

IMPLEMENTATION OF THE TRANSITIONAL REGULATORY PERIOD (2014/15) 'TRUE-UP' FOR ACTEWAGL'S DISTRIBUTION NETWORK

1. RELEVANT PROVISIONS

1.1 Clause 6.2.5 of current Chapter 6 of the NER provides:

- (a) A distribution determination is to impose controls over the prices of *direct control services*, the revenue to be derived from *direct control services* or both.
- (b) The control mechanism may consist of:
 - (1) a schedule of fixed prices;
 - (2) caps on the prices of individual services;
 - (3) caps on the revenue to be derived from a particular combination of services;
 - (4) tariff basket price control;
 - (5) revenue yield control; or
 - (6) a combination of any of the above.

1.2 Clause 11.56.3 of the NER concerns the distribution determination for a transitional regulatory control period. Relevantly:

1.2.1 Clause 11.56.3(a) specifies the general content of the distribution determination for the TRP, which includes:

- (5) ... the same control mechanisms for *standard control services* as those which were decided for the distribution determination for the current regulatory control period of the affected DNSP, except to the extent the *framework and approach paper* that is *published* in respect of the subsequent regulatory control period of the affected DNSP provides otherwise in accordance with paragraph (h)(2), in which case the relevant control mechanisms must be as set out in that *framework and approach paper* ...

1.2.2 Clause 11.56.3(h) relevantly provides:

A framework and approach paper that is *published* in respect of the subsequent regulatory control period of an affected DNSP may specify the following matters in relation to the distribution determination for that affected DNSP for the transitional regulatory control period: ... (2) where a *framework and approach paper* specifies a classification for *distribution services* for the transitional regulatory control period that is different from that decided for the distribution determination for the current regulatory control period, the form of, and formulae to give effect to, the control mechanism for those *distribution services* (which must be the same as the form and formulae that are specified for the subsequent regulatory control period by any *framework and approach paper*).

1.2.3 Clause 11.56.3(b) provides:

The *AER* must only approve the amount that is proposed by an affected DNSP to be its *annual revenue requirement* for the transitional regulatory control period, as set out by the affected DNSP in its transitional regulatory proposal, if the *AER* is satisfied that the amount is such that the recovery of it by the affected DNSP is reasonably likely to minimise variations in prices between the affected DNSP's current regulatory control period, transitional regulatory control period and subsequent regulatory control period and between the *regulatory years* of the subsequent regulatory control period.

1.2.4 Clause 11.56.3(d), in turn, provides:

If the *AER* does not approve the amount that is proposed by the affected DNSP as its *annual revenue requirement* for the transitional regulatory control period, then the *AER* must approve an amount as the *annual revenue requirement* of the affected DNSP for the transitional regulatory control period that it is satisfied is such that the recovery of it by the affected DNSP is reasonably likely to minimise variations in prices between the affected DNSP's current regulatory control period, transitional regulatory control period and subsequent regulatory control period and between the *regulatory years* of the subsequent regulatory control period.

1.3 Clause 11.56.4(a) of the NER provides that, except as otherwise specified in clause 11.56.4, current Chapter 6 governs the making of the distribution determination for the subsequent regulatory control period of an affected DNSP.

1.4 Clause 11.56.4(c) of the NER provides:

For the purposes of making a distribution determination for an affected DNSP for the subsequent regulatory control period of that affected DNSP, the *AER* must determine:

- (1) the *annual revenue requirement* of the affected DNSP for each *regulatory year* of its subsequent regulatory control period;
- (2) the *total revenue requirement* of the affected DNSP for that subsequent regulatory control period;
- (3) the X factor for each control mechanism for each *regulatory year* of that subsequent regulatory control period; and
- (4) the opening value of the regulatory asset base for the relevant *distribution system*,

in accordance with current Chapter 6 (except that clause 6.5.9(b)(2) of current Chapter 6 does not apply to the determination of any X factor) and as if:

- (5) the subsequent regulatory control period comprised the transitional regulatory control period (as the first *regulatory year* of the subsequent regulatory control period) and all of the *regulatory years* of the subsequent regulatory control period (as the remaining *regulatory years* of the subsequent regulatory control period); and
- (6) the transitional regulatory control period were not a separate *regulatory control period*.

For the avoidance of doubt, this paragraph (c) requires the *AER* to determine a notional *annual revenue requirement*, a notional X factor or X factors and a notional opening value of the regulatory asset base for the *regulatory year* that comprises the transitional regulatory control period.

1.5 Clause 11.56.4(h) of the NER provides:

An affected DNSP's *total revenue requirement* for its subsequent regulatory control period must be fully adjusted for the adjustment amount determined in accordance with paragraph (i). The adjustment must be made by increasing (where the adjustment amount is negative) or decreasing (where the adjustment amount is positive) the *annual revenue requirement* of one or more *regulatory years* of the subsequent regulatory control period as the AER considers appropriate, provided that the aggregate of all such increases or decreases for the relevant *regulatory years* is equivalent in net present value terms to the adjustment amount.

1.6 Clause 11.56.4(i) of the NER provides:

For the purposes of paragraph (h), the adjustment amount is calculated as:

- (1) the amount of the annual revenue requirement that was approved for the transitional regulatory control period under clause 11.56.3(b) or (d); less
- (2) the amount of the notional annual revenue requirement for the transitional regulatory control period that is determined under paragraph (c),

subject to such modifications in relation to the calculation of that adjustment amount as are set out in the *framework and approach paper* that applies in respect of a distribution determination for the subsequent regulatory control period and as are necessary by virtue of the application of a price cap or price control, rather than a revenue cap or revenue control, in respect of any *standard control services* that are provided by the affected DNSP.

1.7 Clause 11.56.4(j) of the NER provides that the AER's determination of:

1.7.1 the amount of the notional annual revenue requirement for the TRP under clause 11.56.3(c) of the NER; and

1.7.2 the adjustment amount under clause 11.56.4(i) of the NER,

are each taken to be constituent decisions for the purposes of clause 6.12.1 of current Chapter 6 of the NER.

1.8 Clause 6.12.3 of current Chapter 6 of the NER provides, amongst other things:

- (c) The form of the control mechanisms must be as set out in the relevant *framework and approach paper*.
- (c1) The formulae that give effect to the control mechanisms referred to in paragraph (c) must be as set out in the relevant *framework and approach paper* unless the AER considers that unforeseen circumstances justify departing from the formulae as set out in that paper.

1.9 The above reference to 'relevant *framework and approach paper*' reflects that clause 11.56.4(l) of the NER requires the AER to make the framework and approach paper(s) for the SRP in two stages, each stage dealing with specified matters. Clause 11.56.4(l)(1) provides for the 'Stage 1 F&A Paper' to set out (amongst other things) the form (or forms) of the control mechanisms and the matter referred to in clause 11.56.3(h)(2) of the NER (concerning the form of the control mechanism for the TRP), while clause 11.56.4(l)(2) provides for the 'Stage 2 F&A Paper' to set out (amongst other things) the matter referred to in clause 11.56.4(i) (concerning the modifications in relation to the calculation of the adjustment amount referred to therein).

2. BACKGROUND

AER's Placeholder determination and transitional decision

2.1 In April 2014, the AER published its Placeholder Determination and accompanying Transitional Decision setting out its reasons for that Determination.

2.2 In section 1.14 of the Placeholder Determination, the AER states:¹

The AER does not approve ActewAGL's annual revenue requirement proposal [\$156 million (\$nominal)]. The AER is not satisfied that the amount is such that the recovery of it by ActewAGL is reasonably likely to minimise variations in prices between the relevant regulatory control periods and years.

The AER approves \$145 million (\$nominal) as the annual revenue requirement for ActewAGL's distribution network for the transitional regulatory control period which we are satisfied meets the applicable requirements of the NER. ... (emphasis added).

2.3 In the Transitional Decision, the AER explains:²

... the transitional rules adopt a two stage approach for the regulation of these DNSPs over the next five years:

- the transitional regulatory control period
- the subsequent regulatory control period.

The AER is required to make a placeholder determination for the transitional regulatory control period by 30 April 2014, which will only apply for one year for the NSW/ACT DNSPs. One of the decisions we must make in this determination is whether to approve the DNSPs' proposed placeholder annual revenue requirement for the transitional regulatory control period. The AER will then carry out a full regulatory determination process by 30 April 2015 to apply to the subsequent regulatory control period. If the revenue approved in the full regulatory determination for the transitional regulatory control period is different to our placeholder determination then a true-up will apply.

2.4 The AER performed a (limited) assessment of the inputs to the NSW/ACT DNSPs' proposed annual revenue requirements for the TRP (Transitional Regulatory Period, 2014/15), focusing in particular on the rate of return and tax imputation credits (gamma) proposed by those DNSPs.³

2.5 In addition, the AER formed a view about expected price movements through to the end of the SRP, including in particular through the derivation of an indicative price path for each DNSP for the years 2013/14 to 2018/19 inclusive, and derived a smoothed annual revenue requirement for the TRP. This was in order to give effect to the requirement of clause 11.56.3(b) and (d) of the NER that the AER approve an annual revenue requirement for the TRP that minimises price variations between the 2009/10-2013/14 regulatory control period, the TRP and the SRP and between the regulatory years of the SRP.⁴ In so doing, the AER used most of the inputs provided by the NSW/ACT DNSPs⁵ and, in particular, ActewAGL

¹ At 4.

² At 3.

³ See, for example, Transitional Decision at 4-7, 18 and 33-45.

⁴ See, for example, Transitional Decision at 4 and 19-32..

⁵ Transitional Decision at 4.

Distribution's energy throughput forecast for ActewAGL Distribution's distribution business for the TRP.⁶

- 2.6 Section 4 of the Transitional Decision explains the AER's reasons for not approving each of the NSW/ACT DNSPs' proposed annual revenue requirements for the TRP and instead substituting lower amounts:⁷

... With regard to our rate of return guideline, and taking into account available market information and expected market trends, we expect the rate of return to be lower and the value of gamma higher than proposed. This then leads to lower building blocks for the return on capital and costs of corporate income tax. ...

We consider that annual revenue requirements that incorporate a rate of return and gamma that more accurately have regard to these factors are reasonably likely to minimise price variations. Given this, our assessment at the time of this placeholder determination is that the annual revenue requirements proposed by the DNSPs are not reasonably likely to minimise variations in price. This is because the DNSPs' proposals are not likely to reduce the potential for future significant price changes for consumers. ...

With respect to price variations, we consider that if the reduction to the revenue is not made in this decision, then any resulting over-recovery in the transitional regulatory control period would be reasonably likely to lead to more significant price variations over the relevant regulatory control periods and years. This would therefore not be likely to contribute to the achievement of the NEO to the greatest degree and is not consistent with the RPPs in terms of promoting efficient investment.

... we consider that the smoothing approach employed by the NSW/ACT DNSPs for the subsequent regulatory control period contributes to minimising price variations. For the purposes of this placeholder determination we have adopted their smoothing approach for the subsequent regulatory control period, but we have adjusted the revenue for the transitional regulatory control period.

- 2.7 Table 4.12 of the Transitional Decision reveals that, in respect of ActewAGL Distribution, the substituted smoothed revenue amount for the TRP is \$145 million (\$nominal). By way of comparison, the substituted unsmoothed revenue amount for the TRP was \$141 million (\$nominal).⁸

ActewAGL's SRP Regulatory proposal

- 2.8 In its *Regulatory Proposal 2015-19 Subsequent regulatory control period* dated 2 June 2014 (resubmitted on 10 July 2014) (**SRP Regulatory Proposal**), ActewAGL Distribution contended that the adjustment for the TRP required by clause 11.56.4(h) and (i) of the NER must be performed using the annual revenue requirement for the TRP determined by the AER in the Placeholder Determination, being \$145 million (\$ nominal) for distribution. ActewAGL Distribution observed:⁹

Clauses 11.56.4(h) to (i) of the NER states that the subsequent regulatory period must include an adjustment to the total revenue requirement. The adjustment is the difference between the notional revenue requirement for the regulatory year that is the transitional regulatory period and the amount of the annual revenue requirement that was approved by the AER for the transitional period, subject to any modifications set out in a framework and approach paper.

⁶ Transitional Decision at 17, footnotes 24 and 25.

⁷ At 18.

⁸ Transitional Decision at 32.

⁹ SRP Regulatory Proposal at 303.

No such modifications were set out in the AER's framework and approach papers for ActewAGL Distribution.

The AER's decision on the transitional year was published on 16 April 2014 and allowed \$145.16 million for distribution and \$28.09 million for transmission to be recovered in 2014/15. This is less than the revenue building block requirement as part of this proposal. ActewAGL Distribution has therefore included an adjustment to be recovered over the remaining four years of the subsequent regulatory period.

The adjustment to revenues has been done by setting the smoothed revenue in the first year so it matches the Transitional Decision's allowance, and a P_0 adjustment in the second year so that smoothed revenues from subsequent years make up the shortfall in the first year in NPV terms.

3. AER DRAFT DETERMINATION

3.1 On 27 November 2014, the AER published its Draft Determination. In the Draft Determination, the AER states:¹⁰

As part of our full determination of notional revenues for the 2014-19 period, we have determined further changes to the rate of return and gamma, and reductions to other costs such as capex and opex. The placeholder revenue for 2014-15 reflects changes to the rate of return and gamma only. These further changes mean that the 2014-15 placeholder revenue was too high. A true-up therefore needs to occur.

The true-up can be measured as the difference between the placeholder revenue for 2014-15 and the notional annual revenue requirement for 2014-15 determined by the AER in its draft decision. Table B-1 ... [shows] how the true-up [amount] for ActewAGL's distribution [network is] determined and that \$33.7 million ... will be returned to customers over the 2015-19 regulatory control period (adjusted for the time value of money).

3.2 In a footnote applicable to the passage excerpted above, the AER notes:¹¹

The size of the true-up reflects not only further reductions in costs from the transitional decision but also any difference in the smoothing profile of revenues that occurred between that transitional decision and this draft decision.

3.3 The \$145 million (\$nominal) amount expressly approved and published by the AER in the Placeholder Determination is not contained in Table B-1 in the Draft Determination. Rather, Table B-1 (True-up for ActewAGL - Distribution (\$ million, nominal)) provides:¹²

ActewAGL	2014-15
AER draft decision – annual revenue requirement	117.4
AER transitional decision – placeholder revenue ^a	151.1
Difference	-33.7

Source: AER analysis.
 (a) ActewAGL's placeholder decision ARR for 2014-15 has been updated to reflect our draft decision on energy forecast for that year.

3.4 It appears from the footnote (a) in Table B-1 that the \$151.1 million amount described as "AER transitional decision - placeholder revenue" represents the AER's annual revenue

¹⁰ At 77.

¹¹ Draft Determination at 77, footnote 165.

¹² Draft Determination at 77.

requirement for the TRP approved in the Placeholder Determination of \$145 million (\$nominal) 'updated to reflect [the AER's] draft decision on energy forecast for that year'.

- 3.5 In Attachment 1 to the Draft Determination, which relates to the annual revenue requirement, the AER further explains the derivation of the revenue amounts included in Table B-1. Specifically, the AER states:¹³

To account for the placeholder revenues (\$145.2 million ... for distribution) for 2014-15 that we approved in our transitional determination, we have calculated the difference to be adjusted between the placeholder revenues and our ARR (\$117.4 ...) for 2015-15. Our draft decision is that these adjustments amount to \$27.7 million ... We have applied these adjustments as part of the smoothing process to establish the annual expected revenue for the 2015-19 regulatory control period.

- 3.6 Importantly, the footnote applicable to the \$27.7 million amount explains:¹⁴

ActewAGL's distribution network adjustment amount of \$33.7 million (\$ nominal) is comprised of \$27.7 million (\$ nominal) for differences in transitional revenues and building block costs, and \$6.0 million (\$ nominal) from the higher revenue calculated from the approved revenue yield cap and higher energy delivered forecast for 2014-15.

- 3.7 In respect of the true-up for the TRP, the AER further states:¹⁵

In April 2014, as required under the transitional rules, we conducted a high level review of ActewAGL's proposed revenue requirement for its transitional regulatory control period (2014-15). We determined [a] placeholder revenue [allowance] of \$145.2 million (\$ nominal) for ActewAGL's distribution network ... in the transitional determination. For ActewAGL's distribution network the placeholder revenue was calculated based on the revenue yield for 2014-15 of \$53.0 per MWh using an energy throughput forecast of 2736.7 GWh. At the time of the transitional decision we adopted ActewAGL's energy forecast for the purposes of the transitional determination.

In this draft decision, we make a full regulatory determination for the years 2015-16 to 2018-19 for ActewAGL, and we account for any adjustment amount related to the transitional regulatory control period (2014-15). This includes our decision in relation to ActewAGL's energy forecast for 2014-15. We are required to determine the ARRs for each year of the five year period (2014-19) and use a net present value (NPV) neutral true-up mechanism to account for any difference between:

- the placeholder revenue for the transitional regulatory control period, and
- the ARR for 2014-15 that is established through the full determination process.

Our draft decision on the 2014-15 ARRs for ActewAGL's distribution [network] is \$117.4 million ... This means there is a difference in costs recovered in 2014-15 that must be returned to customers. To give effect to the true-up, we have applied separate approaches for ActewAGL's distribution and transmission network arising from differences between the applicable forms of control. For ActewAGL's distribution network we have set the first year X factor to 19.6 per cent in the PTRM, consistent with the transitional determination. This is because the form of control for ActewAGL's distribution network is a revenue yield cap. For ActewAGL's transmission network we have set the first year expected revenue in the PTRM equal to the AER approved placeholder revenue for 2014-15 ... because the form of control is a revenue cap.

¹³ At 1-7.

¹⁴ Draft Determination at 1-7, footnote 3.

¹⁵ Draft Determination at 1-13. Note that the amount of \$145.2 million (\$ nominal) stated here by the AER indicates that the annual revenue requirement for the TRP specified in the Placeholder Determination was in fact rounded down to \$145 million but this is not stated expressly in that Placeholder Determination.

3.8 The footnote applicable to the bullet points in the passage above relevantly states:¹⁶

For ActewAGL's distribution network, our full determination process includes a review of ActewAGL's energy forecast used to determine the smoothed revenues calculated as revenue yield multiplied by the energy forecast for that year. We have determined different energy forecasts for this draft decision. Therefore, the true-up must also account for this, consistent with the revenue yield cap form of control.

3.9 Further, and consistent with the above passage, the AER states:¹⁷

We do not accept ActewAGL's proposed true-up approach to use the placeholder revenue for 2014-15 as the base from which to smooth the proposed expected revenues over the 2015-19 period for its distribution network ... ActewAGL's distribution network is regulated under a revenue yield cap form of control. Therefore, in addition to differences in building block costs from this draft decision, our change to the energy forecast for 2014-15 affects the amount of revenue ActewAGL can be expected to earn through prices charged to consumers.

3.10 Accordingly, in performing the TRP 'true-up', the AER sets the X factor for the distribution network to 19.6 per cent so deriving 'expected revenue' for the TRP of \$151.1 million (\$ nominal).¹⁸ It explains the derivation of this 'expected revenue' for the TRP as follows:¹⁹

ActewAGL's form of control applying to its distribution network is a revenue yield cap (or average revenue cap). The smoothed expected revenue is determined through adjusting the revenue yield for the previous year by the X factor and forecast inflation, and multiplied by the energy forecast for that year. We set the 2014-15 X factor to give effect to the revenue yield cap consistent with the form of control used in the annual pricing approval process. Applying the energy forecast determined in this decision results in an updated revenue amount from transitional determination of \$145.2 million.

3.11 It then compares this expected revenue for the TRP to the notional (unsmoothed) annual revenue requirement for the TRP determined in that Draft Decision to derive a difference of \$33.7 million (\$ nominal) that it asserts is the amount to be returned to customers over the SRP.²⁰

4. ACTEWAGL DISTRIBUTION'S CONTENTIONS CONCERNING THE AER'S IMPLEMENTATION OF TRP TRUE-UP FOR DISTRIBUTION

4.1 ActewAGL Distribution submits that 'updating' the approved and published annual revenue requirement for ActewAGL Distribution for the TRP to reflect the AER's decision on the energy throughput forecast for that TRP is not permissible under the savings and transitional rules (contained in Chapter 11 of the NER) and, hence, not made in accordance with law. The reasons in support of this submission are detailed below.

4.2 The AER does not calculate the adjustment amount under clause 11.56.4(i) of the NER as the difference between the annual revenue requirement for the TRP approved in the Placeholder Determination pursuant to clause 11.56.3(d) of the NER and the amount of the notional annual revenue requirement for the TRP determined in the Draft Determination, as is contemplated by clause 11.56.4(i) of the NER. Rather, in calculating the adjustment amount under that clause, the AER makes an 'update' to the approved annual revenue requirement for

¹⁶ Draft Determination at 1-13, footnote 18.

¹⁷ Draft Determination at 1-15.

¹⁸ Draft Determination at 1-16 to 1-17.

¹⁹ Draft Determination at 1-17, footnote 21.

²⁰ Draft Determination at 1-17.

ActewAGL Distribution for the TRP. Although not expressly stated in its Draft Determination, the AER's 'update' constitutes a modification in relation to the calculation of that adjustment amount.

- 4.3 Clause 11.56.4(i) provides for the making of certain modifications to the calculation of the adjustment amount thereunder, specifically:

such modifications in relation to the calculation of that adjustment amount as are set out in a *framework and approach paper* that applies in respect of a distribution determination for the subsequent regulatory control period and as are necessary by virtue of the application of a price cap or price control, rather than a revenue cap or revenue control, in respect of any *standard control services* that are provided by the affected DNSP.

- 4.4 However, ActewAGL Distribution submits that the AER's modification in relation to the calculation of that adjustment amount is neither a modification contemplated by, nor permissible under, clause 11.56.4(i) of the NER for the following reasons:

- 4.4.1 The precondition to the making of a modification to the calculation of the adjustment amount under clause 11.56.4(i) of the NER is unambiguous, comprising two distinct components that must each be satisfied by the AER in respect of such a modification. Specifically, a modification will be permissible under the savings and transitional rules if, and only if, that modification is both set out in a framework and approach paper *and* reasonably necessary by virtue of the application of the form of control mechanism. The precondition to the making of modifications established by clause 11.56.4(i) of the NER is properly construed as a cumulative threshold because:

4.4.1.1 the ordinary meaning of the words used in clause 11.56.4(i) of the NER (in particular, the use of the conjunction 'and' in that clause) indicates that the precondition is a cumulative threshold. The word 'and' is ordinarily used conjunctively, whereas the word 'or' is ordinarily used disjunctively; and

4.4.1.2 whilst there are cases in which a court has concluded that 'and' or 'or' was included in error or should not be interpreted in accordance with its ordinary meaning, ActewAGL Distribution submits that neither the context in which clause 11.56.4(i) appears nor the relevant extrinsic materials support the view that 'and' is used disjunctively in this case (whether purposely or by drafting error). In particular:

- (a) when read in the broader context of clause 11.56.4, clause 11.56.4(l) provides that the matter referred to in clause 11.56.4(i) (ie, the calculation of the adjustment amount and allowable modifications to that adjustment amount) is to be addressed in the AER's Stage 2 F&A Paper. In particular, the statutory scheme disclosed by clause 11.56.4(i) and (l) and surrounding provisions is that, at the time of the publication of that Stage 2 F&A Paper, any modifications necessary by virtue of the form of control would then be readily ascertainable by the AER, the form of the control mechanism having been previously and definitively specified for the TRP and the SRP in the Stage 1 F&A Paper, and, accordingly, should then be determined. Therefore, the first component of the precondition must be satisfied, irrespective of whether the modification is necessary by virtue of the application of the form of control mechanism. That is, any

modification must be published in the AER's Stage 2 F&A Paper; and

- (b) the AEMC's *Rule Determination - National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012* published on 29 November 2012 (**2012 Rule Determination**) supports the view that the two components comprising the precondition in clause 11.56.4(i) of the NER are cumulative in nature. The AEMC states that 'the framework and approach paper will be used to set out how the AER intends to deal with a number of matters for the transitional regulatory period, such as ... the manner in which any true-up between the placeholder and full determination will be carried out for DNSPs that are subject to a price-cap form of regulation'.²¹ ActewAGL Distribution submits that the reference to the 'manner in which any true-up ... will be carried out' is properly construed as encompassing any modifications to the calculation of the adjustment amount.

4.4.2 Properly construed as a cumulative threshold, it follows that the AER's implementation of the true-up in its Draft Determination is impermissible under the savings and transitional rules because the AER's *Stage 2 Framework and approach - ActewAGL paper* published in January 2014 is silent on the matter of modifications relating to the calculation of the adjustment amount. The modification made by the AER in its Draft Determination is not a modification 'in relation to the calculation of that adjustment amount ... set out in a framework and approach paper' as required by clause 11.56.4(i) of the NER.

4.4.3 In addition or in the alternative, in the event that the precondition in clause 11.56.4(i) of the NER to the making of modifications to the calculation of the adjustment amount is not construed as a cumulative threshold, the modification made by the AER in its Draft Determination is nevertheless impermissible under the savings and transitional rules because it is also not a modification 'necessary by virtue of the application of a price cap or price control, rather than a revenue cap or revenue control'. This is because:

4.4.3.1 The form of control mechanism applied to ActewAGL Distribution's standard control services is a 'revenue yield control' or 'average revenue cap', which is properly construed as falling within the reference to a 'revenue control' in clause 11.56.4(i). As the AER itself explains in its *Stage 1 Framework and approach paper - ActewAGL* of March 2013 for the TRP and SRP, an average revenue cap 'is a cap on the average revenue per unit of electricity sold that a distributor can recover. The cap is calculated by dividing the [maximum average revenue (MAR)] by a particular unit (or units) of output, usually kilowatt hours (kWh). The distributor complies with the constraint by setting prices so the average revenue is equal to or less than the MAR per unit of output'.²² By setting the cap by reference to the maximum average revenue, an average revenue cap

²¹ 2012 Rule Determination at 247.

²² At 30.

is a control mechanism that sets a constraint by reference to revenue and therefore falls within the ordinary and natural meaning of the term 'revenue control'.

4.4.3.2 Under an average revenue cap, ActewAGL Distribution bears the full forecast volume risk which results in revenue and profit variations. Unlike a revenue cap, there are no adjustment mechanisms (such as an 'unders and overs' account) in applying an average revenue cap. An average revenue cap does not, in effect, place a cap on the total revenue recovered by a distributor in any given year and is hence distinguishable from a revenue cap. However, the differences between a 'revenue cap' and an 'average revenue cap' are contemplated by the inclusion in clause 11.56.4(i) of the words 'revenue cap *or* revenue control' (emphasis added). Absent any modification set out in the Stage 2 F&A Paper, the only modifications permissible under the savings and transitional rules are those 'necessary by virtue of the application of a price cap or price control'. Despite similarities between an average revenue cap and a weighted-average price cap, the former is not properly characterised as a 'price cap or price control' having regard to all of its characteristics and, in particular, how it sets the constraint (ie, by reference to revenue or maximum average revenue). Further, the NER itself (in clause 6.2.5(b)) expressly distinguishes between a 'revenue yield control', on the one hand, and 'a schedule of fixed prices', 'caps on the prices of individual services' or 'tariff basket price control' on the other. Modifications that are necessary by virtue of the application of a revenue control are not permissible under clause 11.56.4(i) of the NER.

4.5 Irrespective of whether the energy throughput forecast used in determining the annual revenue requirement for the TRP in the Placeholder Determination has been scrutinised and revised by the AER subsequent to the publication of that Determination, clause 11.56.4(i) of the NER requires the AER to calculate the adjustment amount for ActewAGL Distribution by reference only to the amount of the annual revenue requirement that was approved for the TRP under clause 11.56.3(d) of the NER (in this case, \$145 million (\$nominal)) and the amount of the notional annual revenue requirement for the TRP determined in the AER's distribution determination for the SRP (in the Draft Determination, \$117.4 million (\$nominal)). This requirement is only qualified by the AER's ability to make modifications that are set out in a framework and approach paper and necessary by virtue of the application of a price cap or price control. For the reasons set out above, the modification made by the AER to take into account its decision in the Draft Determination in respect of ActewAGL Distribution's energy throughput forecast for the TRP is not a permissible modification under the savings and transitional rules. As such, the AER is required to calculate the adjustment amount under clause 11.56.4(i) as the difference between \$145 million (\$nominal) and \$117.4 million (\$nominal), being equal to \$27.6 million (\$nominal) taking account of rounding amounts to the nearest \$100,000.