁶ capital contribution values, forecast depreciation amounts and asset lives. We found most of these inputs were correct and reconcile with relevant data sources such as Australian Bureau of Statistics (ABS) data, annual regulatory information notices (RINs) and the 2016–20 decision models.¹⁷ However, we have identified some of the proposed inputs required corrections and updates. Therefore, we have made the following amendments to AusNet Services' proposed RFM inputs:

- Amended the capex inputs for 2018 to be consistent with the values reported in the annual RIN for that year.¹⁸
- Amended the 2016–20 forecast depreciation amounts, an input for the RAB roll forward calculation, to be consistent with the values in the 2020 return on debt update in the 2016–20 PTRM, as required under the 2016–20 regulatory determination.¹⁹

¹³ The size of the RAB also impacts the benchmark debt raising cost amount. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

¹⁴ We have provided AusNet Services with a set of amended regulatory models and a summary of modelling requirements for use in the Victorian 2021–26 regulatory determinations. This includes a RFM for the 2016–20 regulatory control period and a RFM for the 2016–21 period.

¹⁵ AusNet Services, *ASD - Distribution Proposal RFM (2016-20) - 310120 - PUBLIC*, January 2020.

¹⁶ Our review also includes the capitalised value of the existing leases proposed by AusNet Services. AusNet Services, *Response to AER information request #19*, 20 May 2020.

¹⁷ At the time of this decision, the roll forward of AusNet Services' RAB includes estimated capex values for 2020. We may update this estimated capex for the 2021–26 distribution determination.

¹⁸ AusNet Services, *Response to AER IR#019*, 24 June 2020.

¹⁹ AER, *Final decision AusNet Services distribution determination 2016 to 2020, Attachment 2*, p. 20, May 2016. The 2016–20 final decision is to roll forward the RAB for the commencement of AusNet Services' next regulatory control period using depreciation based on forecast capex (updated for actual inflation).

- Updated the 2019 estimated capex inputs with actual capex reported in the annual RIN for that year, which became available after AusNet Services submitted its proposal.²⁰
- Made adjustments for AusNet Services' expenditure for capitalised leases and IT system upgrade (detailed below).

We accept AusNet Services' proposal to capitalise the value of its existing leases due to a change in the accounting reporting standard. We have assessed AusNet Services' calculation of the capitalised value and are satisfied that it reflects the present value of future lease payments over the remaining contract terms. We note this calculation method is consistent with the requirements set out in the Australian accounting standard.²¹

However, we do not accept AusNet Services' approach in its proposed 2016–20 RFM which adds the value of these capitalised leases as annual capex over the 2019 to 2020 period allocated to two new asset classes of 'Non-network leasehold land & buildings - 1 Apr 2019' and 'Non-network leasehold land & buildings - CY20' in the RAB roll forward process. We do not consider new asset classes should be inserted in the RFM for recording capex in the RAB roll forward for the 2016–20 period. The RFM for this period should only use the approved asset classes in the 2016–20 distribution determination. The value of these leases should instead be rolled into the RAB at the end of the period in the 2016–21 RFM.²² We therefore removed the proposed two new asset classes and associated capex from the 2016–20 RFM. We consider this approach is consistent with the requirements of the RFM and *Capital expenditure incentive guideline*.²³ We notified AusNet Services of this change and in response it agreed with this amendment.²⁴

We also accept AusNet Services' revision to the allocation of its IT system upgrade costs in the 2019–20 capex entries for the 2016–20 RFM. Our review of AusNet Services' proposed RFM identified that it had included a new 'Non-network - metering related IT' asset class for allocating 2019–20 capex. In its response to our information request, AusNet Services submitted that this was an error and the capex for that period should be allocated to the existing 'Non-network general assets - IT' asset class.²⁵ We therefore removed the proposed 'Non-network - Metering related IT' asset class and reallocated the capex associated with this proposed asset class to the existing 'Non-network general assets - IT' asset class.

²⁰ AusNet Services, *Response to AER IR#019*, 24 June 2020.

²¹ Australian Accounting Standard Board, *Accounting Standard AASB 16 Lease*, February 2016 https://www.aasb.gov.au/admin/file/content105/c9/AASB16_02-16.pdf.

²² AER, *Draft decision - AusNet Services distribution determination - RFM*, September 2020.

²³ AER, *Final decision Electricity distribution network service providers Roll forward model handbook, Section 2.3.10* December, 2016; and AER, *Capital expenditure incentive guideline*, November 2013, p. 18.

²⁴ AusNet Services, *RE: Vic EDPR - 6 Month Gap - AusNet Services Update response to AER IR#019*, 31 July 2020.

²⁵ AusNet Services, *Response to AER IR#028*, 24 June 2020; and AusNet Services, *Response to AER IR#031*, 12 June 2020.

To determine the opening RAB as at 1 January 2021, we have rolled forward the RAB over the 2016–20 regulatory control period to arrive at a closing RAB value at 31 December 2020 in accordance with our RFM. This roll forward process includes an adjustment at the end of the 2016–20 regulatory control period to account for the difference between actual 2015 capex and the estimate approved in the 2016–20 determination.²⁶ All other adjustments are applied as part of the final year adjustments at 30 June 2021 to establish the opening RAB value at 1 July 2021 in the 2021–26 distribution determination.²⁷

Table 2.3 sets out the roll forward of AusNet Services' RAB over the 2016–20 regulatory control period.

Table 2.3 AER's final decision on AusNet Services' RAB for the 2016–2020 regulatory control period (\$ million, nominal)

	2016	2017	2018	2019	2020 ^a
Opening RAB	3442.1	3610.5	3809.4	4067.6	4308.1
Capital expenditure ^b	298.7	332.6	367.3	349.0	411.6
Inflation indexation on opening RAB	52.0	36.9	73.7	84.5	68.6
Less: straight-line depreciation ^c	182.3	170.6	182.8	193.0	208.2
Interim closing RAB	3610.5	3809.4	4067.6	4308.1	4580.1
Difference between estimated and actual capex in 2015					–38.1
Return on difference for 2015 capex					–11.6
Closing RAB as at 31 December 2020					4530.4

Source: AER analysis.

- (a) Based on estimated capex provided by AusNet Services. We expect to update the RAB roll forward for actual capex as part of making the 2021–26 distribution determination.
- (b) Net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.
- (c) Adjusted for actual CPI. Based on forecast capex.

2.3 Rate of return

The return each business is to receive on its RAB (the 'return on capital') is 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.

The Victorian Government has passed legislation to change regulatory periods to a financial year basis for electricity distribution network service providers. This resulted in an extension of the 2016–20 regulatory control period by six months to align with the

²⁶ The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2016–20 determination.

²⁷ This includes adjustment for capitalised leases, and reallocation for accelerated depreciation purposes.

next regulatory period. Section 16VJ of the amended NEVA provides that the RoRI applies to the six-month extension period, subject to the AER's modifications of the instrument, to give effect to the extension of the 2016–20 regulatory control period.

The RoRI was developed on the basis of consecutive 12-month regulatory years, and does not contemplate an intervening six-month extension period when moving from calendar years to financial years. This is important for the calculation of the trailing average portfolio return on debt under the Instrument. The RoRI also did not contemplate the nomination of averaging periods for a six-month extension period.

Therefore, with the passage of the NELA Act and the publication of the associated Order in Council, we have published modifications to the RoRI as it applies to the six-month extension period of 1 January 2021 to 30 June 2021.²⁸

The Order allows the application of placeholder averaging periods to the six-month extension period instead of the nominated and accepted averaging periods, if we consider it necessary or expedient for making the variation decision.²⁹ The Order also provides for making appropriate adjustments in the 2021–26 regulatory control period for the difference between applying the nominated and accepted averaging period and applying the placeholder averaging period.³⁰

Our decision is to accept AusNet Services' proposed risk free rate³¹ and debt averaging periods because they satisfied the modified six-month instrument.³² These were submitted to us prior to March 2020.

We have used a placeholder averaging period (as allowed by the Order) in this decision. This is because of the unanticipated delay in the passing of the NELA Act, and to facilitate our pricing process – the nominated (and accepted) averaging periods would not have finished in time to allow practical estimation of the final rate of return (based on the accepted averaging periods). The placeholder averaging period is included in confidential Attachment B, to protect the confidentiality of the nominated and accepted averaging periods.

Consequently, the rate of return for the extension period, calculated in accordance with the modified six-month instrument and the Order, is 2.33 per cent (nominal vanilla) (4.72 per cent annualised). We will determine the appropriate true-up in the 2021–26 regulatory control period for the difference between applying the nominated and accepted averaging period and applying the placeholder averaging period.

²⁸ AER, *Modified rate of return instrument for the Victorian electricity distribution networks during the extension period of 1 January–30 June 2021*, October 2020.

²⁹ Order in Council under section 16VE of the NEVA, October 2020, cl. 5(b).

³⁰ Order in Council under section 16VE of the NEVA, October 2020, cl. 8.

³¹ This is also known as the return on equity averaging period.

³² Clauses 7–8, 23–24 and 36 of the modified six month instrument in Attachment A in AER, *Modified rate of return instrument for the Victorian electricity distribution networks during the extension period of 1 January–1 July 2021*, October 2020.

We note AusNet Services has adopted modifications that are consistent with the modified six-month instrument.³³

Table 2.4 Decision on rate of return (% nominal)

	AER final decision (2016–20)	AusNet Services' proposal (2020–21)	AER decision annualised (2020–21)	AER decision six months (1 Jan 2021- 30 Jun 2021)
Nominal risk free rate	2.93%	1.26%	0.93% ^a	
Market risk premium	6.5%	6.1%	6.1%	
Equity beta	0.7	0.6	0.6	
Return on equity (nominal post-tax)	7.5%	4.90%	4.59%	2.27%
Return on debt (nominal pre-tax)	5.52%	4.90%	4.80%	2.37%
Gearing	60%	60%	60%	60%
Nominal vanilla WACC	6.31%	4.90%	4.72%	2.33%
Expected inflation	2.32%	2.32%	2.25%	1.12%

Source: AER analysis; AusNet Electricity Services Pty Ltd, *Electricity Distribution Price Review 2022-26 Appendix 1C*, Extension period revenues (1 January- 30 June 2021) January 2020, pp. 3–4.

^a Calculated using placeholder averaging period

Our final decision is to accept the method used in AusNet Services' proposal for debt raising costs which uses an annual rate of 8.16 basis points per annum (bppa).³⁴ We have considered this annual rate and found that our alternative benchmark estimate (8.5 basis points) is not materially different from AusNet Services' proposal.³⁵

We accept AusNet Services' proposal to use our approach to estimate equity raising costs.³⁶ We have updated our estimate for this regulatory control period based on the benchmark approach using updated inputs.

³³ AusNet Electricity Services Pty Ltd, *Electricity distribution price review 2022- 26, Appendix C, Extension period revenues (1 January- 30 June 2021, January 2020, p. 1.*

³⁴ AusNet, *Electricity Distribution Price Review 2022-26 Part III*, January 2020, p. 216

³⁵ We use the alternative estimate for the 2016–20 regulatory period, because in our 2020 letter to distribution network service providers we stated that we would apply a trend forward approach for opex. As debt raising costs is recovered via the opex forecast, we consider use of the 2016–20 alternative estimate consistent with our outlined approach.

See: AER, *Re: Victorian distribution reset – 6-month extension period – Final approach*, 17 August 2020.

³⁶ AusNet Services, *Electricity Distribution Price Review 2022-26 Part III*, January 2020, p. 215.

Our decision applies a gamma of 0.585 as per the modified six-month instrument.³⁷ AusNet Services' proposal has adopted a value of 0.585 which is consistent with the modified six-month instrument.³⁸

2.3.1 Inflation forecasts

Our estimate of expected inflation included in this final decision is 2.25 per cent (detailed in Table 2.4).

AusNet Services proposed to adopt our current approach for estimating expected inflation as set out in our PTRM and submitted a placeholder estimate of expected inflation of 2.45 per cent.³⁹

Our decision accepts AusNet Services' proposal to adopt our current approach, but we have substituted its placeholder estimate with our own. In implementing our current approach and calculating a 10 year geometric average inflation estimate our decision uses:

- Inflation forecasts from the August 2020 Reserve Bank of Australia (RBA) Statement on Monetary Policy (SMP) for years ending on 31 December 2021 (year 1) and 31 December 2022 (year 2), and 2.5 per cent for years 3 through 10.
- August 2020 RBA SMP consumer price index (CPI) forecasts (and not trimmed mean inflation (TMI) forecasts).

We used TMI forecasts in making our June 2020 decisions, due to exceptional COVID-19 related volatility reflected in the inflation forecasts over the course of the 2020 calendar year.⁴⁰ This included a price reduction that materially impacted the last quarter of the regulatory control periods ending in June 2020, and the expected price rebound in the first six months of the next regulatory control period. A major driver of this volatility was temporary government policy responses to COVID-19 circumstances. As a result, we did not consider the use of CPI forecasts appropriate for forecasting inflation changes either side of 1 July 2020 forwards. The TMI forecasts trimmed out large COVID-19 related temporary volatility.

We note that the use of CPI forecast for the entire 2020 calendar year is not subject to the same issue. The CPI forecast for the year ending 31 December 2020 captures both the decrease and increase in inflation due to the temporary government policy initiative. By contrast, TMI forecasts may not only exclude these variations, but also other variations arising from key drivers of inflation, such as fuel costs, that are

³⁷ Clause 27 of the modified six month instrument in Attachment A in AER, *Modified rate of return instrument for the Victorian electricity distribution networks during the extension period of 1 January–1 July 2021*, October 2020.

³⁸ AusNet Electricity Services Pty Ltd, *Electricity distribution price review 2022- 26, Appendix C, Extension period revenues (1 January- 30 June 2021*, January 2020, p. 7.

³⁹ AusNet Services, *EDPR 2022-26 Regulatory proposal Part III*, January 2020, p. 217.

⁴⁰ The RBA noted in its May SMP government policy decisions in response to the COVID-19 pandemic were expected to reduce CPI inflation by around 1.5 per cent in the June 2020 quarter, followed by a large rebound when the government policies reversed. Reserve Bank of Australia, *Statement on Monetary Policy*, May 2020, p 79.

ordinarily captured in CPI. As such, CPI forecasts are a better estimate of broad-based inflation changes over this period than TMI forecasts.

2.4 Regulatory depreciation

Depreciation is the amount provided so capital investors recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by AusNet Services, we make determinations on the indexation of the RAB and depreciation building blocks for AusNet Services' six-month extension period. The regulatory depreciation amount is the net total of the straight-line depreciation less the indexation of the RAB.

This final decision sets out AusNet Services' regulatory depreciation amount over the six-month extension period. Under clause 7 of the Order, the AER may apply the depreciation schedules for standard control services included in the relevant 2016–20 distribution determination to the six-month extension period, adjusted to reflect the length of the extension period.

The straight-line depreciation is for existing assets as at 1 January 2021 and so incorporates actual and estimated capex from the 2016–20 regulatory control period. An adjustment is required to reflect that the six-month extension period is a half year rather than full year. It also presents our final decision on the proposed depreciation schedules, including an assessment of the proposed standard asset lives.

We accept AusNet Services' proposed straight-line depreciation method for calculating the regulatory depreciation amount as set out in the PTRM and the year-by-year tracking approach to implement this method, subject to correcting some errors. We have removed some of the proposed asset classes and we accept the proposed standard asset lives (with the exception of the 'Equity raising costs' asset class).

We reduced AusNet Services' proposed forecast regulatory depreciation by \$3.8 million (or 7.3 per cent) to \$48.6 million (\$ nominal). This reduction mainly reflects:

- our amendment for the six-month extension period PTRM to reference the straight-line depreciation output from the depreciation tracking model
- our corrections to AusNet Services' proposed depreciation tracking model
- our determinations regarding other components of AusNet Services' regulatory proposal that affect the forecast regulatory depreciation—the opening RAB at 1 January 2021 and expected inflation for the six-month extension period.

We notified AusNet Services that its half-year revenue proposal did not use the depreciation model for the six-month extension period. We consider that the depreciation amount for the six-month extension period must come from the depreciation model reflecting the latest opening RAB for 1 January 2021. This approach is consistent with our guidance on the package of models provided to the Victorian distributors in September 2019 (and finalised in October 2019).

We accept the proposed asset classes in the six-month extension period PTRM with the exception of:

- 'Secondary systems (pre 2016)'

- 'Non- Network Leasehold Land & Buildings - 1 Jan 2021'
- 'Non-network - Metering related IT'.

In the six-month extension period PTRM, the 'Secondary systems (pre 2016)' has zero opening RAB and tax values, and zero forecast capex. Therefore, it is not necessary to have this asset class or assess the relevant asset life in the PTRM.

We have removed the 'Non- Network Leasehold Land & Buildings - 1 Jan 2021' and 'Non-network - Metering related IT' asset classes from the six-month extension period PTRM for the reasons discussed above in section 2.2.

We accept the proposed standard asset lives with the exception of the 'Equity raising costs'. We have amended the standard life for the 'Equity raising costs' asset class to be 47.9 years to reflect the standard life approved for the 2016–20 regulatory control period. This is consistent with the Order. This is also consistent with the initial guidance provided to AusNet Services in November and December 2019, where we noted that depreciation for the six-month extension period is to be based on existing asset classes/lives/methods approved for the 2016–20 regulatory control period.

Table 2.5 sets out our final decision on the regulatory depreciation amount for AusNet Services' six-month extension period.

Table 2.5 AER's final decision on AusNet Services' forecast depreciation for the six-month extension period (\$ million, nominal)

	HY2021 ^a
Straight-line depreciation	99.2
Less: inflation indexation on opening RAB	50.7
Regulatory depreciation	48.6

Source: AER analysis.

(a) This is for the six-month extension period of 1 January 2021 to 30 June 2021.

2.5 Operating expenditure

Clause 7 of the Order gives effect to the “trend forward” approach for forecast operating expenditure for the six-month extension period. We have adopted the 'trended forward' approach to determine a forecast opex of \$134.9 million (\$2020) for AusNet Services. This is lower than AusNet Services' proposed forecast opex of \$137.2 million (\$2020),⁴¹ as shown in Table 2.6.

⁴¹ AusNet Services, *2021–26 Regulatory proposal – Supporting document – Distribution Proposal PTRM model (Jan-Jun21)*, January 2020.

Table 2.6 Forecast opex, period (\$ million, 2020)

	AER decision	AusNet Services proposal
Total opex, excluding GSL payments and debt raising costs	129.3	NA*
GSL payments	4.5	NA*
Total opex, excluding debt raising costs	133.8	134.9
Debt raising costs	1.2	2.3
Total opex	134.9	137.2

* Not available, AusNet Services did not include an explicit amount for GSL payments.

Source: AusNet Services, *2021–26 Regulatory proposal – Supporting document – Distribution Proposal PTRM model (Jan-Jun21)*, January 2020; AER analysis.

To forecast opex we have:

- Applied a rate of change to half the forecast opex that we determined for 2020, excluding Guaranteed Service Level (GSL) payments and debt raising costs. We have used a rate of change equal to three quarters of the rate of change we used for 2020. This represents the change in the average level of output, prices and productivity between the average levels over the 2020 calendar year and the first six months of 2021. This can be represented as the difference in these levels at the end of June 2020 (the middle of 2020) and the end of March 2021 (the middle of the 2021 half year), which is nine months, or three quarters of a year.
- Included an explicit GSL payments forecast, equal to half the amount allowed in each year from 2016 to 2020.
- We have forecast debt raising costs using the appropriate benchmarking approach.

The difference between our opex forecast and the one proposed by AusNet Services is that:

- We have applied nine months' worth of rate of change, not a full year's worth.
- We have updated the inflation forecast to reflect the latest ABS data and the RBA's latest CPI growth forecasts in its August *Statement on monetary policy*.⁴² AusNet Services also proposed using lagged inflation which we have not adopted.
- We have included an explicit GSL payments forecast, equal to half the amount allowed in 2020. This is required for the application of the efficiency benefit sharing scheme (EBSS), which is not applied to GSL costs.

⁴² Reserve Bank of Australia, *Statement on monetary policy – Appendix: Forecasts*, August 2020.

AusNet Services confirmed it agreed with our approach outlined above but stated trimmed mean inflation forecasts would be more appropriate than CPI forecasts.⁴³ Further details on our decision of using CPI forecasts are explained in section 2.3.1.

2.6 Capital expenditure

Clause 7 of the Order gives effect to the “trend forward” approach for forecast capital expenditure for the six-month extension period. We accept AusNet Services' capital expenditure (capex) forecast for the six-month extension period. AusNet Services' six-month extension forecast was consistent with the trend-forward approach, namely, AusNet Services proposed half of its 2020 capex allowance, which was escalated with CPI only. Table 2.7 shows AusNet Services' proposed forecast and our decision.

Table 2.7 Net capex forecast for the six month extension period (\$ million, 2020)

Six-month extension net capex forecast	
AusNet Services' proposal	\$204.7
Decision	\$204.7
Difference	-

Source: AER analysis, *AusNet Services, Response to Information Request 30 - HY capex allowance*, 12 June 2020, Public. The capex forecast is net of equity raising costs, disposals and capital contributions.

2.7 Corporate income tax

Our determination of the ARR includes the estimated cost of corporate income tax for AusNet Services' six-month extension period. Under the post-tax framework, a corporate income tax amount is calculated as part of the building block assessment. This amount allows AusNet Services to recover the estimated cost of corporate income tax during the six-month extension period. This calculation is based on the approach used for the 2016–20 regulatory control period and therefore uses our previous version of the PTRM (version 3). The only exception is for the value of imputation credits (gamma), which is to be based on the 2018 *Rate of Return Instrument*.

This section presents our assessment of AusNet Services' proposed corporate income tax amount for the six-month extension period. It also presents our assessment of its proposed opening tax asset base (TAB), and the standard and remaining tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

We determine a cost of corporate income tax of \$5.1 million for AusNet Services over the six-month extension period. This represents a reduction of \$0.3 million or 5.8 per cent from AusNet Services' proposal.

⁴³ AusNet Services, *Information request 43*, 18 June 2020.

We accept AusNet Services' proposed method to establish the opening TAB as at 1 January 2021. However, we reduced AusNet Services' proposed opening TAB value as at 1 January 2021 to \$3566.7 million (\$ nominal)—a reduction of \$31.5 million (or 0.9 per cent).

We accept AusNet Services' proposed standard tax asset lives for all of its existing asset classes. The proposed standard tax asset lives are broadly consistent with the tax asset lives prescribed by the Commissioner for taxation in Australian Tax Office (ATO) taxation ruling 2020/3 and/or are the same as the approved standard tax asset lives for the 2016–20 regulatory control period.

For the reasons discussed in section 2.4, we have removed the 'Non- Network Leasehold Land & Buildings - 1 Jan 2021', 'Non-network - Metering related IT' and 'Secondary systems (pre 2016)' asset classes from the six-month extension PTRM.

We also accept AusNet Services' proposed approach to calculating the remaining tax asset lives as at 1 January 2021 for all its existing asset classes because they are calculated based on the weighted average method as set out in our RFM.

Discussed in other sections, our final decision on AusNet Services' proposed return on capital and the regulatory depreciation building blocks affect total revenues, and therefore also impact the forecast corporate income tax amount.

Table 2.8 sets out our final decision on the estimated cost of corporate income tax for AusNet Services over the six-month extension period.

Table 2.8 AER's final decision on AusNet Services' cost of corporate income tax for the six-month extension period (\$ million, nominal)

	HY2021 ^a
Tax payable	12.3
Less: value of imputation credits	7.2
Net corporate income tax	5.1

Source: AER analysis.

(a) This is for the six-month extension period of 1 January 2021 to 30 June 2021.

2.8 Efficiency benefit sharing scheme

Under clause 7 of the Order, we may decide whether revenue increments or decrements from the application of the EBSS or other incentive schemes should apply to the six-month period, and if so, which version of the scheme should apply and how the scheme should be modified when it applies to the six-month extension period.

Under clause 8 of the Order for determining revenue increments and decrements in the 2021–26 regulatory control period from the application of a scheme, we may modify the application of a scheme as we consider necessary as a consequence of the extension of the 2016–20 regulatory control period.

Our final decision is to continue to apply version 2 of the EBSS to AusNet Services in the six-month extension period. However, we have not included any EBSS carryover payments in the annual revenue requirement for the six-month extension period. We have deferred any increment or decrement accrued from the application of the EBSS in the current regulatory control period to 2021–22.

We have amended the calculation of EBSS increments and decrements to be included in revenues for the 2021–26 regulatory control period to account for the six-month extension of the current regulatory control period. The amendments ensure that efficiency gains or losses are carried forward for an additional five years in all years.

Further details on the amount and treatment of EBSS carryovers accrued for the six-month extension are discussed in Attachment 8 of the draft decision for the 2021–2026 regulatory control period.⁴⁴

This approach provides for a fair sharing of efficiency gains and losses between AusNet Services and network users. It also provides AusNet Services a continuous incentive to reduce opex.

2.9 Capital expenditure sharing scheme

As we have adopted a trend forward approach of the 2020 capex allowance—rather than a category specific forecast—we would not have information to assess the materiality of the deferral adjustment mechanism set out in the CESS guideline. We have not applied a capital expenditure sharing scheme (CESS) for the six-month extension.

We note that AusNet Services still receives an incentive to reduce its capex through the financing benefit.⁴⁵

2.10 Service target performance incentive scheme

Our decision is to continue to apply STPIS 1.0 to AusNet Services for the extension period. This is consistent with the guidance we issued in November and December 2019. We have reviewed AusNet Services' proposed performance targets and found it to be inconsistent with our own calculation. AusNet Services' revenue proposal applied a top down approach using network level performance in setting its reliability of supply targets for the extension period.⁴⁶ We consider this method a departure from scheme's methodology of using a bottom up approach using data at the feeder level to calculate performance targets.⁴⁷

⁴⁴ AER, *Draft Decision, AusNet Services distribution determination 2021–2026, Attachment 8 Efficiency Benefit Sharing Scheme*, September 2020.

⁴⁵ This is the return on capital a distributor receives throughout the regulatory control period for the difference between forecast and actual capex.

⁴⁶ AusNet Electricity Services, *Electricity Distribution Price Review 2022, Appendix 1C Extension Period Revenues (1 January – 30 June 2021)*, 31 January 2020, pp. 11.

⁴⁷ AusNet Electricity Services, *Q032 Animal and Bird Faults.xls*, 15 March 2016.

Therefore, we have recalculated AusNet Services STPIS performance targets for the reliability of supply parameters.⁴⁸

However, we accept AusNet Services' proposed STPIS performance targets for the telephone answering parameter because it is consistent with the scheme's methodology.

The incentive rates of the STPIS for the current regulatory period will continue to apply and STPIS performance reward or penalty for the extension period will be applied to electricity prices in financial year 2022–23.

Table 2.9 and Table 2.10 present our decision on the incentive rates and targets that will apply to AusNet Services for the extension period.

Table 2.9 STPIS decision—Incentive rates for AusNet Services for the extension period

	Urban	Short rural	Long rural
SAIDI	0.02070	0.01611	0.00735
SAIFI	1.58716	1.43960	0.66180
MAIFI	0.12697	0.11517	0.05294
Telephone answering			-0.0400%

Source: AER analysis

Table 2.10 STPIS decision—Reliability targets for AusNet Services for the extension period

	Average performance 2010–14	Modification	Value
SAIDI			
Urban	44.64508	0.16035	44.48473
Short Rural	87.54479	0.22776	87.31703
Long Rural	102.14278	0.31011	101.83266
SAIFI			
Urban	0.56028	0.00278	0.55751

⁴⁸ AER, *Information request #12 and #13 to AusNet Services re: AusNet Services' half year targets reconciliation*, 1 May 2020.

	Average performance 2010–14	Modification	Value
Short Rural	1.16237	0.00375	1.15861
Long Rural	1.28918	0.00465	1.28453
MAIFI			
Urban	1.40856	0.00105	1.40751
Short rural	3.14466	0.00278	3.14188
Long rural	5.79036	0.00294	5.78742
Telephone answering			
Percentage of calls will be answered within 30 seconds			80.33

Source: AER analysis.

Application of the performance outcome of the determination extension period

The s-factor outcome of the determination extension period will be applied to the allowable annual revenue of the 2022–23 regulatory year.

2.11 Demand management incentive scheme

Our decision is to continue to apply the current demand management incentive allowance (DMIA) to AusNet Services for the determination extension period.

In our final determination for the 2016–20 regulatory control period, we determined that AusNet Services would be provided an annual DMIA allowance of \$0.6 million (\$2015), or \$3 million over the period, in the 2016–20 regulatory control period.⁴⁹

For the extension period, AusNet Services proposed a DMIA allowance of \$0.3 million (real \$2020), which is half of the annual allowance of \$0.6 million for 2016–20 based on the AER’s 2009 Victorian Demand Management Incentive Scheme.⁵⁰

We agree with AusNet Services’ proposal. For the determination extension period, our decision is to approve a DMIA allowance for AusNet Services of \$0.33 million (\$2020), or one-half of the annual DMIA approved for the 2016–20 regulatory control period.

⁴⁹ AER, *Final Decision AusNet Services distribution determination 2016 to 2020 Attachment 12 Demand management incentive scheme*, May 2016, p. 12-8.

⁵⁰ AusNet Electricity Services Pty Ltd, *Electricity Distribution Price Review 2022–26, Appendix 1C Extension Period Revenues (1 January – 30 June 2021)*, 31 January 2020, section 2.7.

As provided for in the DMIA scheme, any underspent or unapproved allowance in the 2016–20 regulatory control period will be returned to consumers by way of a final year adjustment or true-up mechanism.⁵¹ The true-up calculation will be based on the period 1 January 2016 to 30 June 2021.

Our decision is to continue to apply the new DMIS⁵² to AusNet Services for the determination extension period.

This is because in September 2018, AusNet Services submitted an application⁵³ to the AER for the early implementation of the DMIS. The AER approved AusNet Services' proposal for early application of the new DMIS, with an effective start date of 1 January 2019.⁵⁴

In its proposal for the determination extension period, AusNet Services did not refer to the new DMIS.

As the new DMIS has been already been applied to AusNet Services in the 2016–20 regulatory control period (i.e., since 1 January 2019), our decision is to continue to apply the new DMIS to AusNet Services for the determination extension period.

2.12 Control mechanisms

The control mechanisms for standard and alternative control services (e.g. revenue cap or price cap control) remain as defined in the 2016–20 determination, however the price control formulae have been simplified for the six-month extension period. These price control formulae were discussed with the networks in the second half of 2019, with an indicative position provided by email in December 2019.

Forms of control

Control mechanisms impose limits over the prices of direct control services (standard and alternative control services) and/or the revenues that a distribution network service provider can recover from customers for these services.

Our 2016–20 final decision was that:

- The form of control mechanism for standard control services is a revenue cap.⁵⁵
- The form of control mechanism for type 5 and 6 (incl. smart metering) services is a revenue cap.⁵⁶

⁵¹ AER, *Demand Management Incentive Scheme, Jemena, CitiPower, Powercor, SP AusNet and United Energy 2011–15*, April 2009, section 3.1.5.

⁵² AER, *Demand Management Incentive Scheme, Electricity distribution network service providers*, December 2017.

⁵³ AusNet Services, *Request for early application of the revised DMIS*, 12 September 2018.

⁵⁴ AER, *Final determinations - Early application of the Demand Management Incentive Scheme - AusNet Services, Ergon and Energex*, 11 December 2018.

⁵⁵ AER, *Final Decision AusNet Services distribution determination 2016 to 2020 - Attachment 14 – Control mechanisms*, May 2016, p. 6.

⁵⁶ AER, *Final Decision AusNet Services distribution determination 2016 to 2020 - Attachment 16 – Alternative control services*, May 2016, p. 20.

- The form of control mechanism for all other alternative control services (ancillary network services, metering exit fees, type 7 metering services, and public lighting) is a price cap.⁵⁷

This is consistent with the 2016–20 Framework & Approach. Our decision is to maintain these forms of control into the six-month extension period.

Control mechanism formulae

Our 2016–20 final decision set out formulae to give effect to the control mechanisms. We consider that the addition of the six-month extension period is a material change in circumstances.⁵⁸ Our decision for the six-month extension period is to alter the control mechanism formulae (including simplification of the formulae) to apply to the six-month extension period.

This approach was developed in consultation with the Victorian distributors and reflects a pragmatic approach to the control mechanism formulae and how they will be applied for the six-month extension. The revised formulae are set out in Attachment A of this decision.

Compliance/reporting

Our 2016–20 final decision set out:⁵⁹

- how compliance with the control mechanisms was to be demonstrated⁶⁰
- how recovery of designated pricing proposal charges and jurisdictional scheme charges was to be reported⁶¹
- how adjustments for the under/over recoveries of relevant charges were to be made in subsequent pricing proposals.⁶²

Compliance with the control mechanisms is demonstrated through the annual pricing proposals. This is done by providing calculations that reflect the price control formulae and unders/overs accounts for standard control services and type 5 and 6 (incl. smart metering) services. Unders/overs accounts also apply to designated pricing proposal charges and jurisdictional scheme charges.⁶³

As noted above, we consulted with the Victorian distributors to arrive at a pragmatic approach to the treatment of under/over-recoveries in the six-month extension period. We have chosen to delay application of the under/overs accounts for 2018 and 2019

⁵⁷ AER, *Final Decision AusNet Services distribution determination 2016 to 2020 - Attachment 16 – Alternative control services*, May 2016, pp. 7, 12, 17.

⁵⁸ NER, cl. 6.12.3(c1).

⁵⁹ AER, *Final Decision AusNet Services distribution determination 2016 to 2020 - Attachment 14 – Control mechanisms*, May 2016.

⁶⁰ NER, cl. 6.12.1(13).

⁶¹ NER, cll. 6.12.1(19) and 6.12.1(20).

⁶² NER, cll. 6.12.1(19) and 6.12.1(20).

⁶³ NER, cll. 6.18.7 and 6.18.7A.

until the 2021–26 regulatory period to simplify the annual pricing process for the six-month extension period. For the first two years of the 2021–26 regulatory period, a t-3 period will be included in the unders/overs accounts, with the six-month extension period being trued-up in 2022–23 (year two) along with the true-up for the 2020 year.⁶⁴ For more details, see attachment 14 of our draft decision for the Victorian distributors.

2.13 Pass through events

Our decision is to continue to apply the same nominated pass through events we determined in our 2016–2020 final decision⁶⁵ for AusNet Services over the six-month extension period.

2.14 Alternative control services

Type 5 and 6 (inc. smart metering) services

The Victorian distribution businesses' type 5 and 6 (incl. smart metering) services operate under a revenue cap similar to standard control services, calculated on a limited building block model. For simplicity, the calculation of the type 5 and 6 (incl. smart metering) services revenue cap, will follow the same trend-forward approach as for standard control services (see Box 1 above).

For revenue-capped metering services, we accept AusNet Services' approach to calculating forecast 2021 opex and capex for the six-month extension period. In both cases, AusNet Services followed the AER's approach to calculate these forecasts as per our guidance on the trend-forward methodology.

However, we have made some modelling adjustments:

- We identified differences in the calculation of the opening asset base for 2021. AusNet Services' proposed metering asset base as at 1 July 2021 is calculated based on rolling forward the 2016 metering asset base consistent with our 2016–20 final decision, made in May 2016, and does not reflect the AER's most recent decision (i.e. the AER's Final Decision on AMI transition charges applications December 2016). Our decision on AMI transition charges was made subsequent to our 2016–20 final decision made in May 2016 and includes updates for both 2014 and 2015 actual capital expenditure and operating expenditure for the final two years of the 2016-20 period. This meant we built any compensation required for depreciation, return and operating expenditure into this later decision and AusNet Services was compensated for this in approved AMI prices in the years 2018–2020. For this final decision we have substituted AusNet Service's proposed opening asset base with that in our AMI transition charges decision. We communicated our approach with AusNet Services. AusNet Services disagreed

⁶⁴ AER, *Draft Decision AusNet Services, CitiPower, Jemena, Powercor, and United Energy distribution determination 2021 to 2026 - Attachment 14 – Control mechanisms*, September 2020, pp. 38, 41, 44.

⁶⁵ AER, *Final Decision, AusNet Services distribution determination 2016–2020, Attachment 15 Pass through events*, May 2016.

with our approach.⁶⁶ However we maintain our view that the opening asset base in the transitional RFM should reflect our more recent Final Decision on AMI transition charges rather than our earlier 2016–20 Final Decision. We have adopted this same approach for our 2021–26 Draft Decision.⁶⁷

- AusNet Services also introduced a new asset class, ‘leases capitalised’ in its opening RAB. Previously, costs associated with leases relating to metering sites were reported under opex on an annual basis. In April 2019 there was a change in accounting standards allowing leases to be reported as capex. We accept AusNet Service’s proposal to capitalise leases, but do not accept the proposal to introduce the capitalised leases as a new asset class in the middle of the current regulatory control period. Instead we have added the capitalised leases as a final year adjustment in the roll forward model. This follows the same approach adopted for capitalised leases for SCS (see Section 2.2).
- We corrected an error in AusNet Services’ proposed tax standard lives.
- We adjusted the proposed equity raising costs to reflect the weighted average value of the half-year net capex program instead of the proposed opening asset values.
- We adjusted the proposed opex debt raising costs to reflect six months instead of AusNet Services’ proposed 12 months.

We communicated our changes to tax standard lives, debt raising costs and equity raising costs with AusNet Services. AusNet Services agreed with these changes.⁶⁸

We also updated inputs, including: updating 2019 forecast capex with actual capex, and updating inflation and WACC parameters.

Our revisions result in a lower allowed revenue (of \$26.61 million) than that proposed by AusNet Services (\$28.81 million).

Price-capped alternative control services

In line with our decision on the control mechanism formulae to apply to price-capped alternative control services (see Section 2.12 and Attachment A), we are not setting price caps for these services as part of this decision. The price caps to apply to these alternative control services will be set in the annual pricing process for the six-month extension period.

2.15 Tariff structure statement

Under section 16VD(5) of the amended NEVA, the tariff structure statement (TSS) approved by the AER in 2017 is taken to be a constituent decision or constituent component of the 2016–20 distribution determinations and applies to the six-month

⁶⁶ AusNet Services, Response to information request #044, question 2.

⁶⁷ AER, Draft Decision AusNet Services Distribution Determination 2021 to 2026 – Attachment 16 Alternative control services, September 2020, p.48.

⁶⁸ AusNet Services, Response to information request #044, question 5, 6(a), (b).

extension period. The levels of these tariffs should be set to recover the AER approved revenue for the six-month extension. As a new TSS will apply from 1 July 2021, indicative prices are not required.

2.16 Victorian f-factor Incentive scheme

The f-factor Order in Council was amended on 27 October 2020, to accommodate the extension of the 2016-2020 regulatory control period.

The f-factor scheme is prescribed by the Victorian Government's "f-factor scheme order 2016" to reduce the risk of fire starts by network assets. The performance measures under the f-factor are already, and will continue to be, on a financial year basis. Under the amended f-factor Order in Council the f-factor incentive payments arising from 2018–19 performance would not be applied in the six-month extension; but rather take the form of adjustments to the distributors' regulated revenues for regulatory year 2021–22.

2.17 Submission of pricing proposal

Due to unforeseen delays in the passage of the legislation extending the regulatory control period by six months and changing the commencement of the next regulatory control period to 1 July 2021, we took steps in the pricing process before this decision was released.⁶⁹ This included providing AusNet Services with the information required to prepare its pricing proposal and seeking submission of AusNet Services' draft pricing proposal in mid-October.⁷⁰

In line with our previous communication to AusNet Services, we expect its final pricing proposal to be unchanged from the draft proposal except where we have notified AusNet Services of any required changes.⁷¹

Under Clause 7 of the Order, the AER may specify the manner and form in which the Victorian distributors must submit their pricing proposals for the six-month extension period. In accordance with that clause, and in view of the compressed timelines and staged nature of this process, we require to AusNet Services to submit its final pricing proposal as follows:

1. AusNet Services is to submit its final pricing proposal for the six-month extension period no later than 3 business days after publication of this decision.
2. The final pricing proposal is to consist of the following:

⁶⁹ These steps are set out on our website. See: <<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausnet-services-determination-2021-26/updates>>.

⁷⁰ The key parameters we asked AusNet Services to use are set out in a letter available at the website address in the footnote immediately above. Subsequent to this letter being sent to AusNet Services, we identified an immaterial error in the calculation of the SCS revenue amount. This has been corrected in this final decision and AusNet Services has been notified.

⁷¹ The footnote immediately above sets out one such case. AusNet Services will be notified of any other relevant cases.

- a) resubmission of any components that differ from the draft pricing proposal submitted on 13 October 2020
 - b) a signed letter from a senior officer:
 - i. stating that components of the draft pricing proposal that are not resubmitted in accordance with paragraph 2(a) are taken to be a part of the final pricing proposal;
 - ii. setting out the differences between the final pricing proposal and the draft pricing proposal; and
3. Components that do not differ from the draft pricing proposal submitted on 13 October 2020 are not to be resubmitted.

Other aspects of the compliance and reporting obligations under our 2016–20 decision remain unchanged.

A Constituent decisions

AusNet Services 2016–20 distribution determination is predicated on the constituent decisions referred to in clause 6.12.1 of the NER. This decision varies certain constituent decisions of AusNet Services' 2016–20 distribution determination. We consider these variations are necessary as a consequence of the extension of the 2016–20 regulatory control period.

Variations to constituent decisions of AusNet Services 2016–20 distribution determination

In accordance section 16VK of the NEVA and the Order, the AER varies the following constituent decisions of AusNet Services' 2016–20 distribution determination.

For the extension period of 1 January 2021 to 30 June 2021, the annual revenue requirement referred to in clause 6.12.1(2)(i) of the NER is as set out at section 2.1

The total forecast capital expenditure referred to in clause 6.12.1(3) of the NER for the extended 2016–20 regulatory control period is varied to include the forecast capital expenditure of \$204.7 million (\$2020) for the extension period of 1 January 2021 to 30 June 2021. This is discussed in section 2.6.

The total forecast operating expenditure referred to in clause 6.12.1(4) of the NER for the extended 2016–2020 regulatory control period is varied to include \$134.9 million (\$2020) for the extension period of 1 January 2021 to 30 June 2021, inclusive of GSL payments and debt raising costs. This is discussed at section 2.5.

For the extension period of 1 January 2021 to 30 June 2021, in accordance with the allowed rate of return referred to in clause 6.12.1(5) of the NER, the AER's decision on the allowed rate of return in relation to the six-month extension is to use a placeholder rate of return of 2.31 per cent (nominal vanilla) (4.67 per cent annualised). This will be updated when the averaging periods AusNet Services' nominated have passed. This is discussed in section 2.3.

For the extension period of 1 January 2021 to 30 June 2021, the estimated corporate income tax referred to in clause 6.12.1(7) of the NER is \$5.1 million (\$ nominal). This is set out at section 2.7.

For the extension period of 1 January 2021 to 30 June 2021, the depreciation schedules referred to 6.12.1(8) of the NER are as set out in section 2.4.

A decision referred to in clause 6.12.1(9) of the NER on how any applicable scheme or mechanism is to apply is varied as follows:

- the EBSS will apply for the extension period of 1 January 2021 to 30 June 2021, but revenue adjustments for 2016–20 EBSS calculations are to be deferred to 1 July 2021. Consistent with this approach, the positive EBSS carryovers which AusNet Services has accrued for the six-month extension will not be factored into its annual revenue requirement for the extension period of 1 January 2021 to 30 June 2021 and will be deferred to the start of the next regulatory control period;
- the CESS will not apply for the six-month extension;

- the Service Target Performance Incentive Scheme (STPIS) applies to AusNet Services for the extension period of 1 January 2021 to 30 June 2021. STPIS is discussed at section 2.10;
- AusNet Services is provided with one-half of its annual DMIA allowance, or \$0.33 million (\$2020), for the extension period of 1 January 2021 to 30 June 2021. The new DMIS will apply to AusNet Services for the extension period. This is set out at 2.11.

For the extension period of 1 January 2021 to 30 June 2021, other appropriate amounts, values or inputs referred to in clause 6.12.1(10) of the NER are as set out in this decision.

For the extension period of 1 January 2021 to 30 June 2021, the form of control mechanisms for standard control services referred to in clause 6.12.1(11) is a revenue cap, as defined in the 2016–20 determination, and the control mechanism formulae that give effect to those control mechanisms are varied as set out in section 2.12 and in Attachment A.

For the extension period of 1 January 2021 to 30 June 2021, for the form of the control mechanisms for alternative control services and the formulae that give effect to those control mechanisms, referred to in clause 6.12.1(12) of the NER:

- the form of control mechanisms for type 5 and 6 (incl. smart metering) services is a revenue cap, as defined in the 2016–20 determination, and the control mechanism formulae are varied as set out in section 2.12 and in Attachment A.
- the form of control mechanisms for all other alternative control services (ancillary network services, public lighting, type 7 metering and metering exit fees) is a price cap, as defined in the 2016–20 determination, and the control mechanism formulae are varied as set out in section 2.12 and in Attachment A.

For the extension period of 1 January 2021 to 30 June 2021, the way to demonstrate compliance with a relevant control mechanism as referred to in clause 6.12.1(13) of the NER is as follows:

- AusNet Services must demonstrate compliance with this decision through the annual pricing proposal;
- however, the reporting of the distribution use of service (DUoS) and type 5 and 6 metering unders and overs accounts will be delayed for the six-month extension period.

See section 2.12.

For reporting referred to in clause 6.12.1(19) of the NER, for the extension period of 1 January 2021 to 30 June 2021, consistent with 2016–20 decision, AusNet Services is to report to the AER on its recovery of designated pricing proposal charges through the annual pricing process. The approach to accounting for under and over-recoveries is set out in section 2.12 of this decision.

For reporting referred to in clause 6.12.1(20) of the NER, for the extension period of 1 January 2021 to 30 June 2021, we require AusNet Services to maintain a jurisdictional scheme unders and overs account. It must provide information on this account to us in its annual pricing proposal. The approach to accounting for under and over-recoveries is set out in section 2.12.

This decision also sets out variations to other parts of AusNet Services' 2016–20 distribution determination made in accordance of section 16VK of the NEVA.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ACS	Alternative control services
ARR	Annual revenue requirement
ATO	Australian Tax Office
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
distributor	distribution network service provider
DSO	distribution system operator
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
MAIFI	momentary average interruption frequency index
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RORI	Rate of Return Instrument
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
STPIS	service target performance incentive scheme
SCS	standard control services
WACC	weighted average cost of capital