Jemena Electricity Networks (Vic) Ltd

2021-26 Electricity Distribution Price Review Regulatory Proposal

Attachment 07-07

Price control mechanisms

Jemena
bringing energy to life

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Glossary

Current regulatory period	The regulatory control period covering 1 Jan 2016 to 31 Dec 2020.
Intervening period	The period covering 1 Jan 2021 to 30 Jun 2021 representing the time between the current regulatory period and the next regulatory period. The Intervening period arises with the move from a calendar year regulatory year to financial.
Next regulatory period	The regulatory control period covering 1 Jul 2021 to 30 Jun 2026.

Abbreviations

ABS	Australian Bureau of Statistics
AER	Australian Energy Regulator
CROIC	Cost Recovery Order In Council
DMIS	Demand Management Incentive Scheme
DNSP	Distribution Network Service Provider
DPPC	Designated Pricing Proposal Charges
ESC	Essential Service Commission
F&A	Framework and approach
JCRS	Jurisdictional Cost Recovery Scheme
JEN	Jemena Electricity Networks (Vic) Ltd
NEL	National Electricity Law
NER	National Electricity Rules
PFiT	Premium Feed-in Tariff
PTRM	Post Tax Revenue Model
WACC	Weighted Average Cost of Capital

Overview

This paper outlines how we propose to adjust our prices for each year in the next regulatory period and how we will comply with the requirements of the National Electricity Rules (**NER**) that relate to setting prices.

Specifically:

- Section 1 outlines the control mechanisms for direct control services and how we demonstrate compliance with these

- Section 2 outlines our approach for recovering the payments we make to other networks, which are recovered through Designated Pricing Proposal Charges

- Section 3 outlines our approach for recovery the payments we make for jurisdictional schemes

- Section 4 demonstrates the process for annual pricing proposal revenue true-ups.

We note that the Australian Energy Regulator's (**AER's**) final framework and approach paper (**F&A paper**)[1] that was released in January 2019 predates the announced change of regulatory year from a calendar year to a financial year and that it has not been revised to accommodate the intervening period. Therefore, this attachment has been drafted based on the January 2019 F&A paper and adjusted to accommodate the change in the regulatory year based on advice received by the AER in December 2019 and January 2020.[2]

In principle, we agree with the majority of positions taken in the AER's final F&A paper and subsequent emails, but we have identified some issues that warrant correction or clarification. We have adopted the control mechanisms set in the final F&A paper (adjusted as per the AER's December 2019 advice), subject to the modifications we have detailed in this attachment.

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[1] AER, *Final Framework and approach AusNet Services, Citipower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019.

[2] Emails from the AER to JemenaEDPR2021@jemena.com.au, 2 December 2019, 5:16pm and from AER to Jemena staff on 19 December 2019, 11:45am and on 15 January 2020 at 5:06pm.

1. Control mechanisms

The AER's F&A paper outlines mechanisms under which it controls the way prices are set for JEN's direct control services. Specifically, for alternative control services, JEN must demonstrate how it will comply with these controls.[3]

By adhering to the formulae outlined in this attachment, JEN considers it would meet the requirement of cl. 6.12.1(13) of the NER to demonstrate compliance with the relevant control mechanism.

1.1 Price control mechanism – direct control services

The AER's F&A paper sets out the price control mechanism that JEN applies to determine charges applicable for the direct control service offered in the next regulatory period. These charges are adjusted annually via an annual pricing proposal. We will submit an initial pricing proposal following the AER's final determination on this regulatory proposal and then by 31 March of each remaining year in the next regulatory period.[4]

The AER's price control mechanisms for direct control services include:

- A revenue cap for standard control services (refer Box 1-1)

- A revenue cap for type 5, type 6 and smart meters (refer to Box 1-2)

- Caps on the prices for other services classified as alternative control services (refer to Box 1-3 and Box 1-4).

With the change of regulatory year to a financial year, the speed at which the change occurred and the absence of precedence, the risk of errors in establishing price control formulae increases. With more time to reflect on the changes proposed by the AER with regards to the price control formulae—as advised on 2 December 2019 and updated in the subsequent emails—we have identified a number of issues that warrant correction. The circumstances surrounding this situation are material in nature. Given this, we consider the price control formula that we are proposing can be amended in the AER's decision per the criteria set out in NER.[5]

1.1.1 Revenue cap for standard control services

A revenue cap on standard control services means that we have no scope to recover more or less from our charges than the total revenue allowed. Where price levels and actual demand levels result in an under or over recovery of revenue in any one year (year t-2), we must adjust future (year t) prices to correct this. Adjustments to revenue for the service target performance incentive scheme (**STPIS**) and other cost recoveries occur outside of this true-up process.

Box 1-1 sets out our proposed control mechanism for standard control services; it is presented in a CPI-X format, consistent with the requirements of the NER.[6] This is as set out in the AER's F&A paper, amended in its 2 December 2019 email, and with further clarifications provided in the AER's 19 December 2020 and 15 January 2020 emails. Our proposal is as per these positions subject the clarifications explained below Box 1-1. We have taken the email chain between 2 December 2019 and 15 January 2020 as superseding the AER's position in the F&A paper.

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[3]   NER s. 6.8.2(c)(3).

[4]   Should 31 March fall on a weekend or public holiday then the submission will be by the first business day following 31 March.

[5]   NER, s. 6.12.3(c1).

[6]   NER s. 6.2.6(a).

Box 1-1. Control mechanism for standard control services

(1) $\quad TAR_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij}$ $\qquad$ i=1,...,n and j=1,...,m and t=1, 2,...,5

(2) $\quad TAR_t = AAR_t + I_t + B_t + C_t$ $\qquad$ t = 1, 2,…,5

(3) $AAR_t = AR_t \times (1 + S_t)$ $\qquad$ t = 1

(4) $AAR_t = AAR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + S_t)$ $\qquad$ t = 2

(5) $AAR_t = AAR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t)$ $\quad$ t = 3, 4, 5

Side constraint

$$\frac{\left(\sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij}\right)}{\left(\sum_{i=1}^{n} \sum_{j=1}^{m} p_{t-1}^{ij} q_t^{ij}\right)} \leq (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) \times (1 + S_t) + I'_t + B'_t \qquad \text{t = 1, 2}$$

$$\frac{(\sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij})}{(\sum_{i=1}^{n} \sum_{j=1}^{m} p_{t-1}^{ij} q_t^{ij})} \leq (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) + I'_t + B'_t \qquad \text{t = 3, 4, 5}$$

Where:

TAR_t	is the maximum allowable revenue in year t.
p_t^{ij}	is the price of component 'j' of tariff 'i' in year t.
q_t^{ij}	is the forecast quantity of component 'j' of tariff 'i' in year t.
t	is the regulatory year
AR_t	is the nominal annual smoothed revenue requirement in the Post Tax Revenue Model (PTRM) for year t.
AAR_t	is the adjusted annual smoothed revenue requirement for year t.
I_t	is the sum of incentive scheme adjustments in year t.
	For t = 1, $I_t = f_{t-2} + f_{t-3} + D_t$
	For t = 2, $I_t = f_{t-2} + D_t$
	For t = 3, 4, 5, $I_t = S_{t-2} + f_{t-2} + D_t$
	Where:
	D_t is all applicable demand incentive schemes for year t.
	f_t is the f-factor incentive scheme for year t.
I'_t	is the sum of incentive scheme adjustments in year t converted into a percentage of revenue.
B_t	is the sum of annual adjustment factors in year t, including t-2 licence fees and adjustments for the overs and unders account. To be decided in the final decision.
B'_t	is B_t converted into a percentage of revenue.

C_t

For t = 1, is the sum of approved cost pass-through amounts (positive or negative) with respect to regulatory year t and the intervening period, as determined by the AER. It will also include any end-of-period adjustments in year t. The events which can trigger a cost pass-through application are to be decided in the final decision.[7]

For t = 2, 3, 4, 5 is the sum of approved cost pass-through amounts (positive or negative) with respect to regulatory year t, as determined by the AER. It will also include any end-of-period adjustments in year t. The events which can trigger a cost pass-through application are to be decided in the final decision.[8]

S_t

is the s-factor for regulatory year t.[9] As it currently stands, the s-factor will incorporate any adjustments required due to the application of the AER's STPIS.[10]

For t = 2, S_t will incorporate the S factor relevant to performance in both the 2020 period and the 2021 intervening period.

S'_t

is the s-factor for regulatory year t converted to a percentage of revenue.

ΔCPI

is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities[11] for the December quarter in regulatory year t–1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2

minus one.

For example, for 2020–21, year t–2 is the December quarter 2018 and year t–1 is the December quarter 2019.

X_t

is the X-factor in year t, incorporating annual adjustments to the PTRM for the trailing cost of debt where necessary. To be decided in the final decision.

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7   In this submission we clarify that the pass through events are decided in a final decision, absent this clarification, it could be construed that the amount for cost pass-through are outlined in the final decision.

8   As above.

9   The meaning for year "t" under the price control formula is different to that in Appendix C of STPIS. Year "t+1" in Appendix C of STPIS is equivalent to year "t" in the price control formula of this decision.

10 AER, Electricity distribution network service providers - service target performance incentive scheme, 1 November 2009. In the F&A paper the AER notes that they are reviewing STPIS and this application of this factor may be impacted.

11 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

Box 1-1 reflects some changes that we propose to the control mechanism from that issued in the 2 December 2019 email. The changes and why are proposing them are as follows:

- **Additional detail on the side constraint**, including:

  - Incorporating incentive mechanisms (I'_t) and s-factor (S_t), recognising that in years 3, 4 and 5 that the S-factor becomes part of I_t. This is consistent with the treatment in NER clause 6.18.6(d) and is also consistent with the current side constraint.[12]

  - Splitting the side-constraint to ensure that there is consistent treatment of the S-factor in years 1 & 2, when it is incorporated as a scaling factor and years 3, 4 and 5 when it is incorporated as a dollar amount. This has required the introduction of

- **A minor change to clarify the definition of the C_t term**—Specifically, in the F&A paper, the description against this term states *"It will also include any end-of-period adjustments in year t. To be decided in the distribution determination."*[13] We consider the reference to the phrase "*to be decided in the distribution determination*" could be interpreted a number of ways, including possibly deciding the cost pass-through amounts in the determination itself. We do not believe this is the intent, but instead, that the types of events are to be decided in the determination. To clarify this, we have made some changes to reflect this intent.

- **Reflecting AER updates to f-factor from the 19 December 2019 email**[14]—The AER noted that, should consistent changes be made to the f-factor scheme with the Victorian Government, "we would apply two f-factors to the revenue cap of the first year of the 21-26 RCP (i.e. 18/19 and 19/20 f-factor applied in the 21/22 year)". In Box 1-1 JEN has incorporated the two f-factors into year 1.

- **Using the consistent convention, we have used p_t to denote prices rather than d_t in the side-constraint.**

- **The B_t term includes t-2 licence fees**, consistent with AER advice in their 19 December 2019 email.

1.1.1.1 Relevant matters to be determined in applying the control mechanism

The AER has indicated that the following matters should be determined in its final decision. We have provided additional relevant information for each to assist that decision.

'I' Term

JEN notes there are several incentive schemes[15] in the next regulatory period. However, consistent with the AER's 2 December 2019 email, we only propose including the State Government's f-factor scheme applicable in the 2021-26 regulatory period[16], demand incentive schemes and s-factor as appropriate in the 'I' term.

Annual adjustments, 'B' Term

During the current regulatory period, electricity distribution licence fees paid by JEN to the Victorian Essential Service Commission (**ESC**) are recovered through the 'B' term. We propose to continue this cost recovery approach.

JEN also proposes to include the true-up method used in the current regulatory period for the under or over recovery of revenue in the t-2 year. The method adjusts for the time value of money by calculating the present

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[12] This change appears to be acknowledged as required in the AER's 15 January 2020 email.

[13] AER, *Final Framework and approach AusNet Services, Citipower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 58.

[14] Email from AER to Jemena staff on 19 December 2019, 11:45am.

[15] JEN notes that other incentive schemes outlined in NER cl. 6.3.2(a)(3) are (i) captured in the building block model (efficiency benefit sharing scheme (**EBSS**) and capital expenditure sharing scheme (**CESS**)), (ii) applied under a 'S factor' in the price control formula or not proposed at all (Small-scale incentive scheme).

[16] AER, *Final Framework and approach AusNet Services, Citipower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 88.

value of actual revenue equal to the present value of revenue allowable. The mechanism to achieve this is demonstrated by way of the example in section 4.

We consider this should be calculated as the sum of:

- the recovery of licence fee charges by the Victorian Essential Services Commission indexed by two years of interest, calculated using the following method:

$$L_{t-2} \times (1 + WACC_t) \times (1 + WACC_{t-1})$$

where:

L_{t-2} are the licence fees paid by Jemena to the Victorian Essential Services Commission in the financial year ending in June of regulatory year t–2,

$WACC$ is the approved nominal weighted average cost of capital (WACC) for the relevant regulatory year using the following method:

Nominal vanilla WACC$_t$ = ((1+ real vanilla WACC$_t$) x (1+ΔCPI$_t$)) - 1

where the real vanilla WACC$_t$ is as set out in our final decision PTRM and updated annually.

- any under or over recovery of actual revenue collected through DUoS charges as calculated using the method in section 4.

Adjusting X-factor for the trailing average return on debt

The X-factor is determined by the Post Tax Revenue Model (**PTRM**).[17] The value of X-factor is to be amended annually to adjust for the trailing average cost of debt.

1.1.1.2 Calculation of revenue amounts using the control mechanism

The key inputs into the control mechanism for standard control services are the annual smoothed revenue requirement for year "t" and the X factors. These inputs are calculated using the AER's PTRM (Attachment 07-15 (SCS PTRM FY22-26)), and the inputs into this calculation are explained in Attachment 7-01 (Annual Revenue Requirement).

1.1.2   Revenue cap for type 5, type 6 and smart regulated metering

Similar to the approach adopted for setting prices for standard control services, the AER has set out a revenue cap for type 5, type 6 and smart regulated metering in the F&A.[18] We outline the formula for setting prices for these services in Box 1-2, consistent with the F&A and therefore consistent with the requirements of the NER.[19] We have adopted the AER's control mechanism for these services as set out in its 2 December 2019 email with the following exceptions:

- We have not included a side-constraint as there is no requirement in the NER for a side constraint on any alternative control service. This is consistent with the approach in the F&A paper

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[17]   AER, *Final decision, Amendment, Electricity transmission and distribution network service providers, Post-tax revenue models (version 3)*, 29 January 2015.

[18]   Including for 'installation, operation, repair & maintenance, and replacement' and 'collection of meter data, processing and storage of meter data, and provision of access to meter data' alternative control services

[19]   NER s. 6.2.6(b).

We amended the methodology for calculating the AR$_t$ for the first year of the next regulatory period to adopt the same approach as used for recovering revenue for standard control services. This method looks to the PTRM for the revenue, rather than relying on X-factors. This approach is preferable, because there is no valid X-factor for the first year of the next regulatory period.[20]

Box 1-2. Control mechanism for type 5, type 6 and smart meters

(1) $TARM_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij}$ i=1,...,n and j=1,...,m and t=1,...,5

(2) $TARM_t = AR_t + B_t + C_t$ t=1, 2, …,5

(3) $AR_t = ASR_t$ t=1

(4) $AR_t = AR_{t-1}(1 + \Delta CPI_t)(1 - X_t)$ t=2,…5

Where:

$TARM_t$	is the total annual revenue for annual metering charges in year t.
p_t^{ij}	is the price of component i of tariff j in year t.
q_t^{ij}	is the forecast quantity of component i of tariff j in year t.
AR_t	is the annual revenue requirement for year t.
ASR_t	is the nominal annual smoothed revenue requirement for year *t* in the Post Tax Revenue Model.
AR_{t-1}	this is the AR$_t$ from the previous year.
B_t	is the sum of annual adjustment factors in year t for the overs and unders account.
C_t	is the sum of approved cost pass-through amounts (positive or negative) with respect to regulatory year t, as determined by the AER. It will also include any end-of-period adjustments in year t. To be decided in the final decision.
ΔCPI	is the percentage increase in the consumer price index. To be decided in the final decision.
X_t	is the X-factor in real terms in year t, incorporating annual adjustments to the PTRM for the trailing cost of debt where necessary. To be decided in the final decision.

1.1.2.1 Relevant matters to be determined in applying the control mechanism

The AER has indicated that the following matters should be determined in its final decision. We have provided additional relevant information for each to assist that decision.

Annual adjustments, 'B$_t$' term

JEN proposes to include a true-up for the under or over the recovery of revenue in the t-2 year, including adjusting for the time value of money. The method adjusts for the time value of money by calculating the present value of

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[20]   Indeed, the method presented by the AER on 2 December 2019 did not have any ability to recover revenue for the first year of the next regulatory period at all because the t was constrained between years 2 and 5.

actual revenue equal to the present value of revenue allowable. The mechanism achieves this is best displayed by way of the example provided in section 4.

JEN does not propose to include any other adjustments under this term.

Adjustments relating to the AMI-OIC, "T_t" term

The F&A included a T_t term to adjust for true-ups relating to the AMI Order in Council. However, this was not included in the 2 December 2019 email, and we have not included it. We agree this is not required for the next regulatory period because the AMI Order in Council only allowed for true-ups to occur in 2017 and any subsequent years of the 2016-20 regulatory control period.[21]

'CPI$_t$' term

We propose calculating this CPI$_t$ term using the same method as outlined in Box 1-1.

'X$_t$' term

The X-factor is determined by the PTRM; the value of X-factor is to be amended annually to adjust for the trailing cost of debt.

1.1.2.2 Calculation of revenue amounts using the control mechanism

The key inputs into the control mechanism for type 5, type 6 and smart meters are the annual smoothed revenue requirement for year "t" and the X factors. These inputs are calculated using the PTRM (see Attachment 07-24), and the inputs into this calculation are explained in Attachment 07-09.

1.1.3   Cap on the prices of individual services for other alternative control services[22,23]

For other alternative control services (other than those discussed in section 1.1.2 above), the price control mechanism we propose is a caps on the prices of individual services. We have adopted the AER's price control mechanism for fee-based services, as set out in the final F&A paper with one addition.

For our quoted services we have included two new terms—a term for tax and the other for margin. We explain reasoning in section 1.1.3.2. While this is a change to the F&A paper, we consider it is consistent with the requirements of the NER.[24]

Box 1-3 provides the control mechanism for ancillary service fee-based services, and Box 1-4 provides this for quoted services.

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[21]   *Victorian Advanced Metering Infrastructure Cost Recovery Order in Council*, cl 5L.3.

[22]   Excludes alternative control services provided under "type 5, type 6 and smart regulated metering".

[23]   Whilst public lighting is classified as alternative control service it will be calculated using a limited building block model which is effectively compliant with this price control model.

[24]   NER s. 6.2.6(b), NER s 6.2.6(c) and Part C.

1.1.3.1 Fee-based alternative control services

Box 1-3. The control mechanism for alternative control services (fee-based)

$$\bar{p}_t^i \geq p_t^i \qquad\qquad\qquad i=1,...,n \text{ and } t=1,2,...,5$$

$$\bar{p}_t^i = \bar{p}_{t-1}^i \times (1 + \Delta CPI_t) \times (1 - X_t^i) + A_t^i$$

Where:

$\bar{p}_t^i$ is the cap on the price of service i in year t

p_t^i is the price of service i in year t. The initial value is to be decided in the final decision.

$\bar{p}_{t-1}^i$ is the cap on the price of service i in year t-1

t is the regulatory year

ΔCPI_t is as provided in Box 1-1

X_t^i is the X-factor for service i in year t. The X factors are to be decided in the distribution determination and will be based on the approach we undertake to develop our initial prices.

A_t^i is the sum of any adjustments for service i in year t. Likely to include, but not limited to adjustments for any approved cost pass-through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

1.1.3.2 Quoted alternative control services

Box 1-4. Control mechanism for alternative control services (quoted services)

$Price = Labour + Contractor\ Services + Materials + Tax\ Allowance + Margin$

Where:

$Labour$ consists of all labour costs directly incurred in the provision of the service which may include labour on-costs, fleet on-costs and overheads. Labour is escalated annually by $(1 + CPI_t)(1 - X_t^i)$, where:

CPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[25] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2

minus one.

X_t^i is the X factor for service i in year t, as set out in the AER's price review determination.

$Contractor\ Services$ reflects all costs associated with the use of external labour including overheads and any direct costs incurred. The contracted services charge applies the rates under existing contractual arrangements. Direct costs incurred are passed on to the customer.

$Materials$ reflects the cost of materials directly incurred in the provision of the service, material storage and logistics on-costs and overheads.

$Tax\ Allowance$ reflects the tax wedge that applies to the capital component of the expenditure that necessarily incurs a tax liability.

$Margin$ is an amount equal to JEN's nominal vanilla WACC applied to the total cost of Labour, Contractor Services and Materials.

JEN is proposing to amend the price control formula, as outlined in the F&A paper, to account for a:

- Tax allowance - the tax component of the capital works that would necessarily arise, even if those capital works are fully funded by the customers

- Margin - consistent with the principle of competitive neutrality, and the revenue and pricing principles in the National Electricity Law (**NEL**), meaning that customers pay a price similar to that in a competitive market.

Our reasoning for this change is outlined below:

Tax allowance

We have included a tax allowance to allow for the tax component of the capital works that would necessarily arise, even if those capital works are fully funded by the customers. If strictly applied, the formulae in the F&A paper

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[25] If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

would prevent JEN from recovering our efficient costs. To address this issue, we propose the price control formulae for the next regulatory period be amended to that shown in Box 1-4.

Connection management and public lighting services we provide are classified as alternative control services in the F&A paper. We propose to adopt this classification and further propose some of these services are classified as quoted alternative control services. Examples of services that are capital in nature include:

- New public lighting installation

- Alteration or relocation of existing public lighting assets

- Temporary connection greater than 100 amps per phase[26]

- Upgrade of overhead supply to underground

- Reserve feeder installation.

The approach to classification of these services as alternative control services means that capital expenditure costs will not be added to the Regulatory Asset Base (**RAB**) and therefore does not, on the first appearance, give rise to the need for a tax allowance. However, given the capital nature of assets constructed in the provision of some connection management services, JEN capitalises these costs for tax and accounting purposes and will incur a tax liability for the service based on the revenue less depreciation over time.

As we cannot avoid incurring the tax liability, we believe the tax liability to be an efficient cost and, therefore, consider that the price control formulae must provide an ability to recover the tax liability associated with the connection works.

We refer to an Australian Tax Office (**ATO**) Interpretative Decision (ATO ID 2011/42)[27] made on 12 May 2011 which outlines that tax must be applied to capital works, and therefore, applies in circumstances outlined above.

> *Issue: Is expenditure incurred by a taxpayer on salary or wages an allowable deduction under section 8-1 of the Income Tax Assessment Act 1997 (ITAA 1997), to the extent that the relevant employees perform work on projects to construct and upgrade depreciating assets of the taxpayer?*
>
> *Decision: No. Expenditure incurred by a taxpayer on salary or wages is not an allowable deduction under section 8-1 of the ITAA 1997, to the extent that the relevant employees perform work on projects to construct and upgrade depreciating assets of the taxpayer as it is capital or capital in nature.*

We note the allowance of a tax component in the fee-based charges is consistent with the treatment of capitalised costs as determined by the AER in previous regulatory decisions for ACS connection services (< 100 Amps)[28,29] and has been proposed again in this Regulatory Proposal.[30]

Clause 7A(2)(a) of the NEL requires that a Distribution Network Service Provider (**DNSP**) should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in providing direct control network services, be they alternative control services or standard control services.

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[26] Temporary supply connections greater than 100 amps per phase are provided to developers of large commercial buildings and large public infrastructure projects e.g. road tunnel.

[27] https://www.ato.gov.au/law/view/document?docid=AID/AID201142/00001.

[28] AER, *Final Decision, Jemena distribution determination, 2016 to 2020, Attachment 16 – Alternative control services*, May 2016, s. 16.1.1.

[29] AER, *Final decision, Victorian electricity distribution network service providers, Distribution determination 2011–2015*, October 2010, p. 932.

[30] See Attachment 07-11.

The tax rate adopted in this Regulatory Proposal is 30%. We consider this rate will result in a material amount of tax, and therefore consider the formula can be amended per the NER[31] to recover these costs necessarily incurred by JEN.

Margin

Including a margin in the price cap formula for ancillary network services provided on a quotation basis is consistent with the principle of competitive neutrality and the revenue and pricing principles in the NEL[32]. It ensures that customers pay a price similar to that in a competitive market.

The AER has accepted a margin in a number of recent decisions for DNSPs.[33] JEN has proposed a definition of 'margin' to be equal to JEN's nominal vanilla WACC, consistent with the AER's most recent decision for SA Power Networks.

As with the price control mechanism approved for SA Power Networks, for simplicity, we have added the margin component at the end of the formula as a dollar amount based on a fixed percentage.

1.1.3.3 Relevant matters to be determined in applying the control mechanism

'p^i_t' term

The 'p^i_t' term represents the price outlined in the final determination. Our proposed prices and method of calculating these prices are set out in Attachment 07-11.

'X^i_t' term

The 'X^i_t' term represents the value outlined in the final determination.

1.2   Application of control mechanism for alternative control services

The NER requires JEN to demonstrate the application of the control mechanisms and provide supporting information for alternative control services.[34] We demonstrate the application of the control mechanism and provide the relevant supporting information in:

• Attachment 07-09 (Advanced Metering Infrastructure)

• Attachment 07-11 (Alternative control services)

• Attachment 07-12 (Public lighting services).

Each attachment sets out the forecast prices for the first year of the next regulatory period, as supported by the model calculations which apply the control mechanism.[35] As part of the annual pricing proposal, the models mathematically solve prices for each service in accordance with the constraints of the price control formula for each year of the regulatory control period.

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[31]   NER, s. 6.12.3(c1).

[32]   NEL s. 7A(5) states "A price or charge for the provision of a direct control network service should allow for a return commensurate with the regulatory and commercial risks involved in providing the direct control network service to which that price or charge relates".

[33]   AER, *Draft Decision - TasNetworks Distribution Determination 2019 to 2024 - Attachment 13 - Control Mechanisms*, September 2018, pp. 13-18 and 13-20 to 20-21; *SA Power Networks distribution determination 2020 to 25, Draft decision, Attachment 13 – Control mechanisms*, October 2019, pp. 13-6 and 13-16 to 13-17.

[34]   NER, s. 6.8.2(c)(3).

[35]   Attachments 07-24 'ACS Metering PTRM FY22-26', 07-30 'ACS Quoted services model', 07-31 'ACS Fee based services model' and 07-32 'ACS Public lighting model'.

2. Designated pricing proposal charges

Designated Pricing Proposal Charges (**DPPC**)[36] recover the payments we make for:

• Transmission charges which are payments for using a Transmission Network Service Provider's (**TNSP's**) high voltage network

• Inter-distribution business charges which relate to recognising cross-boundary settlements between networks. This applies when a neighbouring network supplies customers located near the network border

• Amounts paid for avoided Transmission Services in accordance with section 5.5(j) of the NER, which are payments recognising that energy supplied to the DNSP by an Embedded Generator (e.g. large scale solar and wind farms) would have otherwise been supplied from a TNSP's high voltage network.

To recover these charges, JEN proposes to include the same true-up method that applies in the current regulatory period for the under or over recovery of DPPC costs incurred during the t-2 year. The method adjusts for the time value of money by calculating the present value of actual DPPC revenue equal to the present value of recoverable charges. The mechanism to recover these charges is demonstrated by way of the example in section 4.

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[36]   NER cl. 6.18.7.

3. Jurisdictional cost recovery scheme

The Jurisdictional Cost Recovery Scheme (**JCRS**)[37] provides for cost recovery for services that are required within the Victorian Jurisdiction. These include, but are not limited to rebates for the Premium Feed-in tariff (**PFiT**).[38]

JEN proposes to include a true-up as required by the NER[39] and used in the current regulatory period for the under or over recovery of JCRS costs incurred during the t-2 year as part of its annual pricing proposal. The method adjusts for the time value of money by calculating the present value of actual JCRS revenue equal to the present value of recoverable charges. The mechanism to achieve this is best displayed by way of the example provided in section 4.

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[37]   NER cl. 6.18.7A.

[38]   NER cl. 6.18.7A(e)(1)(iv).

[39]   NER cl. 6.18.7A(b).

4. Annual pricing proposal revenue true-ups

The revenue cap form of price control requires a true-up of the actual revenue received as it varies to revenue allowance—in the case of standard control services and type 5 and 6 regulated metering services—or costs—in the case of DPPC and JCRS.

To undertake these adjustments, we will follow the process demonstrated in Box 4-1.

In all calculations, the balance amounts must be adjusted for the time value of money using the weighted average cost of capital (**WACC**) consistent with the rate the AER approved in the final determination in the year in which the determination is applicable, i.e. the WACC in previous regulatory periods—updated for the trailing cost of debt—will be used where the formula crosses multiple regulatory periods.

Box 4-1 Demonstration of revenue true-up

In year t we are truing up revenue under and over recoveries for t-2, the over or under recovery in year t itself won't be trued up until t+2. The following example demonstrates how we will perform the calculations:

	t-2	t-1	t
(A) Revenue from tariffs	247,500	247,000	249,511
(B) Allowed revenue	247,000	248,000	249,000
(C) Pass through	-	2	14
(D) Revenue under / (over) recovery (A) – ((B) + (C))	500	- 1,002	497
(E) WACC	10.00%	10.00%	10.00%
(F) Opening balance (J) from t-1	-	524	- 474
(G) Interest on opening balance	-	52	- 47
(H) Revenue under / (over) recovery (D)	500	- 1,002	497
(I) Interest on under / (over) recovery[1]	24	- 49	24
(J) Closing balance (F) + (G) + (H) + (I)	524	- 474	0[2]

[1] Calculated using a half year effect on the WACC, i.e., $(1+WACC)^{0.5}-1$
[2] Must set tariffs at rates that cause this value to be close to zero

The revenue true-ups will also cover the intervening period. Specifically, this will include:

- For t=1=2021-22, the unders/overs accounts (for SCS, metering, TUoS, and JUoS) will incorporate four periods: 2019 actuals, 2020 estimates, 2021 intervening period estimates, and 2021-22 forecasts

- For t=2=2022-23, the unders/overs accounts (for SCS, metering, TUoS, and JUoS) will incorporate four periods: 2020 actuals, 2021 intervening period actuals, 2021/22 estimates, and 2022-23 forecasts

- For t=3,4,5, the unders/overs accounts (for SCS, metering, TUoS, and JUoS) will revert to the standard three periods: t-2 actuals, t-1 estimates, and t forecasts.