

# ATTACHMENT H - COMPLIANCE AND REPORTING ARRANGEMENTS

---

There are several compliance arrangements that have to be addressed in the transitional regulatory proposal. The sections below set out how we intend to report on the recovery of designated pricing proposal charges, the NSW CCF which is utilised to recover the cost of the NSW SBS, and Queensland solar rebates.

As part of this reporting, we present our proposed approach to adjusting charges for an under or over recovery in collecting designated pricing proposal charges, the NSW CCF or Queensland solar rebates. The proposed approaches are based on reporting and recovery arrangements in the current regulatory control period for these and other similar arrangements.

## Reporting on Recovery of Designated Pricing Proposal Charges

Designated pricing proposal charges include the transmission related charges payable to TransGrid, avoided transmission use of system (TUOS) charges payable to certain generators as well as inter-distributor payments.

### Relevant rule requirements

For the transitional year, the transitional provision 11.56.3(a)(14) requires the AER to:

*“specify as the manner in which the affected DNSP is to report to the AER on its recovery of designated pricing proposal charges and jurisdictional schemes amounts, the manner that was decided for the current regulatory control period of the affected DNSP, except to the extent the designated pricing proposal charge or jurisdictional scheme was not subject to such a decision for that current regulatory control period, in which case the manner or reporting must (to that extent) be as decided by the AER in the distribution determination for the transitional regulatory control period..”*

While Clause 11.56.3(a)(15) requires the AER to:

*“specify as the adjustments to be made to subsequent pricing proposal to account for over or under recovery of any designated pricing proposal charges or jurisdictional scheme amounts, the adjustments that were decided for the current regulatory control period of the affected DNSP, except to the extent the designated pricing proposal charge or jurisdictional scheme was not subject to such a decision for that current regulatory control period, in which case the adjustments must (to that extent) be as decided by the AER in the distribution determination for the transitional regulatory control period”*

For the reasons explained below no formal decision has been made by the AER in relation to the reporting on the recovery of designated pricing proposal amounts and adjustments in subsequent pricing proposals, therefore the AER are required to make a decision for the transitional year.

### Arrangements for the 2009-14 regulatory control period

Under the transitional rules which applied to the current regulatory control period, Rule 6.12.1(19) provided for broadly the same decision, but required the AER to make a decision in relation as to how we were to report on the recovery of TUOS and on the adjustments to be made in future pricing proposals, rather than designated pricing proposal charges.

As part of its decision for the 2009-14 regulatory control period the AER imposed requirements for Essential Energy to maintain a TUOS unders and overs account. These requirements were set out in detail in Appendix I to the AER's final decision.

### Proposed arrangements for 2014-19 regulatory control period

Essential Energy proposes that the AER make a decision which results in the same mechanism for the reporting on recovery of designated pricing proposal charges and subsequent adjustments to that used for TUOS during the current regulatory control period. The current mechanism is based on the audited closing balance in year t-2, and an estimate of the closing balance in year t-1.

The under or over recovery in year t-1 is recovered via an adjustment in year t. This information is reported in the form of a table in the pricing compliance model, submitted to the AER as part of the annual pricing proposal. An example based on the requirements of Appendix I referred to in section 6.1.2 above is shown in table 6-1 below.

**Table 6-1: Proposed reporting on recovery of designated pricing proposal charges (2013-14 used as an example)**

\$000s nominal	t-2 2011-12 audited	t-1 2012-13 expected	1 2013-14 forecast
<b>Revenue from Transmission Cost Recovery (TCR) Tariffs</b>	<b>276,097</b>	<b>279,826</b>	<b>282,324</b>
Transmission charges to be paid to Transmission Network Service Providers (TNSPs) (Settlement residue payments)	239,691	262,708	259,217
Avoided TUOS payments	1,475	1,478	1,444
Inter-distributor payments	20,025	20,975	22,507
<b>Total transmission related payments (net of settlement residue)</b>	<b>261,191</b>	<b>285,161</b>	<b>283,167</b>
<b>Overs and Unders Account forecast closing balance</b>			
Interest rate applicable to balance	10.02%	10.02%	10.02%
Opening balance	(8,920)	5,822	809
Interest on opening balance (365 days)	(894)	583	81
Forecast over/(under) recovery for financial year	14,906	(5,335)	(844)
Interest charged on over/under recovery for financial year	729	(261)	(41)
<b>Closing balance of transmission Overs/ (Unders) account</b>	<b>5,822</b>	<b>809</b>	<b>5</b>

## Reporting on Recovery of Jurisdictional Scheme Amounts (Climate Change Fund and Section 44A of the Electricity Act 1994 (Qld) for Queensland solar rebates)

Jurisdictional schemes amounts are amounts which distributors are required to pay under jurisdictional obligations, which have been recognised by the NER or the AER as amounts which may be recovered as part of the annual pricing proposal. There are currently three jurisdictional schemes relevant to Essential Energy which are recognised by the NER. The first is the NSW Solar Bonus Scheme, the second is the NSW Climate Change Fund, and the third is the Queensland Solar Rebate, each of which are recognised under Rule 6.18.7A(e)(1), (2) and (3) respectively.

### Relevant rule requirements

For the transitional regulatory control period, the transitional provision 11.56.3(a)(14) requires the AER to:

*“specify as the manner in which the affected DNSP is to report to the AER on its recovery of designated pricing proposal charges and jurisdictional schemes amounts, the manner that was decided for the current regulatory control period of the affected DNSP, except to the extent the designated pricing proposal charge or jurisdictional scheme was not subject to such a decision for that current regulatory control period, in which case the manner of reporting must (to that extent) be as decided by the AER in the distribution determination for the transitional regulatory control period.”*

While Clause 11.56.3(a)(15) requires the AER to:

*“specify as the adjustments to be made to subsequent pricing proposal to account for over or under recovery of any designated pricing proposal charges or jurisdictional scheme amounts, the adjustments that were decided for the current regulatory control period of the affected DNSP, except to the extent the designated pricing proposal charge or jurisdictional scheme was not subject to such a decision for that current regulatory control period, in which case the adjustments must (to that extent) be as decided by the AER in the distribution determination for the transitional regulatory control period”*

For the reasons explained below no formal decision has been made by the AER in relation to reporting on the recovery of jurisdictional scheme amounts and adjustments in subsequent pricing proposals, therefore the AER must make a decision for the transitional year.

#### Arrangements for the 2009-14 regulatory control period

During the current regulatory control period all payments made under the NSW Solar Bonus Scheme have been recovered by Essential Energy through payments to and from the NSW Climate Change Fund. Clause 6.18.7 of the NER transitional Chapter 6 expressly provided for pricing proposals to pass on payments into the Climate Change Fund to customers. Once payments were made into the Climate Change Fund, the NSW government arranged for Essential Energy to be reimbursed from the fund. Clause 6.18.7 was amended into its current form when amendments were made to the NER in July 2010 by the National Electricity Amendment (Payments under Feed-in Schemes and Climate Change Funds) Rule 2010. Consequently the AER has not been required to make a formal decision on reporting on the recovery of jurisdictional scheme amounts for Essential Energy.

In February 2013, Essential Energy was advised by the Queensland Department of Energy and Water Supply that they would cease to reimburse payments made by Essential Energy to customers covered by the (*Electricity Act 1994 (Qld)*) after 30 June 2013. These amounts have been claimed outside of the jurisdictional scheme arrangements during the current regulatory control period, however we intend to claim the amounts paid during the 2013-14 financial year through the reporting on the recovery of jurisdictional scheme amounts in 2014-15.

#### Proposed arrangements for 2014-19 regulatory control period

Essential Energy anticipates that the current arrangements will continue whereby Solar Bonus Scheme payments are recovered through the Climate Change Fund until the NSW Solar Bonus Scheme ceases. However should there be any change to these arrangements, Essential Energy would need to recover NSW solar bonus payments directly as a jurisdictional scheme. Consequently, Essential Energy is seeking that the AER make a decision on how we are to report on the recovery of the NSW Climate Change Fund, the NSW Solar Bonus Scheme, and any subsequent adjustments. In addition, Essential Energy seeks a decision from the AER on how we are to report on the recovery of payments made under Section 44A of the Electricity Act 1994 (Qld).

Essential Energy proposes that the AER makes a decision that results in the same mechanism for the reporting on recovery of jurisdictional scheme amounts and adjustments in subsequent pricing proposals for the NSW Climate Change Fund and the NSW Solar Bonus Scheme as that which has been in place during the current regulatory control period. Essential Energy also proposes to use a similar mechanism to recover the jurisdictional scheme amounts related to Queensland solar rebates under Section 44A of the Electricity Act 1994 (Qld).

The current mechanism is based on the audited closing balance in year t-2, and an estimate of the closing balance in year t-1. The under or over recovery in year t-1 is recovered via an adjustment in year t. This information is reported in the form of a table in the pricing compliance model, submitted to the AER as part of the annual pricing proposal. An example of this is shown in Table 6-2 below.

**Table 6-2: Proposed reporting on recovery of Climate Change Fund, NSW Solar Bonus Scheme and Queensland Solar Rebate**

\$000s nominal	t-2 2011-12 audited	t-1 2012-13 expected	1 2013-14 forecast
Revenue from Climate Change Fund Recovery (CCF) Tariffs	34,706	61,671	61,190
Climate Change Fund Payments	34,754	57,750	64,366
<b>Overs and Unders Account forecast closing balance</b>			
Interest rate applicable to balance	10.02%	10.02%	10.02%
Opening balance	(851)	(986)	3,028
Interest on opening balance (365 days)	(85)	(99)	303
Forecast over / (under) recovery for financial year	(48)	3,921	(3,176)
Interest charged on over/under recovery for financial year	(2)	192	(155)
<b>Closing balance of Climate Change Fund overs/(unders) account</b>	<b>(986)</b>	<b>3,028</b>	<b>0</b>

## Demonstration of Compliance with Control Mechanism for Standard Control Services

This section provides Essential Energy's proposed approach to demonstrating compliance with the control mechanism for distribution standard control services. We also provide the AER with an understanding of some of the key outstanding issues in relation to the control mechanism.

### Proposed control mechanism for distribution standard control services

The AER proposed formula for the revenue cap is shown below:

$$MAR_t = \sum_{i=1}^n \sum_{j=1}^m p_{ij}^t q_{ij}^{t*}$$

$$MAR_t = AR_t + I_t + T_t + B_t$$

$$AR_t = AR_{t-1}(1 + CPI)(1 - X_t)$$

Where:

$MAR_t$  is the maximum allowable revenue in year t.

$P_{ij}^t$  is the price of component I of tariff j in year t.

$q_{ij}^{t*}$  is the forecast quantity of component I of tariff j in year t.

$AR_t$  is the allowable revenue for year t.

$I_t$  is the sum of incentive scheme adjustments in year t.

$T_t$  is the sum of transitional adjustments in year t.

$B_t$  is the sum of annual adjustments in year t.

$CPI_t$  is the percentage increase in the consumer price index.

$X_t$  is the X-factor in year t.

$AR_1$  is the allowable revenue in the first year of the regulatory control period.

It is important to note that there are many aspects to the above control mechanism formula that have not yet been decided by the AER.<sup>1</sup>

### Under or over recovery in the transitional year

There are some minor practical complexities around the calculation of the under or over recovery of standard control services revenue in the transitional year. To understand this issue further, we note that the AER decided in its stage 1 F&A paper that the control mechanism for standard control services is to be a revenue cap. Compliance with this control mechanism would require the maintenance of an unders and overs account, which compares the actual revenue collected by a DNSP against the revenue allowed by the AER.

Under or over recovery relates to not achieving the allowed revenue requirement for standard control services. 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 under or over recovery of the allowed revenue requirement in 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 requirement for standard control services only. To avoid doubt, it is not the allowed revenue for the transitional year as determined by the AER in the determination for the subsequent regulatory control period, as that difference would already have been adjusted in the ARR for the subsequent years.

<sup>1</sup> AER, *Formulae for control mechanisms – revised, Matters relevant to the framework and approach for NSW and ACT DNSPs 2014-19*, February 2013, p. 7.

Whilst this concept is clear, complications in calculating the under or over recovery are present due to the DUOS charges being an aggregated charge that recovers not only the allowed revenue requirement for standard control services, but also the additional revenue relating to alternative control services and unclassified services. This issue does not occur for the subsequent years, as we would have separate charges for standard control services and alternative control services.

The complication arises because the NSW DNSPs do not have the system capabilities to accurately disaggregate the revenue collected in the transitional year between revenue for standard control services, revenue for alternative control services and revenue for unclassified services.

As an example, the NSW DNSP collects total revenue based on the aggregated DUOS charges. This means that the NSW DNSP is unable to provide an accurate actual amount of revenue collected for standard control services to compare against the allowed revenue requirement determined by the AER in the determination for the transitional year.

The NSW DNSPs consider the most practical resolution to this issue is to deduct the additional revenue amount for alternative control services and unclassified services used to calculate the aggregated DUOS charges for the transitional year from the total actual revenue collected in the transitional year. This is shown in table 6-3 below.

*Table 6-3 - Calculation of under or over recovery of revenue for the transitional year*

	Revenue used for calculation aggregated DUOS charge	Actual revenue collected from charging aggregated DUOS
Revenue approved by the AER as the annual revenue requirement for the transitional year	\$200	\$280
Additional revenue for alternative control and unclassified services recovered through DUOS	\$50	
Total	\$250	\$280

To calculate the under or over recovery of revenue for the transitional year, the actual revenue for standard control services 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 standard control services in the transitional year, and will be used to calculate the under or over recovery. In this case it would be an over recovery of \$30.

For clarity, the allowed revenue requirement to be used for the under or over recovery is the amount determined in the AER's determination for the transitional year (e.g. \$200 from Table 2) not the amount that is eventually approved as part of the final determination for the subsequent regulatory control period.

### Essential Energy's position on managing price stability issues through the application of tolerance limits

Essential Energy has expressed its concern over the potential risk under the revenue cap control mechanism for unanticipated changes in volumes to result in our customers being exposed to increased price uncertainty.<sup>2</sup> We note that the AER shares our concerns and proposes to address this issue by applying tolerance limits to the design of the unders and overs account mechanism to smooth the adjustments to prices during the course of the regulatory control period.<sup>3</sup>

Essential Energy believes that in the current uncertain volume environment it is in the long term interest of electricity customers for the tolerance limits to be sufficiently generous to enable us to smooth price adjustments that arise. Essential Energy's preliminary analysis of the potential impacts of our volume risk exposure on pricing outcomes under the revenue cap indicates that this tolerance limit would need to be in the order of five per cent of the maximum allowed revenue.

It is also important that there are appropriate arrangements in place to deal with a situation where the actual under or over recovery of revenue in period t-2 exceeds the prescribed tolerance limit. Essential Energy's preference would be for the AER to adopt a light handed approach involving an obligation being imposed on us to develop a

<sup>2</sup> Ausgrid, Endeavour Energy and Essential Energy, *NSW DNSPs' response to the AER's Preliminary Framework and Approach paper*, 17 August 2012, p. 34.

<sup>3</sup> AER, *Stage 1 Framework and Approach – NSW electricity distribution network service providers*, March 2013, p.52

plan to address the issue over a reasonable time frame. The AER should assess the plan on the basis of explicit criteria to ensure that we have a clear understanding of how best to address this issue.

We consider the key criteria will need to provide sufficient guidance so that we can develop a plan that strikes an appropriate balance between satisfying the short term need of customers for price certainty with the longer term need to avoid unacceptable transitional pricing issues across regulatory control periods. We are keen to work with the AER to ensure that this important design feature of the control mechanism is appropriately addressed in the AER's final distribution determination.

#### Essential Energy's position on the need for an annual audit of volume and various unders and overs balances in year t-2

Essential Energy believes that there is merit in continuing the audit process that was undertaken for the weighted average price cap (WAPC) in the current regulatory control period. This audit process is well understood by Essential Energy and provides adequate independent assurance to the AER in relation to the key actual inputs to the compliance process, including the closing balance on the transmission unders and overs account in year t-2, and the actual volumes at the tariff component level in year t-2.

Essential Energy does not support an independent audit of the estimate of volumes at the tariff component level in year t-1 and the forecast of volumes at the tariff component level in year t. This is because the revenue cap provides a clear incentive for us to adopt the most accurate volumes given that there is no long term gain from doing otherwise.