



Final decision

**Control mechanisms for direct control services
for the ACT and NSW 2009 distribution
determinations**

February 2008

© Commonwealth of Australia 2008

This work is copyright. Apart from any use permitted by the *Copyright Act 1968*, no part may be reproduced without permission of the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601.

Contents

Shortened forms	iii
1 Introduction	1
2 Rule Requirements	2
3 Reasons for the guideline on control mechanisms for direct control services	3
4 AER preliminary positions paper	4
5 Issues raised in submissions and the AER response	6
5.1 General support for AER position	6
5.2 Overs and unders.....	6
5.2.1 Issues raised in submissions.....	6
5.2.2 AER considerations	7
5.2.3 AER conclusions.....	8
5.3 Miscellaneous services, monopoly services and emergency recoverable works.....	8
5.3.1 Issues raised in submissions.....	8
5.3.2 AER considerations	8
5.3.3 AER conclusion	9
5.4 Use of audited quantity data	10
5.4.1 Issues raised in submissions.....	10
5.4.2 AER considerations	10
5.4.3 AER conclusion	11
5.5 Relationship with side constraints	11
5.5.1 Issues raised in submissions.....	11
5.5.2 AER considerations	12
5.5.3 AER conclusion	12
5.6 Temporal issues in side constraint formula	12
5.6.1 Issues raised in submissions.....	12
5.6.2 AER conclusion	12
5.7 L term in side constraint formula.....	13
5.7.1 Issues raised in submissions.....	13
5.7.2 AER considerations	13
5.7.3 AER conclusion	13
5.8 TUOS recovery in the ACT	14
5.8.1 Issues raised in submissions.....	14
5.8.2 AER considerations	15
5.8.3 AER conclusion	15
5.9 Minor errors in preliminary positions paper	15
5.9.1 Issues raised in submissions.....	15
5.9.2 AER conclusion	16
6 Consideration of factors set out in the rules	17
7 AER decision.....	18
Appendix A: Submissions	19
Appendix B: Guideline on control mechanisms for direct control services.....	20

Shortened forms

ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
CPI	consumer price index
DNSP	distribution network service provider
DUOS	distribution use of system
ICRC	Independent Competition and Regulatory Commission (ACT)
IPART	Independent Pricing and Regulatory Tribunal (NSW)
KWh	kilowatt hour
M&M	miscellaneous services, monopoly services and emergency recoverable works, provided by NSW DNSPs
MCE	Ministerial Council on Energy
MEU	Major Energy Users Inc
NEL	National Electricity Law
NEM	national electricity market
NER	National Electricity Rules
NPV	net present value
NUOS	network use of system
TNSP	transmission network service provider
TUOS	transmission use of system

1 Introduction

In November 2007 the Australian Energy Regulator (AER) published a preliminary positions paper on a range of guidelines, schemes and models relevant to distribution network service providers (DNSPs) in the ACT and NSW for the 2009–14 regulatory control period. This paper included the AER’s preliminary position as to how control mechanisms for direct control services would be applied in the 2009–14 regulatory control period.

The preliminary positions paper invited submissions from interested parties. The AER received six submissions on the proposed form of control for direct control services. This decision sets out the AER’s consideration of comments raised in relation to the proposed preliminary position on control mechanisms for direct control services. It has been prepared by the AER under clause 6.2.8 (a)(2) of the transitional Chapter 6 rules.

The AER’s guideline on control mechanisms for direct control services, attached at appendix B, sets out the AER’s decisions on the control mechanisms, and the way in which the control mechanisms will operate for the 2009–14 regulatory control period. The attached guideline is not binding on the AER or DNSPs, however if the AER’s distribution determination is not in accordance with the guideline, the AER will be required to state its reasons from departing from the guideline under transitional clause 6.2.8(c).

The AER is responsible for regulating the revenues of DNSPs in the national electricity market (NEM) in accordance with the National Electricity Rules (NER), which were notified in the South Australian Gazette on 20 December 2007. This decision and corresponding guideline apply to Country Energy, EnergyAustralia, Integral Energy (collectively referred to in these documents as ‘the NSW DNSPs’) and ActewAGL.

Within the NER, Chapter 6 deals with the classification and economic regulation of distribution services, while Chapter 6A deals with the economic regulation of transmission services. The Ministerial Council on Energy (MCE) has determined that transitional arrangements will apply in the preparation and assessment of the ACT and NSW 2009 distribution determinations. The transitional arrangements for the 2009 distribution determinations for the ACT and NSW are set out in appendix 1 to Chapter 11 of the NER. Clause references in appendix 1 are numbered commencing with a six. This decision and accompanying guideline will apply only to the 2009–14 regulatory control period.

The NER distinguishes between the rules in Chapter 6 and Chapter 11 by referring to the Chapter 6 rules as ‘general Chapter 6 rules,’ and Chapter 11 rules as ‘transitional Chapter 6 rules.’ The AER has followed this convention in this document when referring to the two sets of rules.

2 Rule Requirements

The guideline on control mechanisms for direct control services has been developed by the AER under clause 6.2.8(a)(2):

6.2.8 Guidelines

- (a) The AER may publish guidelines as to:
 - (2) the control mechanisms for direct control services;

The control mechanisms for direct control services must comply with the relevant requirements prescribed in the NER under clauses 6.2.5 and 6.2.6 of the transitional Chapter 6 rules:

6.2.5 Control mechanisms for direct control services

- (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) *****
- (c) *****
- (c1) The control mechanism for:
 - (1) subject to subparagraph (3), standard control services provided by a NSW Distribution Network Service Provider in the regulatory control period 2009-2014:
 - (i) must be substantially the same as that determined by the IPART for the corresponding prescribed distribution services provided in the regulatory control period 2004-2009; and
 - (ii) may, with the agreement of the provider, apply differently for different categories of services; and
 - (2) standard control services provided by the ACT Distribution Network Service Provider in the regulatory control period 2009-2014 must be substantially the same as that determined by the ICRC for prescribed distribution services provided in the regulatory control period 2004- 2009; and
 - (3) EnergyAustralia prescribed (transmission) standard control services provided in the regulatory control period 2009-2014 and referred to in clause 6.1.6(c) must be substantially the same as that determined by the ACCC for the corresponding prescribed transmission services provided in the regulatory control period 2004-2009.

6.2.6 Basis of control mechanisms for direct control services

- (a) For standard control services, the control mechanism must be of the prospective CPI minus X form, or some incentive-based variant of the prospective CPI minus X form, in accordance with Part C.

Direct control services are divided into two categories under the NER: standard control services and alternative control services. This guideline deals with standard control services only. The AER will also publish a guideline on the form of control for alternative control services by 1 March 2008.

3 Reasons for the guideline on control mechanisms for direct control services

Under clauses 6.2.4 and 6.2.5 of the transitional Chapter 6 rules, the AER is to make a distribution determination for each DNSP, controlling the prices, or revenue, or both, of direct control services. The control mechanism is the means by which the AER will impose controls over the prices and/or revenues of direct control services.

Clause 6.2.5 (c1) of the transitional Chapter 6 rules states that:

(c1) The control mechanism for:

(1) subject to subparagraph (3), standard control services provided by a NSW Distribution Network Service Provider in the regulatory control period 2009-2014:

(i) must be substantially the same as that determined by the IPART for the corresponding prescribed distribution services provided in the regulatory control period 2004-2009;

Accordingly, in determining the form of control for direct control services in this guideline, the AER has adopted the form of control for direct control services that was applied in IPART's 2004 distribution determinations.

While the transitional Chapter 6 rules set out the forms of control that are to apply to direct control services for the ACT and NSW 2009–14 regulatory control period, the purpose of the AER's guideline is to set out in detail the control mechanisms that will apply. The AER has released the guideline to ensure that the AER and DNSPs have a common understanding of how the forms of control for direct control services will be applied in the 2009 regulatory determinations.

4 AER preliminary positions paper

The AER's November 2007 preliminary positions paper, *Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009–14*, set out the AER's preliminary position as to how regulatory control mechanisms for direct control services would be applied in the 2009–14 regulatory control period.

In its preliminary positions paper, the AER proposed not to depart from the approaches adopted by the Independent Competition and Regulatory Commission (ICRC), Australian Competition and Consumer Commission (ACCC) and The Independent Pricing and Regulatory Tribunal (IPART) in determining control mechanisms for direct control services in the 2004–09 regulatory control period. The AER proposed the following control mechanisms:

- average revenue cap control for ActewAGL
- revenue cap control for EnergyAustralia's prescribed (transmission) standard control services
- weighted average price cap control formula for other standard control services in NSW operated by Country Energy, EnergyAustralia and Integral Energy.

The forms of control that applied in the 2004 ACT and NSW distribution determinations were set out in detail in the preliminary positions paper. The AER proposed that consistent with IPART's approach, it would determine a schedule of fees and/or charges for miscellaneous and monopoly services and emergency recoverable works to be fixed for the regulatory control period.

The AER proposed that the control mechanisms were to be applied in substantially the same manner as they were applied by the ICRC, ACCC and IPART in the 2004–09 regulatory control period, with the exception of the following matters, which are requirements of the transitional Chapter 6 rules:

- Clause 6.18.6 of the transitional Chapter 6 rules requires the AER to consider prescribed side constraints in assessing annual pricing proposals. The AER proposed that the prescribed side constraints would replace the application of price limits imposed by IPART in NSW, and impose a constraint that had not been previously applied in the ACT. Side constraints would not be applied to EnergyAustralia's prescribed (transmission) standard control services.
- Clause 6.18.7 of the transitional Chapter 6 rules requires DNSPs to include certain tariffs in their pricing proposals that are based on forecast transmission use of system (TUOS) charges, adjusted for the difference between forecast and actual TUOS payments in the previous regulatory year. TUOS services are provided by transmission network service providers (TNSPs), and used by DNSPs to transport electricity from generators to distribution networks. The charges for these services (TUOS charges) are passed onto DNSPs' customers within DNSP prices. As DNSP prices are set on an ex ante basis, and forecast TUOS charges often vary from actual TUOS charges incurred, there is frequently an over or under recovery of these costs. Clause 6.18.7(b) of the transitional Chapter 6 rules provides that the amount of TUOS charges recovered for a particular regulatory year must not exceed the estimated amount of TUOS for the relevant regulatory year, adjusted

for any over or under recovery in the previous regulatory year. The AER's preliminary positions paper did not propose to allow the recovery of the difference in TUOS charges from a preceding regulatory year over a number of future regulatory years.

- The AER noted that in assessing compliance with the prescribed side constraint, clause 6.18.6(d)(2) the transitional Chapter 6 rules require that the AER must disregard the recovery of revenues to accommodate the pass through of charges for TUOS services to customers.

5 Issues raised in submissions and the AER response

5.1 General support for AER position

The AER received six submissions from interested parties in response to its November 2007 preliminary positions paper. Submissions received were generally supportive of the AER's preliminary position on the control mechanism for direct control services.

ActewAGL stated that it 'is generally supportive of the AER's preliminary positions on the matters covered in the paper.'

The Major Energy Users Inc (MEU) submitted that 'the AER approach to the proposed control mechanisms is the best that can be implemented under the constraints. In particular, the MEU agrees that the TUOS cost element in the tariffs should be adjusted annually to reflect actual TUOS costs.'

Country Energy's submission stated that it 'generally supports the proposed guideline on control mechanisms for direct control services.'

Some issues and points of clarification with the AER's proposed position were raised. These are outlined and addressed below.

5.2 Overs and unders

5.2.1 Issues raised in submissions

Integral Energy, Country Energy and ActewAGL raised the possibility that actual TUOS over or under-recoveries may vary materially from their forecast amounts, affecting DNSPs' revenue recovery and customer prices. Integral Energy suggested that these over and under-recovery amounts could be spread over a number of years, to spread the impact on revenue and prices.

Country Energy's submission stated that the preliminary positions paper, while consistent with the transitional Chapter 6 rules, does not account for the fact that the over or under TUOS adjustment from the previous regulatory year cannot be practically achieved. This is because DNSPs will not know actual TUOS recovery amounts until well after the annual pricing proposal is submitted and approved by the AER.

5.2.2 AER considerations

The relevant clause in the transitional Chapter 6 rules is 6.18.7:

6.18.7 Recovery of charges for transmission use of system services

- (a) A pricing proposal must provide for tariffs designed to pass on to customers the charges to be incurred by the Distribution Network Service Provider for transmission use of system services.
- (b) The amount to be passed on to customers for a particular regulatory year must not exceed the estimated amount of the transmission use of system charges for the relevant regulatory year adjusted for over or under recovery in the previous regulatory year.
- (c) The extent of the over or under recovery is the difference between:
 - (1) the amount actually paid by the Distribution Network Service Provider by way of transmission use of system charges in the previous regulatory year; and
 - (2) the amount passed on to customers by way of transmission use of system charges by the Distribution Network Service Provider in the previous regulatory year.

The AER notes that clause 6.18.6(d)(2) of transitional Chapter 6 rules states that, in determining compliance with the side constraint formula, the AER must disregard the recovery of revenue to accommodate the pass through of charges for TUOS services to customers.

The AER considers that one concern with allowing the outstanding balance of the overs and unders account to be recovered over several regulatory years is that if there is a repeated over or under recovery, it would involve the establishment of several concurrent glide-paths. If there are a series of TUOS forecasting errors in the same direction over a number of regulatory years, the balance could become quite large with respect to TUOS charges, which may lead to large distortions in prices.

The AER also considered whether recovery could be permitted over a number of regulatory years if the overs and unders account exceeded a threshold. However, the AER now considers such an account may result in the actual tariffs faced by consumers being further away from the actual costs of providing the services for that regulatory year.

For these reasons, the AER considers that TUOS overs or unders should be settled in a single regulatory year. Further, the AER considers that this approach is more consistent with the requirements of the transitional Chapter 6 rules. Accordingly, the AER has decided not to allow a phased TUOS overs and unders recovery.

The AER considered Country Energy's submission that calculation of the over or under recovery TUOS charges for year $t-1$ are not available for recovery in year t , as DNSPs do not know actual TUOS recovery amounts until well after the annual pricing proposal is submitted.

The AER notes that clause 6.18.7(b) the transitional Chapter 6 rules prescribe that the amount to be passed on to customers for a particular regulatory year must not exceed the estimated amount of the TUOS charges for the relevant regulatory year adjusted for any TUOS over or under recovery in the previous regulatory year. The AER has

consulted with several DNSPs subsequent to receiving Country Energy's submission and considers that it is not possible to know the quantum change of the TUOS overs and unders account balance from year $t-1$ in year t .

The AER will use data from the 2004–09 regulatory control period for which there is actual data available in determining the TUOS overs and unders adjustment for each regulatory year.

5.2.3 AER conclusions

The AER has decided that it will not allow a phased TUOS overs and unders recovery.

The preliminary positions paper stated that annual pricing proposals would be based on forecast TUOS charges adjusted for over or under recovery of TUOS in the previous regulatory year. The AER has decided that it will use data from the 2004–09 regulatory control period for which there is actual TUOS data available in determining the TUOS overs and unders adjustment for each regulatory year.

5.3 Miscellaneous services, monopoly services and emergency recoverable works

5.3.1 Issues raised in submissions

Country Energy's submission raised concerns relating to the AER's preliminary position on miscellaneous services, monopoly services and emergency recoverable works (M&M) for NSW DNSPs. The AER's preliminary positions paper proposed that the AER would set a schedule of fees and/or charges for M&M services. It proposed that this would be determined by increasing the current fees and charges by an escalation factor to be determined as part of the distribution determinations. The AER proposed that this schedule is to be fixed for the regulatory control period, consistent with IPART's 2004 determinations.

Country Energy submitted that fees and/or charges for all M&M should be escalated at the beginning of each regulatory year of the regulatory control period. Country Energy submitted that it does not believe it is fair or reasonable that prices are fixed for the entire regulatory control period, given the substantial increases in input costs that have occurred during the 2004–09 regulatory control period.

5.3.2 AER considerations

The AER considered the submission on the schedule of fees and/or charges for M&M, and accepts that it is likely that input costs for DNSPs may change over the regulatory control period.

In considering this issue, the AER also considered IPART's 2004–09 Final Report, which outlines IPART's reasons for applying the once-only adjustment for cumulative CPI increases over the 1999–2004 regulatory control period to the schedule of charges for M&M. This report stated that:

It (IPART) believes this approach will result in broadly cost reflective charges, without creating complexity or reducing transparency.¹

IPART's Final Report discussed the possibility of allowing prices to be indexed by CPI over the regulatory control period, however it pointed out that this would result in reduced transparency in relation to these charges, as stakeholders would not know the exact charge that applies for each service throughout the regulatory control period.² IPART acknowledged that transparency is important for monopoly service charges because of the implications for competition.³ By implication a constant charge over the regulatory control period could enhance transparency and facilitate competition.

IPART also considered that given the relatively small percentage of each DNSP's revenue recovered by M&M,⁴ employing a simple process for determining appropriate prices for these services is desirable.

The AER considers that publishing a schedule of fees and charges for these services to be fixed over the regulatory control period will provide transparency and avoid complexity.

The AER notes that these services are to be regulated under the weighted average price cap in NSW, and as such are part of the determination process. This process takes account of forecast input costs, and also allows DNSPs to rebalance their tariffs. While charges for M&M may be fixed, the total revenue to be recovered is set on the basis of the DNSPs forecast building block costs, and will be recoverable in total over the regulatory control period.

The AER liaised with Country Energy to gain a clear understanding of the points raised in its submission. Country Energy agreed that while the prices for M&M services are fixed, by applying a P-nought and consumer price index (CPI) adjustment at the beginning of the regulatory control period, on average, DNSPs will be able to recover costs over the regulatory control period. The AER considers that this escalation will allow M&M services to have a net present value (NPV) neutral impact on DNSPs' revenues.

Accordingly, the AER does not consider it is necessary to escalate the fees and/or charges for M&M on an annual basis over the regulatory control period.

5.3.3 AER conclusion

The AER has decided that it will approve a schedule of fees and/or charges for M&M services provided by NSW DNSPs at the time of its 2009 ACT and NSW distribution

¹ IPART *NSW Electricity Distribution Pricing 2004/05 to 2008/09 Final Report* June 2004, p 114

² *ibid*, p114

³ *ibid*, p115

⁴ *ibid*, p109. IPART's Final Report stated that these services account for approximately 2 per cent of revenue.

determinations. The fees and/or charges will be escalated from current prices by P-nought and CPI adjustments, and will be fixed for the regulatory control period. The AER will approve this schedule at the time of its 2009 distribution determinations.

5.4 Use of audited quantity data

5.4.1 Issues raised in submissions

ActewAGL raised in its submission that the AER's formula for side constraints requires the use of audited data on the quantity of each component of the tariff sold, which is not ActewAGL's current practice as it was not required by the ICRC. ActewAGL stated that this requirement would add to the cost of regulation and hence increase prices, while providing limited benefits to consumers.

Appendix 1 of EnergyAustralia's submission expressed support for the use of audited quantities, stating that they are 'not subject to debate or controversy' and included a quote to this effect from a report by NERA Economic Consulting to the MCE on distribution pricing.

The MEU recommended in its submission that the AER make a much closer examination of proposed tariffs to ensure they are as close to long run marginal cost as possible.

5.4.2 AER considerations

The AER considers that there may be a need to ensure historic quantity data is audited to limit the scope for inappropriate pricing outcomes. IPART's 2004 distribution determinations required DNSPs to submit audited quantities to allow IPART to check compliance with its price limits (side constraints).

The AER notes the report by NERA Economic Consulting to the Ministerial Council on Energy on distribution pricing rules stated:

In our opinion the distribution pricing rules should use audited historic charging parameter quantities as a proxy for current charging parameter quantities. The requirement for use of audited quantities provides several key benefits in that it:

- offers simplicity of application;
- limits the scope for manipulation of pricing outcomes within the price control and side constraint;
- reduces the compliance costs for DNSPs by removing the need to generate and substantiate sales forecasts; and
- reduces the compliance assessment costs for the AER by removing the need to obtain verification of the reasonableness of forecast methods and estimates.⁵

⁵ NERA Economic Consulting *Distribution Pricing Rules Framework – Network Policy Working Group*, December 2006, pp. 45–46

The AER also notes the MEU's recommendation that the AER closely inspect proposed tariffs to ensure that they more closely reflect the long run marginal costs of providing DNSP services. The AER notes that audited quantities will increase the rigour with which prices are established from building block revenues.

The AER notes ActewAGL's concern regarding the increased cost of regulation that auditing requirements impose. The AER has decided to request ACT and NSW DNSPs to provide audited quantity data. However it will allow some flexibility, so that if DNSPs are able to satisfy the AER as to the quality of unaudited quantity data, then the AER may accept this unaudited data in assessing their compliance with side constraints. This will apply to the quantity data provided to the AER to enable it to assess DNSPs' compliance with side constraints and the control mechanisms for direct control services, being the average revenue cap in the ACT and the weighted average price cap in NSW.

5.4.3 AER conclusion

The preliminary positions paper proposed that the AER would require the use of audited quantity data in determining compliance with side constraints. The AER will maintain a request for ACT and NSW DNSPs to provide audited quantity data to enable it to assess DNSPs' compliance with side constraints and the control mechanisms for direct control services, being the average revenue cap in the ACT and the weighted average price cap in NSW.

However, should the DNSPs verify the quality of their unaudited quantity data in writing to the AER, then the AER may elect to accept this unaudited data. As an example, the DNSP may provide an audit of relevant internal procedures or a statement that demonstrates internal quality assurance processes are sufficient in place of audited quantities. The AER does not expect DNSPs that currently provide audited quantity data to propose to cease this practice unless a view is taken by the relevant board that internal procedures are adequate.

5.5 Relationship with side constraints

5.5.1 Issues raised in submissions

EnergyAustralia submitted that the reason for including the proposed side constraint formula within the guideline on the control mechanisms for direct control services it was not clear within the AER's preliminary positions paper.

EnergyAustralia submitted that in its view, the pricing side constraints within the transitional Chapter 6 rules relate to pricing provisions under Part I, and not the control mechanism, as suggested by the AER's preliminary positions paper. EnergyAustralia indicated that it considers side constraints should be dealt with outside of the AER's guideline on control mechanisms for direct control services.

EnergyAustralia however acknowledged in discussion with the AER, subsequent to its submission, that it is useful for DNSPs to be aware at an early stage in the determination process as to the AER's proposed approach to applying side constraints.

5.5.2 AER considerations

The AER notes that the control mechanisms for direct control services relate to the application of the average revenue cap in the ACT and the weighted average price cap in NSW. The weighted average price cap and average revenue cap control mechanisms are established through building block calculations in the post-tax revenue model, including derivation of the relevant X factors. These calculations and derivations are done as part of the regulatory determination process.

The AER notes that side constraints are to be applied at the time of the annual price review, in accordance with clause 6.18.6(c), within Part I of the transitional Chapter 6 rules. The side constraints will be applied starting from the second regulatory year of the regulatory control period, which is separate to the AER's determination of the form of control for direct control services.

However, the AER considers that in setting out its understanding of the control mechanisms (the weighted average price cap and average revenue cap), it is useful for the AER to consider the side constraints that will apply as part of the annual pricing review.

5.5.3 AER conclusion

The AER has retained its discussion of side constraints within its guideline on control mechanisms for direct control services, as in its preliminary positions paper, but notes that these will be applied at the time of the annual price review. The guideline is attached at appendix B.

5.6 Temporal issues in side constraint formula

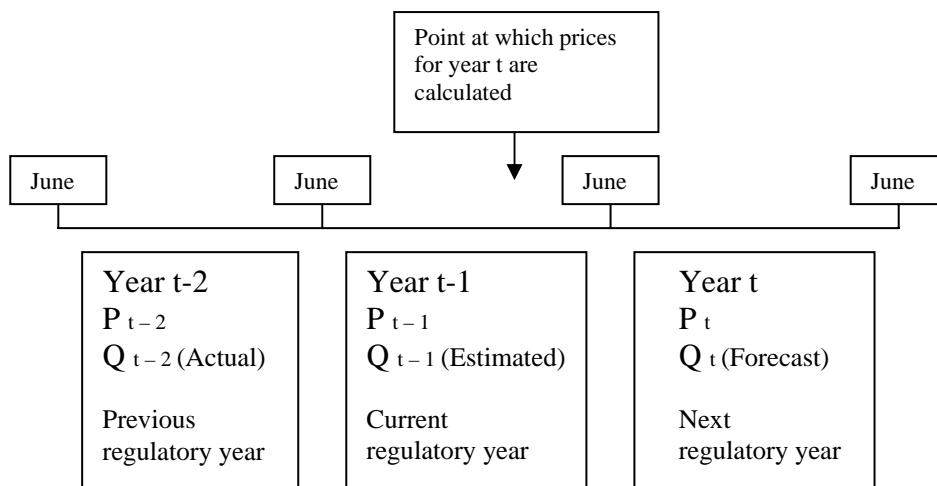
5.6.1 Issues raised in submissions

Integral Energy's submission raised a discrepancy between the AER's definition for ΔCPI in its side constraint formula, and the definition used by IPART in its price limit formula, reproduced on page 85 of the AER's preliminary positions paper. In particular, Integral Energy noted that t in the formula should refer to CPI statistics available within the current financial year.

5.6.2 AER conclusion

The AER notes the discrepancy relating to year references within the formulas. The AER has made a minor adjustment to the weighted average price cap and side constraint formulas. The AER has redefined year references within the formulas, so that the year known by IPART in the 2009–14 regulatory control period as $t+1$ will now be year t , and year $t-1$ will now be year $t-2$, and so on.

The temporal indicators are represented in the diagram on the next page:



Source: Adapted from a diagram in EnergyAustralia’s submission, *Comments on the AER Preliminary Positions Paper Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009–2014*, January 2008, p 15

In this diagram, year $t-1$ is the current year, during which prices for year t are determined.

The formulas in the AER’s guideline on control mechanisms for direct control services, attached, reflect the above diagram.

5.7 L term in side constraint formula

5.7.1 Issues raised in submissions

EnergyAustralia’s submission stated that the AER’s preliminary positions paper does not fully articulate the proposed calculation of the L term in the side constraint formula. The L term is defined in the AER’s November 2007 preliminary positions paper as being the permissible real percentage change in an individual distribution tariff. EnergyAustralia’s submission stated that it should be expanded to capture the two side constraints included in the transitional Chapter 6 rules. EnergyAustralia submitted that this would enable interested parties to confirm the mathematical accuracy of the two limits within the price compliance formula.

5.7.2 AER considerations

The AER considers that EnergyAustralia’s suggested changes to the definition of the L term in the AER’s side constraint formula are consistent with the transitional Chapter 6 rules. The AER acknowledges that greater clarity could be achieved by incorporating the relevant section of the transitional Chapter 6 rules in the definition of the L term.

5.7.3 AER conclusion

The AER has changed the definition of the L term in its side constraint formula in the attached guideline from that which was published in the preliminary positions paper, to the following:

L_t is the permissible real percentage change in an individual distribution tariff from year $t-1$ to year t of the regulatory control period determined in accordance with clause 6.18.6(c) of the transitional Chapter 6 rules

5.8 TUOS recovery in the ACT

5.8.1 Issues raised in submissions

ActewAGL submitted that the AER's representation of the calculation of forecast TOUS recoveries in the preliminary positions paper should to be clarified. ActewAGL currently uses the following methodology for determining recoverable TUOS amounts for future financial years:

1. Forecast sales quantities for the upcoming financial year t , using 2006–07 as an example.
2. Forecast the total TUOS costs to be recovered for the same period. This is done in consultation with TransGrid. Due to the timing of the ICRC's annual tariff approval process, TransGrid's actual TUOS charges are not known and forecasts must be used for setting ActewAGL's TUOS charges that are incorporated into its network use of system (NUOS) tariffs.
3. Total estimated TUOS costs recoverable for 2006–07 (established at step two) is adjusted by a change factor. The change factor represents the change in energy sales between 2005 calendar year actuals and forecast energy sales for 2006–07 (established at step one). Where sales volumes increase over time, the change factor will reduce the total TUOS amount derived in this step.
4. TUOS prices are derived that when applied to the actual sales quantity in the previous calendar year (2005 in this example) will yield revenue not exceeding that calculated in step three. Note that TransGrid's TUOS charges comprise a fixed, energy, peak energy and maximum demand based charges. ActewAGL does not apply an average TUOS price across all consumers. It attempts to reflect the cost of TranGrid's variable TUOS charges. The table below provides an example calculation of ActewAGL's TUOS pass through amounts.

Example calculation of TUOS amounts

a)	Forecast TUOS costs for year t 2006–07	\$18 000 000
b)	Actual energy sales t -1/calendar year (2005) (kWh)	2 500 000 000
c)	Forecast energy sales year t , 2006–07	2 700 000 000
d)	Change factor = b / c	0.925926
e)	TUOS recoverable based on 2005 sales = $a * d$	\$16 666 667
f)	Forecast average TUOS costs per kWh for financial year t , 2006–07 (based on 2005 calendar year volumes) = e / b =	\$0.0067 [#]
TUOS costs recoverable, financial year t 2006-07		
g)	Total TUOS costs recoverable 2006–07 = $c * f$	\$18 000 000
h)	Forecast average TUOS cost recoverable per kWh 2006–07 = a / c =	\$0.0067 [#]

[#] These values represent indicative average TOUS charges, and are applied as a term of the equation rather than an actual price or tariff input.

Note in the above example that the average TUOS cost per kWh in 2005 of \$0.0067 per kWh (e/b) equals the average TUOS cost per kWh in 2006–07 (a/c). This example also demonstrates that ActewAGL's expected TUOS revenue for the financial year t .

5.8.2 AER considerations

The AER acknowledges the approach currently employed by ActewAGL to determine TUOS amounts. However, the transitional Chapter 6 rules now prescribe the methodology to be used to derive recoverable TUOS amounts.

5.8.3 AER conclusion

The AER will adopt the approach set out at 6.18.7 of the transitional Chapter 6 rules, and appendix B of this decision, to determine recoverable TUOS amounts for ActewAGL during the 2009–14 regulatory control period.

5.9 Minor errors in preliminary positions paper

5.9.1 Issues raised in submissions

Country Energy and Integral Energy noted an error within the side constraint formula on page 38 of the AER's preliminary positions paper. The formula in the preliminary positions paper contained the term q_k^{t-1} , while the list of definitions below defined:

q_k^{t-2} is the audited quantity of component k of the distribution tariff that was charged by the DNSP in year $t-2$ (being the year immediately preceding year $t-1$)

ActewAGL submitted that the table on page 80 of the description of the revenue cap mechanism does not reflect the fact that, while TUOS costs are forecast for the

coming financial year, DUOS charges are derived from annual sales in the previous calendar year. It suggested that 'Forecast TUOS charges t ' should read 'Forecast TUOS charges $t-1$ calendar.'

ActewAGL's submission sought to further clarify the AER's example in table 1 stating that, 'Allowed pass through amounts t ' should read 'Allowed pass through amounts $t-1$ calendar' to reflect the fact that ActewAGL adjusts the amount it claims in pass through costs in the pricing process according to the difference in sales between the forecast in the coming financial year and the actual sales in the previous calendar year.

ActewAGL also corrected the AER's interpretation of the calculation of miscellaneous fees and charges revenue. It stated that the revenue from these services is calculated by applying the prices proposed for the next financial year to the actual quantity of services provided in the previous calendar year. This amount is then deducted from the revenue cap for prescribed services to derive the DUOS revenue cap for setting DUOS prices.

5.9.2 AER conclusion

The AER has amended its description and examples of the constraint to reflect these details in its guideline. The AER notes that it has changed the ij reference for tariff components in the weighted average price cap formula to ik , to reflect consistency with the references to tariff components within the side constraint formula. These changes are reflected within the AER's guideline on control mechanisms for direct control services, attached at appendix B.

6 Consideration of factors set out in the rules

Clause 6.2.5(c1) of the transitional Chapter 6 rules states that:

(c1) The control mechanism for:

(1) subject to subparagraph (3), standard control services provided by a NSW Distribution Network Service Provider in the regulatory control period 2009-2014:

(i) must be substantially the same as that determined by the IPART for the corresponding prescribed distribution services provided in the regulatory control period 2004-2009; and

(ii) may, with the agreement of the provider, apply differently for different categories of services; and

(2) standard control services provided by the ACT Distribution Network Service Provider in the regulatory control period 2009-2014 must be substantially the same as that determined by the ICRC for prescribed distribution services provided in the regulatory control period 2004-2009; and

(3) EnergyAustralia prescribed (transmission) standard control services provided in the regulatory control period 2009-2014 and referred to in clause 6.1.6(c) must be substantially the same as that determined by the ACCC for the corresponding prescribed transmission services provided in the regulatory control period 2004-2009.

The AER notes that it has considered the requirements set out in clause 6.2.5(c1) of the transitional Chapter 6 rules in determining the control mechanisms for direct control services. The AER will apply a control mechanism for:

- standard control services provided by NSW DNSPs that is substantially the same as that determined by IPART for prescribed distribution services provided in the 2004–09 regulatory control period
- standard control services provided by ActewAGL that is substantially the same as that determined by the ICRC for prescribed distribution services provided in the 2004–09 regulatory control period
- EnergyAustralia prescribed (transmission) standard control services that is substantially the same as that determined by the ACCC for prescribed transmission services provided in the regulatory control period 2004–09.

The control mechanisms that will be applied are set out in the guidelines attached at appendix B.

The AER notes that ACT and NSW DNSPs have reviewed the AER's control mechanisms for direct control services through the consultation process on the AER's preliminary positions paper, and have agreed that the forms of control to be applied by the AER are substantially the same as those applied by IPART, the ICRC and the ACCC for each corresponding service in the 2004–09 regulatory control period.

7 AER decision

The AER has decided to apply the following control mechanisms to standard control services:

- average revenue cap control for ActewAGL
- revenue cap control for EnergyAustralia's prescribed (transmission) standard control services
- weighted average price cap control formula for other standard control services in NSW operated by Country Energy, EnergyAustralia and Integral Energy.

The details of the control mechanisms are set out in the attached guideline on the control mechanism for direct control services.

Appendix A: Submissions

The following interested parties provided submissions on the AER's proposed control mechanisms for direct control services, as outlined in the AER's preliminary positions paper:

- ActewAGL
- EnergyAustralia
- ETSA Utilities
- Country Energy
- Integral Energy
- Major Energy Users Inc

Copies of these submissions are available on the AER's website at www.aer.gov.au.

Appendix B: Guideline on control mechanisms for direct control services

Appendix B is the AER's guideline on control mechanisms for direct control mechanisms to apply to the NSW and ACT 2009 distribution determinations, attached.