ATTACHMENT 8.11
TRUE-UP FOR ALTERNATIVE CONTROL SERVICES

Contents

1. Background

Essential Energy submitted a transitional regulatory proposal to the Australian Energy Regulator (AER) on 31 January 2014. The transitional regulatory proposal set out the indicative charges for alternative control services (ACS). The charges for these services were set either based on the provisions of the transitional National Electricity Rules (NER) or based on the AER's preferred approach to setting charges in order to address an anomaly in the transitional NER.

In Essential Energy's transitional regulatory proposal, the charges for ACS in the transitional year of 2014-15 were set as follows:

1. Public lighting services – 2014-15 charges were set by escalating 2013-14 charges by the consumer price index (CPI), in accordance with 11.56.3(j) of the transitional NER.
2. Type 5 & 6 metering services – separate charges were not established, rather the cost of providing the Type 5 & 6 metering services were recovered as part of the general network charges
3. Ancillary network services – for those services currently being provided that have existing charges, CPI was applied to the 2013-14 charges to derive 2014-15 charges. For those services currently being provided but that do not have existing charges, the cost of providing these services were recouped as part of the general network charges.

The NER provide that the AER, in its framework and approach paper that is published in respect of the 2015-19 regulatory control period, may specify the manner in which charges that may be charged for ACS during the subsequent regulatory period are to be adjusted to account for any under or over recovery of revenue earned from the provision of those services during the transitional regulatory period (true-up mechanism for ACS).

Essential Energy is required to submit its regulatory proposal for the subsequent regulatory control period as if this period includes the transitional regulatory year as the first year.[1] We have set out proposed charges for each ACS in chapter 8 of our regulatory proposal and in associated attachments and supporting documents.

2. The AER's stage 2 framework and approach paper

The AER did not set out a true-up mechanism for ACS because at the time of publishing the stage 2 F& A, the AER was yet to see how Essential Energy intended to treat ACS charging, and as such it preferred not to prejudice whether, and if so, how ACS charges are to be trued-up. Instead the AER stated that:

> *We will examine the options for a true-up of these services as part of our regulatory review and provide reasons for the approach that is eventually to be adopted in our determination.*
>
> *A true-up would involve making adjustments to prices in 2015-16 and subsequent years to account for differences between placeholder prices adopted for 2014-15 and those prices determined once our full assessment has been completed. Any true-up will be conducted in accordance with the rules.*

As stated above, Essential Energy has set ACS charges either in accordance with the NER or in accordance with the AER's preferred approach to the setting of these charges for the transitional year, as outlined in the AER's letter to NSW DNSPs on 11 December 2013 (and which is reproduced in the appendix to the stage 2 F&A).

3. Options for a true-up

As advised to the AER previously[2], Essential Energy considers that a true up mechanism for ACS should be implemented so that the AER can exercise its power in accordance with the National Electricity Objective (NEO) and the NEL Revenue and Pricing Principles (RPP) of ensuring the long term interest of customers in respect of

[1] See clause 11.56.4(b) of the NER.
[2] See Appendix 1, letter of 10 January 2014 to the AER's chairman, from the Chief Executive Officer of Ausgrid, Endeavour Energy and Essential Energy

charges, and of ensuring the DNSPs are given a reasonable opportunity to recover their efficient costs.[3] With this in mind, Essential Energy has set out below our consideration on how a true-up for ACS may operate. Essential Energy notes that the suggested mechanism stated below relates only to ACS. The true-up for standard control services that must be applied by the AER is set out in 11.56.4(h) of the NER.

Due to an anomaly in the transitional NER that necessitated an approach to setting charges for the transitional year that complies with the NER, whilst at the same time give proper effect to the AER's decision on classification of services, the workings of a true-up mechanism for ACS (apart from public lighting services) is rather complicated. The true-up options outlined below have been formed on the basis of 'undoing' what has been developed in the transitional year in relation to the recovery of ACS revenue.

Public lighting services

True-up amount:	The amount that will subject to true-up will be the difference between the revenue amount recovered through the charges that were derived from the escalation of 2013-14 charges by CPI and the 'cost reflective' revenue that would have been allowed by the AER (in other words, revenue that would have been recovered if cost reflective charges were allowed to be charged for 2014-15). The 'cost reflective' charge/revenue would be determined by the AER in its distribution determination for the subsequent regulatory period, as it relates to the transitional year.
True-up mechanism:	Adjust public lighting charges in one or more years of the 2015-19 regulatory control period as long as net present value (NPV) neutrality is met.
Effect on charges:	Public lighting charges in one or more years of the 2015-19 regulatory control period will reflect the adjustments.

Type 5 & 6 metering services

True-up amount:	The difference in the revenue allowed to be recovered by the AER for the transitional year in the determination for the transitional period and the revenue allowed by the AER for the transitional year in the determination for the subsequent period.
True-up mechanism:	From a classification perspective, it would be technically correct to 'true-up' under and over recovery through metering charges in one or more years of the 2015-19 regulatory control period. From a fairness perspective however, we consider the amount should be returned or recovered from the customer group that incurred the charges in the transitional year (in this case, the general customer base).For this reason, we consider that the adjustment should apply to general network charges (ie: DUOScharges) for one or more years of the 2015-19 regulatory control period, with the revenue increment or decrement to meet the NPV neutrality principle. Essential Energy also notes that this would ensure that charges are cost reflective for metering in the 2015-19 regulatory control period, and do not contain any distorting effect on customer decisions if metering contestability eventuates. Essential Energy would welcome the opportunity to discuss this true-up option with the AER in greater detail.
Effect on charges:	No effect on Type 5 & 6 metering charges for the 2015-19 regulatory control period. However, DUOS charges for one of more years of this period will reflect the true-up.

Ancillary network services

True-up amount:	The difference in the net revenue allowed to be recovered (i.e. total revenue after deducting revenue from separate miscellaneous and monopoly charges) in the determination for the transitional period and the amount allowed in the determination for the subsequent period, in relation to the transitional year. The amount is to be calculated by reference to the net revenue included in the bundled revenue in the transitional determination and the amount that should have been

[3] As per letter to the AER's chairman on 10 January 2014.

	included/recovered through cost reflective charges as per the substantive determination.
True-up mechanism:	Similar to metering services, we consider that from a classification perspective, it would be technically correct to 'true-up' under and over recovery via an adjustment of ancillary service charges in one or more years of the 2015-19 period. While this may be the case, Essential Energy considers that from a fairness perspective, the amount should be returned or recovered from the customer group that incurred the charges in the transitional year (in this case, the general customer base). For this reason, Essential Energy considers that the adjustment should apply to general network charges (ie: DUOScharges) for one or more years of the 2015-19 regulatory control period. Essential Energy also note that this would ensure that charges are cost reflective for ancillary network services and avoid a situation where a customer receiving an ancillary network service in the 2015-19 regulatory control period has to pay a substantial uplift in charges for under-recovered amounts. We consider that the impact of the adjustment to an individual customer would be far more diluted when applied to a large customer base. We would be happy to discuss this true-up option with the AER in greater detail.

Appendix 1 – Response to 11 December 2013 letter on preferred approach to alternative control services pricing

Ausgrid Endeavour Energy essential energy

10 January 2014

Mr Andrew Reeves
Chairman
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Reeves

RE: Response to 11 December 2013 AER letter on preferred approach to alternative control service pricing

I am writing to you in response to a letter prepared by AER staff on 11 December 2013. In this letter, AER staff set out their view on how alternative control services (ACS) prices should be set for the transitional year (2014-15). This is to fulfil the requirements of the transitional national electricity rules (transitional rules) that require the NSW DNSPs to provide indicative prices for direct control services.

We note that in its Stage 1 Framework and Approach paper (F&A) the AER decided to reclassify / not classify certain services that are deemed to be standard control services in the current 2009-14 period. In summary, the AER decided that types 5 and 6 metering services and ancillary network services are alternative control services and that emergency recoverable works are not to be classified, hence, unregulated. These classifications apply from 1 July 2014 onwards.

The NSW DNSPs are required to provide indicative prices for direct control services in the transitional proposal. To give proper effect to the AER's classification for the transitional period and to comply with the transitional rules, separate prices would need to be set for standard control services and alternative control services (as they are defined in the AER's F&A). This would necessitate the proper allocation of the costs between services to ensure the prices set are cost reflective. As there has been a reclassification of services, a reallocation of costs between services would be required to give effect to separate prices.

In its letter of 11 December 2013, AER staff noted that the transitional rules prevented the reallocation of costs between services for the transitional year. The NSW DNSPs had raised this anomaly in the Rules with the AER in its meeting of 14 June 2013 and we understand the AER's preference at the time was to give primacy to the proper delineation of costs between services and that there should be a consistent approach throughout the five year period from 2014 to 2019. The NSW DNSPs had been preparing the transitional proposals on this basis.

Based on discussions with AER staff in late 2013, we understand the AER has reviewed its position on how to deal with this anomaly and AER staff have indicated a preferred approach (indicative preferred approach) to the setting of indicative prices for the transitional year that '*seeks to comply with the rules and minimise significant changes that would impact on customers in the transitional year*'.

As such, the indicative preferred approach, as set out in the letter of 11 December 2013, effectively maintains the status quo of the current period; that is, recovers the costs of providing alternative control services (as defined in the AER's F&A) for the transitional year as part of standard control services (SCS).

The NSW DNSPs have considered the AER's indicative preferred approach. We agree with the AER that the transitional rules requirements are complex and it makes practical sense to minimise significant changes that would impact on consumers in the transitional year. With this in mind, the NSW DNSPs intend to adopt the substance of the AER's preferred approach.

Nevertheless, we consider that a number of clarifications be made on the scope of the AER's indicative preferred approach to ensure there are no unintended consequences upon implementation. For this purpose, we have:

- Clarified our approach to giving effect to the substance of the AER staff's indicative preferred approach, including interactions with the AER's decision on the NSW DNSP's annual revenue requirement for the transitional and substantive determinations;
- Identified the need for the AER to clarify these arrangements in the Stage 2 Framework and Approach paper; and
- Identified the need for a true up arrangement for alternative control services, which we consider would be best addressed through the Stage 2 Framework and Approach paper.

We understand that the AER is about to publish the Stage 2 Framework and Approach Paper. Clause 11.56.3(h)(5) provides scope for the AER to include in this paper '*the treatment of any other matters relating to the transitional regulatory control period, providing that the treatment of those matters is not inconsistent with this Division 2*'.

We appreciate that the approach outlined in the AER's letter represents the view of the AER's staff and has not necessarily been endorsed by the AER. However, given the importance of this matter, particularly the interaction of the AER's indicative preferred approach with the determination for the subsequent regulatory control period, the NSW DNSPs request that the AER sets out, in its Stage 2 F&A paper:

- Its indicative preferred approach as outlined in its letter of 11 December 2013, noting the clarification needed for the inclusion of emergency recoverable work;
- Clarifications in respect of its indicative preferred approach to make clear that the annual revenue requirement (ARR) determined by the AER under NER clauses 11.56.1(b) and 11.56.3(b) – (f) is the amount that only relates to services that the AER has classified as standard control services in the AER's Stage 1 F&A paper. Importantly, this amount will be used for the 'true up' of the annual revenue requirement in the subsequent regulatory control period (i.e. 2015/16 to 2018/19) and in the over/under recovery calculation of revenue in the transitional year; and
- A mechanism for adjusting the prices that may be charged for alternative control services during the subsequent regulatory control period to account for any over and under recovery of revenue earned from the provision of these services during the transitional year (see NER clause 11.56.3(h)(4)).

Addressing the above matters in the AER's Stage 2 F&A will provide certainty and clarity for both the NSW DNSPs and the AER. This will also provide the DNSPs with certainty that adopting the substance of the AER's approach will not place in jeopardy our compliance with the transitional rules.

Finally, we consider that it would be beneficial to have a "true up mechanism" for ACS specified in the Stage 2 F&A paper and made available. Whether that true up mechanism will need to be utilised depends on the outcomes of the AER's determination for the transitional regulatory period and the subsequent regulatory control period. It may be that no true up would be needed as there is no under/over recovery of revenue for ACS (though highly unlikely) or the over/under recovery amount is immaterial such that applying the true up mechanism would be administratively burdensome.

In any case, we consider that the availability of a true up mechanism for ACS should not be pre-determined by the AER as not being required. In fact, we consider a true up mechanism should be made available so that the AER can exercise its power in accordance with the National Electricity Objective (NEO) and the NEL Revenue and Pricing Principles (RPP) of ensuring the long term interest of customers in respect of prices and of ensuring the DNSPs are given a reasonable opportunity to recover their efficient costs.

Attachment A provides our detailed comments on the above matters.

If you would like to discuss this letter further, please contact Mr Zubin Meher-Homji, Manager Group Regulatory Strategy at Networks NSW on (02) 9269 2395 or via email at ZMeher-Homji@ausgrid.com.au or alternatively Mr Mike Martinson, Group Manager Regulation at Networks NSW on (02) 9249 3120 or via email at michael.martinson@endeavourenergy.com.au.

Yours sincerely

Vince Graham
Chief Executive Officer
Ausgrid, Endeavour Energy and Essential Energy

Attachments:

A: NSW DNSPs' detailed comments on the pricing of alternative control services

Attachment A – NSW DNSPs' detailed comments on pricing of alternative control services

The following are detailed comments provided by the NSW DNSPs for the pricing of alternative control services for the transitional and subsequent regulatory proposals.

1. Clarifying issues in applying the AER's indicative preferred approach

We consider that clarity is required on the interaction between the AER's approach for the transitional regulatory control period and the AER's decision on the NSW DNSPs' annual revenue requirement for the subsequent regulatory control period. Below, we have set out what we consider to be the required clarifications.

AER's service classification will be maintained and revenues of various services will be delineated

The NSW DNSPs are obliged to propose an amount to be the annual revenue requirement for standard control service for the transitional year[1] and the AER is required to make a decision on this proposed annual revenue requirement. The AER can either approve the amount proposed or approve a substitute amount. These obligations on the DNSPs and the AER are the cornerstone of the transitional proposal and the AER's determination.[2]

The annual revenue requirement (ARR) approved by the AER is not only important for the transitional year, but is also important to the determination of the ARR for the subsequent period. This is because the amount approved by the AER for the transitional period is only a "placeholder" amount. The NSW DNSPs are required to re-submit the annual revenue requirement for the transitional year in the substantive proposals and the AER is required to make a decision on this proposed amount again in its determination for the subsequent period.

Any difference in the amount determined as the annual revenue requirement for the transitional year under the distribution determinations for the transitional period and the subsequent period must be adjusted, or "trued up", in the annual revenue requirement for the subsequent four years.[3]

Therefore it is important to clearly identify:

- The amount that the NSW DNSPs propose as the ARR for standard control services for the transitional year in the transitional proposal; and
- The amount that the AER approves as the ARR for the transitional year in the subsequent distribution determination for the transitional regulatory control period.

The AER's indicative preferred approach of pooling together the revenues for SCS and most of the ACS revenues may have the unintended consequence of this total amount being taken to be the annual revenue requirement for the transitional year and to be used in the

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[1] Clause 6.8.2 as amended by 11.55.2(b).

[2] 11.56.1(b)

[3] 11.56.4(h)

adjustments required under 11.56.4(h) – (j) and for the calculation of over/under recovery of revenue for the transitional year.

To avoid this unintended consequence, the NSW DNSPs consider that:

1. For the transitional proposals, the NSW DNSPs will identify the amount that the NSW DNSPs will propose as the annual revenue requirement for standard control services for the transitional year (as required by NER clause 6.8.2 and amended by clause 11.55.2(b)). For clarity, this amount relates to the provision of standard control services as they are defined by the AER in its stage 1 F&A;
2. The AER will make a constituent decision on this amount as required under 11.56.1(b) and in accordance with 11.56.3(b) to (f); and
3. This amount (accepted as proposed or otherwise determined by the AER) will be the amount used for:
   i. Adjusting the annual revenue requirement of the subsequent period as set out in 11.56.4(h) – (j). To avoid doubt, this amount will be the amount for the purpose of clause 11.56.4(i)(1); and
   ii. Calculating the over/under recovery of revenue (as compared to actual revenue) in the transitional year in demonstrating compliance with the control mechanism for standard control services applicable from 1 July 2014.

There are some minor practical complexities around the calculation of the over/under recovery of SCS revenue in the transitional year. This is further set out below.

Total revenue will be used only for indicative prices for the transitional year

It therefore follows from above that the 'pooling' of revenue for the transitional year is only for the purpose of setting prices for the transitional year. To this end, the NSW DNSPs will add to the amount proposed as the annual revenue requirement for the transitional year the revenues needed to recover the costs relating to:

- Types 5-6 metering services;
- Ancillary network services[4]; and
- Emergency recoverable works (net of any forecast revenue expected to be recovered from third parties).

This total revenue will be referred to in the transitional proposal as 'bundled revenue'. We note that this bundled revenue includes the costs of emergency recoverable works for transitional year (net of any revenue expected to be recovered through third parties). This inclusion was not raised by the AER in its letter of 11 December 2103. However, the AER's approach rests on the fact that the National Electricity Rules (NER or Rules) prevent the re-allocation of costs between services in the transitional year.

For this same reason, we consider that costs relating to emergency recoverable works, which are classified as standard control services in the current period, but unclassified by the

[4] The bundled revenue would not include the forecast revenues raised from prices paid for M&M services. We also note that we do not consider at this stage that we have any new ancillary services (Group 4 in the AER staff's letter).

AER from 1 July 2014, should also be left in the standard control services costs pool in the transitional year and recovered through the bundled DUOS prices for the transitional year.

The NSW DNSPs will nominate this total revenue amount as the amount to be recovered from DUOS prices for the transitional year. This amount will be effectively accepted or otherwise amended by the AER in its transitional determination (for the purpose of tariff recovery in the transitional year).

For avoidance of doubt, the NSW DNSPs note that:

1. The fact that revenues needed to recover costs relating to alternative control services (e.g. type 5-6 metering services) and unclassified services) do not render ineffective the AER's classification of these services from 1 July 2014 onwards;
2. The bundled revenue[5] will not:
    a. Be used in adjusting the annual revenue requirement of standard control services of the subsequent period (as per clause 11.56.4(h)-(j)) or
    b. Be used in calculating the over/under recovery of standard control services revenue for the transitional year;
3. The aggregation of revenues is for the transitional year only and only for the purpose of setting the DUOS prices of this year. In relation to the indicative revenue requirements of clause 11.56.2(b)(5), the indicative revenue requirements for the transitional year and the subsequent four years will be the revenue relating to the provision of standard control services (as they are defined in the AER's stage 1 F&A). Similarly, for the purpose of 11.56.2(b)(6) the NSW DNSPs will provide a summary of expenditure plan relating to standard control services only; and
4. The recovery of revenue needed to cover the costs of providing alternative control services in DUOS prices is for the transitional year only. Separate alternative control prices will be established for the period subsequent to the transitional control period.

The AER's indicative preferred approach can only be used for the transitional year

In the letter, the AER's staff stated that '*The approach also reflects, where possible, our proposed approach for the subsequent regulatory control period*'.

Without the benefit of further clarification from the AER, the NSW DNSPs' view is that the indicative preferred approach cannot be maintained in totality for the subsequent regulatory control period. The indicative preferred approach cannot be carried over to the subsequent period in totality because:

1. NER clause 11.56.3(i) does not apply to the subsequent regulatory period, hence the issue of reallocation of cost within a regulatory period does not arise;
2. NER clause 11.56.3(j) (i.e. prices in transitional year to be escalated by CPI) does not apply in the subsequent period;
3. Maintaining the indicative preferred approach contradicts the cost allocation principles which require costs to be allocated to the services to which they belong;
4. Maintaining the indicative preferred approach in the subsequent regulatory period is only possible if the AER departs from its classification in the Stage 1 F&A. This is only possible if the AER considers there are unforeseen circumstances. We are not aware of any indication that the AER is contemplating such an approach; and

[5] That is, the total revenue aggregated from the annual revenue requirement for standard control services and the revenues needed to recover the costs of alternative control services and unclassified services.

5. Giving proper effect to the AER's proposed classification would almost certainly entail changes for customers, either negatively or positively. This is not a proper reason for maintaining an approach that appears inconsistent with the applicable Rules.

2. Framework and approach paper – Stage 2

We understand that the AER is about to publish the Stage 2 Framework and Approach Paper. Clause 11.56.3(h)(5) provides scope for the AER to include in this paper '*the treatment of any other matters relating to the transitional regulatory control period, providing that the treatment of those matters is not inconsistent with this Division 2*'.

We appreciate that the approach outlined in the AER's letter represents the view of the AER's staff and has not necessarily been endorsed by the AER. However given the importance of this matter, particularly the interaction of the AER's indicative preferred approach with the determination for the subsequent regulatory control period, the NSW DNSPs request that the AER sets out, in its stage 2 F&A paper:

- Its indicative preferred approach as outlined in its letter of 11 December 2013, noting the clarification needed for the inclusion of emergency recoverable work;
- The clarification, as outlined above, on the scope of this indicative preferred approach, making it clear that the annual revenue requirement determined by the AER under NER clauses 11.56.1(b) and 11.56.3(b) – (f) is the amount for standard control services (as defined by the AER stage 1 F&A); particularly this amount will be used for the 'true up' of the ARR in the subsequent period and over/under recovery calculation of the transitional year; and
- A mechanism for adjusting the prices that may be charged for alternative control services during the subsequent regulatory control period to account for any over and under recovery of revenue earned from the provision of these services during the transitional year (see NER clause 11.56.3(h)(4)). We set out our view on this issue further below.

Addressing the above matters in the AER's Stage 2 F&A will provide certainty and clarity for both the NSW DNSPs and the AER. Further it will provide the DNSPs with certainty that adopting the substance of the AER's approach will not place in jeopardy our compliance with the transitional rules.

3. Adjusting alternative control services prices in subsequent years

In the letter of December 2013, the AER stated that 'further we think it may not be necessary to true up these prices (i.e. public lighting prices for the transitional year) in the subsequent regulatory period.

It appears that the AER contemplates not having a true up arrangement for alternative control services at all despite scope in the rules for such a mechanism to be specified in the Stage 2 F&A. However, the AER is open to suggestions from the DNSPs on how a true up arrangement might work for these services in this group. The true up arrangements, if any, will be clarified in the AER's determination on the transitional regulatory control period.

The NSW DNSPs consider that it would be beneficial to have a true up mechanism specified in the Stage 2 F&A paper for ACS and that the AER should make available a true up mechanism. Whether that true up mechanism will need to be utilised depends on the outcomes of the AER's determination for the transitional regulatory period and the

subsequent regulatory control period. It may be that no true up would be needed as there is no under/over recovery of revenue for ACS (though highly unlikely) or the over/under recovery amount is immaterial such that applying the true up mechanism would be administratively burdensome.

We consider that the availability of a true up mechanism for ACS should not be pre-determined as not needed. In fact, we consider a true up mechanism should be made available so that the AER can exercise its power in accordance with the National Electricity Objective (NEO) and the NEL Revenue and Pricing Principles of ensuring the long term interest of customers in respect of prices and of ensuring the DNSPs is given a reasonable opportunity to earn its efficient costs

More importantly, the availability of a true up mechanism for ACS is important if there is no agreement from the AER with our consideration that the amount proposed as the annual revenue requirement for the transitional year, for the provision of SCS as defined in the stage 1 F&A paper, should be kept separate from the bundled revenue and this ARR will be used for the adjustment required under 11.56.4(h). If this is the case, the AER must have available (and if necessary apply) a true up mechanism for ACS if the Revenue and Pricing Principles are to be satisfied.

Below, we set out preliminary views on how a true up mechanism would work. The precise mechanics would have to be further discussed between the NSW DNSPs and the AER and would depend on the AER's consideration of the clarification needed to the AER's indicative preferred approach set out above.

For public lighting services, the true-up recovery will be made to public lighting prices for the subsequent regulatory period to account for any over or under recovery of revenue, as contemplated in rule 11.56.3(h)(4).

In relation to types 5-6 metering services, ancillary services recovered through DUOS prices and emergency recoverable works (ERW), the working of a true up mechanism is more complicated. As noted above, the indicative preferred approach effectively pooled revenues for SCS, metering type 5-6 services, ancillary services and ERW and recover these revenues via DUOS prices for the transitional year. The basis of a true up mechanism would be to 'undo' what had been done in the transitional year in relation to any over recovery of revenue. That is any true-up for recovery of revenue relating to type 5-6 metering services and ancillary network services (M&M) would have to be 'returned' to customers via adjustments to DUOS prices for the subsequent period.

We would also like to work with the AER on whether an over-under recovery adjustment would be needed for a difference between forecast and actual volumes for type 5-6 metering services, ancillary services and ERW for the 2014-15 year.

4. Demonstrating compliance with the control mechanism for the transitional year

In the section above we noted that there are some minor practical complexities around the calculation of the over/under recovery of SCS revenue in the transitional year.

To understand this issue further, we note that the AER decided in its Stage 1 F&A that the control mechanism for SCS is to be a revenue cap. Compliance with this control mechanism

would require the maintenance of an 'over/under' account which compares the actual revenue collected by the DNSP against the revenue allowed by the AER.

The over and under recovery arrangements in the control mechanism is separate to the issue of the true up. The true up relates to the efficient costs of providing standard control services which is then included as an adjustment to the ARR.

Table 1 below is an example that shows the adjustment to the annual revenue requirement. The amounts shown for 2014-15 (i.e. $200 million and $180 million) relate to standard control services only (that is, exclusive of the additional revenue for ACS and unclassified recovered through DUOS). In this example, the AER has deducted an amount of $20 million on the basis that the costs proposed in the transitional proposal were inefficient. The adjustment is accounted for in the ARR.

Table 1 - Adjustment to annual revenue in subsequent regulatory years

Regulatory Years	Determination for transitional period	Annual revenue requirement determined in determination for subsequent period	Adjustment to annual revenue requirement of subsequent years
2014-15	$200	$180	Difference = $20
2015-16		$210	Adjust the annual revenue requirement for one or more of the following 4 years to return the difference between the amounts approved in the transitional and substantive determinations in NPV terms (i.e. $20).
2016-17		$220	
2017-18		$230	
2018-19		$240	

Over and under recovery relates to not achieving the allowed revenue, for instance due to lower or higher volumes than forecast. Under a revenue cap, the DNSP is able to increase or decrease revenue in future years to recover the under or over recovery amount.

In calculating the over/under recovery of the allowed revenue for the transitional year, the NSW DNSPs consider that the allowed revenue for the transitional year needs to be the amount determined by the AER in the transitional determination to be the allowed revenue for standard control services. To avoid doubt, it is not the allowed revenue for the transitional year as determined by the AER in the determination for the subsequent period, as the difference would have been adjusted in the ARR for the subsequent years.

Using example 1 above, if the DNSP had recovered $220 million in the 2014-15 year, the recovery adjustment would relate to the allowed revenue of $200 million, that is an over-recovery of $20 million. To be clear, the calculation would not be derived from the efficient costs undertaken in the true-up mechanism, which is accounted for adjustments in the ARR.

While this concept is clear, complications in calculating the under-over recovery exist because the DUOS price is a hybrid price that recovers not only the allowed revenue for SCS but also the additional revenue for ACS and unclassified services. This issue would not occur for the subsequent years as we would be transitioning to separate charges for SCS and ACS.

The complication arises because the NSW DNSPs do not have the system capabilities to accurately disaggregate the revenue collected between revenue for standard control services, revenue for alternative control services and revenue for unclassified services. As an example, the NSW DNSPs collect a total revenue based on the hybrid DUOS charges .

This means that the NSW DNSPs are unable to provide an accurate actual amount of revenue collected for standard control services to compare against the allowed revenue determined by the AER in the determination for the transitional proposal.

The NSW DNSPs consider the most practical resolution to this issue is to deduct the additional revenue amount for ACS and unclassified services used to calculate the hybrid DUOS charges from the total actual revenue collected for the transitional year. This is shown below. **Table 2 - Calculation of over/under recovery of revenue for the transitional year**

	Revenue used for calculation hybrid DUOS price	**Actual revenue collected from charging hybrid DUOS**
Revenue approved by the AER as ARR for the transitional year	$200	$280
Additional revenue for ACS and unclassified recovered through DUOS	$50	
Total	$250	$280

To calculate the over/under recovery of revenue for the transitional year, the actual revenue for SCS would be calculated as the difference between $280 and $50 (i.e. $280 less $50 = $230) as outlined in Table 2. $230 will be taken to be the actual revenue collected for SCS for the transitional year and will be used to calculate the over / under recovery. In this case it will be an over recovery of $30.

For clarity, the allowed revenue to be used for under / over recovery is the amount determined in the determination for the transitional period (e.g. $200 from Table 2) not the amount approved in the determination for the subsequent period (e.g. the $180 from Table 1. The difference between the amounts determined in these two determinations has already been accounted for by adjusting the ARR for the subsequent years.