Final decision

CITIPOWER'S AND POWERCOR'S PROPOSED SECURITY FEE SCHEME

April 2011

Contents

Glossary

AER	Australian Energy Regulator
ESCV	Essential Services Commission of Victoria
Guideline 14	Essential Services Commission of Victoria, *Electricity Industry Guideline No. 14 – Provision of Services by Electricity Distributors*
DNSP	Distribution network service provider
EDL	Electricity distribution licence
WACC	Weighted average cost of capital
NPV	Net present value

1 Introduction

Victorian electricity distribution network service providers (DNSPs) are required to make formal offers to customers requesting connection to the distribution network. This responsibility is set out in clause 6.1 of the DNSPs' electricity distribution licences (EDL). The Australian Energy Regulator (AER) is responsible for exercising certain powers and functions previously undertaken by the Essential Services Commission of Victoria (ESCV). This includes powers relating to compliance monitoring and enforcement of DNSPs' obligations under their respective distribution licences and the ESCV's codes and guidelines.

When new works or augmentation is required to facilitate a customer's connection to the DNSP's distribution system, the ESCV's Electricity Industry Guideline 14 (Guideline 14) allows that in certain circumstances, a DNSP may require a security fee from the connecting customer. In particular, where a DNSP determines that there is a high risk of not recovering the estimated revenue associated with a connection from a connecting customer the DNSP may request a security fee from that customer. Guideline 14 outlines the obligations of Victorian DNSPs if, and when, they choose to implement a security fee scheme. The AER does not have a direct role in approving a particular security fee scheme, however, Guideline 14 provides the responsibility of the AER to approve the interest rate payable on a security fee, held by the DNSP, and the terms and conditions of the fee. The ESCV's Guideline 14 can be found at www.esc.vic.gov.au.

In addition, under a DNSP's Electricity Distribution Licence and Guideline 14, any question as to the fairness and reasonableness of the other terms and conditions of a security fee scheme is to be determined by the AER should a dispute arise.

CitiPower and Powercor have sought approval from the AER for their proposed interest rate payment in respect of their security fee scheme. CitiPower and Powercor are the first DNSPs in Victoria to draft and submit a security fee scheme to the AER. This final decision outlines the AER's final decision on CitiPower's and Powercor's proposed interest rate, and terms and conditions.

The AER issued a draft decision on 21 December 2010 which requested submissions relating to CitiPower's and Powercor's proposed security fee scheme by 4 February 2011. In response to the draft decision, the AER received one submission, which was from CitiPower and Powercor.

1.1 Purpose of a security fee

A security fee acts to insure a DNSP against the risk of failing to collect the total incremental revenue estimated with regard to a connection offer. The incremental revenue is the revenue a DNSP receives through a customer's electricity tariffs. If the actual incremental revenue from the new connection is below the estimated incremental revenue, then a security fee, or a portion of it, is retained and forms part of the customer's capital contribution. However, if the estimated incremental revenue of the connection offer is realised, then the security fee is refunded with interest.

In the absence of a security fee scheme, if the DNSP does not collect the total estimated incremental revenue, then the shortfall would eventually be recovered through higher network tariffs to all other network users. Thus, the security fee also reduces the risks to existing customers from bearing inefficient connection costs attributable to certain new connecting customers.

Clause 3.3.1 of Guideline 14 requires Victorian DNSPs to calculate the maximum amount of a customer's capital contribution for new works and augmentation in association with a connection offer, as follows:

CC = [IC – IR] + SF

where:

- CC is the maximum amount of the customer's capital contribution
- IC is the amount of incremental cost in relation to the connection offer
- IR is the amount of incremental revenue in relation to the connection offer
- SF is the amount of any security fee under the connection offer.

When making a connection offer, a DNSP must estimate the incremental revenue it will receive from the new connection. The incremental revenue component of a new connection offer reduces the overall customer contribution received by a DNSP under this approach.

Clause 3.2(a) of Guideline 14 provides that customers are not to contribute towards the capital cost of new works and augmentation unless the incremental cost in relation to the connection offer is greater than the incremental revenue. Clause 3.2(b) provides that the amount of a customer capital contribution is not to be greater than the amount of the excess of the incremental cost in relation to the connection offer over the incremental revenue. Once the amount of a capital contribution has been calculated, a security fee may be sought.

1.2 Conditions for security fee

Under clause 3.5.1 of Guideline 14, Victorian DNSPs may request security fees from customers if a DNSP determines that there is a high risk they may not earn the estimated incremental revenue in relation to a connection offer.

Clause 3.5.2 of Guideline 14 requires that the value of the security fee must not be greater than the portion of the estimated incremental revenue which the DNSPs believe has a high risk of not recovered in total. The security fee also cannot be higher than the net present value (NPV) of the incremental cost that a DNSP will incur.

Under clause 3.5.3 of Guideline 14, DNSPs must pay customers interest on the security fee using an interest rate and terms and conditions of the interest rate which have been approved by the AER.

Clause 3.5.4 requires DNSPs to rebate the amount of the security fee together with interest earned as the DNSP receives incremental revenue. The rebate must be paid at least once per calendar year, beginning after the calendar year in which the connection services are provided.

1.3 Role of the AER

Clause 3.5.3 of Guideline 14 requires the AER to approve the interest on the amount of a security fee to be paid to a DNSP's customer including the rate and the terms and conditions of the interest payment.

In addition, the AER has functions regarding other terms and conditions of a security fee scheme should a question of the fairness and reasonableness of any of those terms and conditions arise. Under the EDL, any question as to the fairness and reasonableness of a term or condition of an offer made by a licensee under clause 6—obligation to offer connection services and supply to a customer—is to be decided by the AER based on the AER's opinion of what is fair and reasonable. This responsibility is set out in clause 11.4 of the EDL.

Furthermore, should a question arise, the AER is to determine the fairness and reasonableness of a DNSP's estimate with regards to clause 3.5.1 and 3.5.2 of Guideline 14. The AER must determine from its opinion of what is fair and reasonable in the circumstances. This responsibility is set out in clause 7 of Guideline 14.

1.4 Purpose of this final decision

This paper will outline the AER's final decision regarding the interest rate on the security fee to be paid by the DNSPs to a customer, and the terms and conditions of that payment for the purposes of clause 3.5.3 of Guideline 14.

2 The proposed security fee scheme

CitiPower and Powercor re-proposed the identical security fee scheme which is attached in Appendix A. According to CitiPower and Powercor, their proposed security fee scheme will only apply to customers who's NPV of the incremental revenue for the connection is greater than $750,000.

The proposed scheme calculates the amount of a security fee via a two stage process which assesses the customer's risk against three risk factors.

2.1.1 Location, industry, and customer diversity risk factors

The scheme takes the average of the risk criteria 'Location' and 'Industry', which are each given a rating from 0 to 5 in accordance with the criteria outlined in table 2.1. This average figure will provide a prima facie assessment of whether the location of the project and broad industry characteristics indicate that risks to realising the estimated incremental revenue are high.

If the average of these two risk factors is 'high' (a risk rating of 4) or 'very high' (a risk rating of 5), a subsequent assessment is made of the number of end customers at the site and their estimated contribution to the estimated incremental revenues. This third risk factor, called 'Customer diversity', has been designed to ascertain if the number of customer at each connection site mitigates risk.

For example, if the Customer diversity score is not classified as at least 'high', a security fee is deemed not applicable to the connection.[1] If the score for diversity is classified as high or above, the average of the three risk factors is used to determine the amount of a customer's security fee.

2.1.2 Amount of the security fee

If the overall risk rating is classified as at least 'high', being the average of the three risk factors, the security fee is calculated as one third of the 15 year NPV of the estimated incremental revenue multiplied by the average risk factor divided by five.

If a customer is situated in a rural area (risk factor 4), is in the mining industry (risk factor 5) and there is only one customer involved (risk factor 5), the overall risk rating is classified as 'high', hence a security fee will be required. Assuming the incremental revenue is $200,000 per annum then the security fee over a five year period is calculated as a 15-year NPV of incremental revenue of:

$1,600,370 / 3 = $533,457 * (4.67/5) = $497,893.[2]

2.1.3 Interest rate

CitiPower and Powercor have outlined that they will pay interest on any amount of the security fee which was refunded to the connecting customer—this occurs when

1 'High' customer diversity refers to the amount of diversity risk, and not the diversity. See table 2.1 for more information

2 CitiPower and Powercor intend to use the WACC to calculate the 15 year NPV.

the estimated incremental revenue is realised—at a rate equal to the 90 day Bank Accepted Bill rate published by the Reserve Bank of Australia.

CitiPower and Powercor consider that using the WACC would be an inappropriate basis for the calculation of interest on security fees, as the security fees are effectively held in trust until such a time as they are repaid or retained. CitiPower and Powercor arrived at this view noting the security fee is not available for investment in the business. In addition, they stated that paying interest at the WACC would impose an economic cost and would create a disincentive to charge security fees. [3] CitiPower and Powercor have noted that the payment of interest at the 90 day bank bill rate is consistent with the interest payable on refundable advances set out in clause 8.3(a) of the Energy Retail Code.

CitiPower and Powercor intend that an administration charge for the security fee be paid by the connecting customer. The administration charge will be calculated as a 0.25 per cent reduction to the proposed interest rate. CitiPower and Powercor have outlined their view that the administration charge equates to only a fraction of the interest rate to be paid on the security fee and that no administration charge will be applied if the security fee is not refunded.[4] CitiPower and Powercor also noted that the charge would not be material in the context of the security fee scheme and that expressing the charge as a percentage of the security fee is easier to administer than an upfront handling charge.[5]

2.1.4 Other terms and conditions

The proposed scheme seeks to refund any security fee or part thereof to the connecting customer over a five year period. CitiPower and Powercor believe that the amount of risk associated with a new connection decreases over time. CitiPower and Powercor also believe that the greatest uncertainty with regards to the incremental revenue for a connection exists in the first five years. [6]

Guideline 14 provides that a DNSP may only collect a security fee if it fairly and reasonably assesses that there is a risk that it may not earn the incremental revenue in relation to a connection offer.

CitiPower and Powercor have noted that the classification of high risk is encapsulated in the risk factors and is supported by not requiring more than one third of the net present value of the estimated incremental revenue as a security fee. [7]

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[3] CitiPower and Powercor submission, *CitiPower's and Powercor's Proposed Security Fee Scheme*, 27 July 2010.

[4] CitiPower and Powercor submission, *CitiPower's and Powercor's Proposed Security Fee Scheme*, 27 July 2010.

[5] CitiPower and Powercor submission, *CitiPower's and Powercor's Proposed Security Fee Scheme*, 27 July 2010.

[6] CitiPower and Powercor submission, *CitiPower's and Powercor's Proposed Security Fee Scheme*, 27 July 2010.

[7] CitiPower and Powercor submission, *CitiPower's and Powercor's Proposed Security Fee Scheme*, 27 July 2010.

A shortfall of incremental revenue followed by above estimated incremental revenue

CitiPower and Powercor do not intend that any shortfall of incremental revenue—resulting in the retention of a portion of the security fee—in a given year, should be offset by above estimated incremental revenue received in other years.[8]

The AER's draft decision outlined the AER's indicative view that the term may not be fair and reasonable.[9] In the draft decision, the AER outlined its view that in order to remove this risk, any shortfall in incremental revenue—requiring the retention of part of the security fee—should be offset if the new connecting customer has above estimated incremental revenue in another year during which the proposed scheme operates.

The AER recognised that the proposed methodology is simpler to administer, however, it noted that the costs to an individual new connecting customers have the potential to be material.[10]

The acceptable balance between the interests of new and existing customers

With a security fee scheme in operation, if a DNSP is unable to recover the total estimated incremental revenue from a new customer, it will retain the shortfall from the security fee. CitiPower's and Powercor's intention is that not more than one third of the NPV of the estimated incremental revenue as a security fee be collected. CitiPower's and Powercor's proposed scheme intends to retain some or all of the security fee over a five year period (or one third of the NPV of the estimated incremental revenue[11]) which the DNSPs contend represents a balance between mitigating as much risk as possible whilst minimising the customer impacts and administration costs.[12]

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[8] That is, above estimated incremental revenue in a year will not be used to reduce shortfalls in estimated incremental revenue in other years, but rather, the above estimated incremental revenue will be received by the DNSP and the security fee will also be retained in the year of below estimated incremental revenue.

[9] In the draft decision the AER considered that a new connecting customer should not have to bear the risk of an inaccurate incremental revenue forecast.

[10] AER, *draft decision*, 21 December 2010.

[11] Under Guideline 14, a business customer is assumed to have a connection life of 15 years.

[12] CitiPower and Powercor submission, *CitiPower's and Powercor's Proposed Security Fee Scheme*, 27 July 2010.

Table 2.1: Risk assessment criteria and ratings proposed by CitiPower and Powercor

Risk Rating Factor	Location	Industry	Customer Diversity (largest customer's share of IR)
0		Essential Services	
1 Very Low	CBD – Melbourne CBD	Residential (low/high density), public admin / education	<25%
2 Low	Urban – Melbourne metropolitan area	Accommodation / food services, commercial / residential occupancy, health care / social assistance, wholesale / retail trade	>=25% < 50%
3 Medium	Regional – large regional provincial centres (e.g. Ballarat, Bendigo, Geelong, Mildura, and Shepparton)	Industrial estate, telecomm / information media, transport, postal / warehousing, other	>=50% < 75%
4 High	Rural – settled areas outside of above	Agriculture, forestry / fishing, manufacturing	>=75% < 100%
5 Very High	Remote rural – all other areas (i.e isolated areas)	Mining	100%

3 Submissions

The AER released a draft decision on 21 December 2010 which outlined CitiPower's and Powercor's proposed security fee scheme. The paper also invited submissions regarding the AER's draft decision and indicative views on:

- interest rate
- administration charge
- risk factors
- term that that above estimated incremental revenue in any year, will not offset below estimated incremental revenue in another year (which results in a part of the security fee being retained)
- other terms and conditions.

One submission was received in response to the draft decision. The submission was from CitiPower and Powercor. Both DNSPs agreed with the AER's draft decision to approve an interest rate, to be paid to customer's whose security fees are returned, at the 90 day bank bill rate less 0.25 per cent for administrations fees.[13] The DNSPs also agreed with the AER's indicative views that:

- the proposed risk factors would be fair and reasonable
- the proposed security fee scheme would fairly and reasonably assess whether there is a risk that a DNSP may not earn the total estimated incremental revenue from a new connecting customer
- the proposed scheme would fairly and reasonably assess whether the amount of the security fee would not be greater than the amount of incremental revenue which the DNSP fairly and reasonably assessed as high risk
- the proposal to refund security fees or part thereof over a five year period would be fair and reasonable
- requiring one third of the NPV of the estimated incremental revenue as a security fee would fairly and reasonably balance the risks to new and existing customers.

However, the DNSPs did not agree with the AER's indicative view that it may not be fair and reasonable that above estimated incremental revenue in any year will not offset below estimated incremental revenue in another year (which would result in the retention of a portion of the security fee).[14]

In CitiPower's and Powercor's submission the DNSPs outlined that using the AER's approach presumably would mean that one year of above incremental revenue (and return of security fee) followed by a number of years of below estimated incremental

[13] CitiPower/Powercor, submission, 3 February 2011
[14] CitiPower/Powercor, submission, 3 February 2011

revenue may result in the customer being required to return a portion of the refunded security fee. The DNSPs noted that this situation may occur due to insolvency or downsizing, in which case it may be difficult to claw back the refunded security fee—thus the whole security fee may need to be retained for the full five years whereupon an accurate calculation for the entire period could be made. CitiPower and Powercor also outlined that this would necessitate the tracking across the five year term of the present value of actual and forecast incremental revenue.[15]

CitiPower and Powercor further contended that a retrospective adjustment is inconsistent with the overall design of the scheme and will therefore necessitate the alteration of other elements of the scheme including the administrations charge. They also reiterated their proposal to the draft decision that, where incremental revenue is higher than estimated, it is likely that there will be additional costs to the network incurred by the above estimated load. The DNSPs stated that they maintain their position that it is not appropriate or necessary to adjust the security fee retrospectively given that the scheme, when considered in its entirety, is fair and reasonable.[16]

15 CitiPower/Powercor, submission, 3 February 2011
16 CitiPower/Powercor, submission, 3 February 2011

4 AER considerations

4.1 Interest rate and administration charge

Under clause 3.5.3 of Guideline 14, DNSPs must pay customers interest on the amount of a security fee held by the DNSP at a rate, and on terms and conditions approved by the AER.

In the draft decision the AER accepted that the 90 day Bank Bill rate is an appropriate basis for determining the interest payable on the security fee because:

- CitiPower and Powercor have noted that the security fee will be used for short term funding and is not available for investment in the business
- the payment of interest at the 90 day bank bill rate is consistent with the interest payable on refundable advances set out in clause 8.3(a) of the Energy Retail Code.[17]

CitiPower and Powercor proposed a 0.25 per cent reduction in the security fee as an administration charge. The AER considers that CitiPower and Powercor should be able to recover the costs of administering the security fee scheme from the new connecting customer in order to prevent the charges being recovered from the DNSPs' existing customer base. However, the AER considers the administration charge must not be recovered by the DNSPs elsewhere and the AER will have regard to this should any dispute to the fairness and reasonable of the scheme arise. The AER's final decision is to approve the proposed 0.25 per cent reduction in the interest rate for administration costs on the portion of any security fee refunded to the customer because:

- the AER considers that the administration charge is unlikely to be excessive in terms of overall project cost
- there were no other submissions received on the AER's draft decision proposing an alternative method to calculate the administration charge.

- The AER's final decision is to approve CitiPower's and Powercor's proposed security fee interest rate at the 90 day Bank Bill rate less a 0.25 per cent administration charge.

4.2 A shortfall of incremental revenue followed by above estimated incremental revenue

CitiPower's and Powercor's security fee scheme does not allow below estimated incremental revenue in a year to be offset against above estimated incremental revenue in another year. That is, in any year of below estimated revenue the DNSP can retain the security fee to recover the estimated amount, and in any year of above estimated revenue the DNSP can retain above estimated revenue (whilst refunding the security fee). The AER still has concerns that CitiPower's and Powercor's security fee

[17] ESCV, *Energy Retail Code*, Version 7, February 2010.

scheme may, in some circumstances, allow for over recovery from individual customers. The AER will further assess this matter should a dispute arise from a specific new customer regarding whether an over recovery of incremental revenue has resulted from the application of CitiPower's and Powercor's proposed security fee scheme.

5 Final decision

The AER's final decision is to approve the use of the 90 day Bank Bill rate less a 0.25 per cent administration charge as the interest payable on the amount of a security fee returned to a customer.

A. Appendix: Proposed security fee scheme by CitiPower and Powercor

This appendix outlines CitiPower's and Powercor's revised proposed security fee scheme which was provided in an appendix to its submission on the AER's consultation paper. CitiPower's and Powercor's deletions from their original proposed security fee schemes are marked in square brackets and additions are market in blue text. A full copy of CitiPower's and Powercor's submission, including appendix is available at http://www.aer.gov.au/content/index.phtml/itemId/737791.

What is a security fee?

Some projects may require a security fee to be paid. The Security Fee is applied to manage the risk associated with CitiPower not receiving the distribution revenue amount that was assumed when the connection offer was prepared. Subject to the required load being achieved the security fee is refundable with interest. The customer's load is assessed from the customer's weighted average maximum billed demand for the preceding 12 months.

Risk Factors

Incremental revenue may be less than expected due to:

- Site vacancy: There is a risk that a site will be vacant for part of the period of time that revenue is assumed to accrue for the purpose of determining customer contribution (15 years for non-residential and 30 years for residential). A vacancy may occur for a number of reasons, including customer insolvency or changing business conditions.

- Energy intensity: The energy consumption of the customer may change over time.

Risk criteria are assessed to determine the overall level of risk applicable to a customer connection. If the risk score is high a security fee may be required.

The risk criteria used are as follows:

- Location: This criterion is used to help assess the probable duration of the vacancy, should the site become vacant for whatever reason. The more remote the location the less likely that a site vacancy will be quickly filled, therefore the higher the risk that incremental revenue will be less than expected. The risk of a site vacancy in the CBD is comparatively lower than in the urban areas.

- Industry: Some industries are inherently more risky than others. This criterion is used to help assess the risk that the customer will experience financial difficulties due to changes in industry conditions, which in turn may result in changed usage patterns. For instance, government and residential sectors are considered low risk, and high tech and mining sectors are considered high risk.

- Customer diversity: This criterion is determined by the number of customers at the connection site. The larger a single customer's share of IR, the greater the risk

Please see Table 1 below for criteria ratings.

Table 1 Criteria Ratings

Risk Rating Factor	Location	Industry	Customer Diversity (largest customer's share of IR)
0		Essential Services	
1 Very Low	CBD	Residential (low/high density) public admin / education	<25%
2 Low	Urban	Accommodation / food services Commercial / residential occupancy Health care / social assistance Wholesale / retail trade	>=25% < 50%
3 Medium	Regional	Industrial estate Telecomm / information media Transport, postal / warehousing, other	>=50% < 75%
4 High	Rural	Agriculture, forestry / fishing Manufacturing	>=75% < 100%
5 Very High	Remote rural	Mining	=100%

When will a Security Fee be required?

A security fee may be required where it is assessed that there is a high risk that CitiPower will not receive the distribution revenue.

Assessment will only apply where the NPV of the incremental revenue (IR) calculated for the purposes of determining the connection charge is greater than $750k. (The NPV of the IR is calculated over 30 years for residential and 15 years for other customer types in accordance with Guideline No.14)

If the connection project triggers the revenue threshold above then an assessment is carried out to determine the risk. If the risk to CitiPower is assessed as being high, a security fee will be required.

In assessing whether a security fee is required, CitiPower considers three risk factors, location, industry type, and customer diversity. The weighted average of the risk criteria “industry type” and “location” is assessed to gain a prima facie assessment of whether broad industry characteristics and the location of the project indicate that risks to IR realization are high. The risk is assessed on a scale of 0 to 5 and ratings of 4 or 5 are regarded as high risk. If the risk is classified as high on the basis of “industry type” and ‘location” then a further assessment is made of the number of end customers at the site and their estimated contribution to the predicted revenues to ascertain if “customer diversity” mitigates risks. If the score for “diversity” is also classified as high then the average of the three risk criteria is calculated to determine the risk factor, otherwise no security fee is required.

The security fee is calculated from the product of the risk factor and [~~five years’~~] one-third of the present value of the IR applicable to the connection. This [~~The five year IR figure~~] is analogous to classifying 1/3 of the present value of the forecasted revenue used to calculate the connection charge as high risk and is viewed as a conservative assumption.

This revised methodology more accurately assesses risk levels and security fee amounts, and ensures that risk assessments can be conducted quickly and easily.

The Security Fee will be calculated by CitiPower and included in the offer for connection services.

The following examples are provided to demonstrate the risk assessment and calculation of the security fee.

Example 1:

Consider a mining enterprise in a rural location, only one customer involved and annual revenue of $200,000

Location = “Rural”; Risk Rating = 4

Industry = “Mining”; Risk Rating = 5

Average risk rating for “Location and Industry” = 4.5 therefore assess for third criteria, “Customer Diversity”. Only single customer therefore Risk Rating = 5

Overall Risk Rating = (4 + 5 + 5) / 3 = 4.67

Therefore Security Fee = $200,000 per annum = a 15 year NPV of IR of $1,600,370 [~~*~~] / 5 years = $533,457 * 4.67 Risk Rating = [~~$933,400~~] $497,893

Example 2:

Consider an Industrial estate in a regional location, with 10 customers with the largest one being 30% of the total load and the annual revenue is $200,000

Location = “Regional”; Risk Rating = 3

Industry = [~~“Mining”~~] “Industrial Estate”; Risk Rating = 3

Average risk rating for “Location and Industry” = 3, not high risk therefore no further assessment and no Security Fee required.

Example 3:

Consider a forestry enterprise in a rural location, consisting of two customers, the largest one being 55% of the total load and the annual revenue is $200,000

Location = “Rural”; Risk Rating = 4

Industry = “Forestry”; Risk Rating = 4

Average risk rating for “Location and Industry” = 4 therefore assess for third criteria, “Customer Diversity”. Largest customer = 55% therefore Risk Rating = 3

[~~Overall Risk Rating = (4 + 4 + 3) / 3 = 3.67~~

~~Overall Risk Rating less than 4 (High) therefore no Security Fee required.~~]

As the Customer Diversity figure is less than 4, the overall risk rating is not classified as high, therefore no Security Fee required.

Security Fee Refunds

CitiPower will allow an annual rebate of the Security Fee over a five year period. CitiPower will compare the weighted average maximum billed demand against the estimate used for that year in calculating the customers capital contribution incorporated into the connection offer. In each of the five years CitiPower will refund to the customer a sum equal to one fifth of the initial Security Fee adjusted pro rata if the weighted average maximum billed demand was less than the estimated maximum demand, with interest.

In other words if there is a shortfall in the weighted average maximum billed demand for that year the rebate will be reduced by the shortfall expressed as a fraction of the estimated maximum demand. Any shortfall for any year may not be off-set against additional revenue received for any other year or vice versa.

The first qualifying year of the rebate period commences on the date of completion of the works. Subsequent rebate periods will follow at successive 12 month intervals from the first period.

Interest is paid on the annual rebate. Interest is not payable on the amount of the reduction of any rebate. The interest rate is based on the average monthly 90 day Bank Accepted Bill rate published by the Reserve Bank of Australia, less 0.25%, from the date CitiPower receives the security fee.

Any security fees which are not refunded will be recognised as a customer contribution to the network augmentation. This assessment commences 12 months after the date of completion of works, and is performed annually for a five year period.

Why is a security fee required?

The purpose of collecting a security fee is to afford some protection to the distributor and its existing customers against the intending customer failing to take up the electrical load advised to the distributor and included in the calculation of their incremental revenue. To the extent that anticipated revenue is not realised, a financial cost is incurred. This cost will flow to the distributor during the current regulatory period and other customers in subsequent regulatory periods.

This approach helps to ensure that other customers and the distributor aren't required to subsidise inefficient costs.

Administration Fee

The administration costs will be recovered by an adjustment to the interest rate. The adjustment to the interest rate is easier to administer than an up-front handling charge, expressed as a percentage of any security fee required. Administrative costs are incurred whether or not a refund is made.

Period

A five year period has been proposed for the following reasons:

- The greatest uncertainty with regards to the incremental revenue for a connection exists in the first five year period, with the risk generally reducing over the remainder of the 15 year economic life of a non-residential connection;

- A shorter period was not adopted because it can take several years for a customer to achieve full load. This period includes the construction period which can be up to 18 months from the time of the connection;

- A longer period was not adopted because the benefits of a longer period didn't outweigh the additional administration costs; and

- A five year period represents a balance between mitigating as much risk as possible whilst minimising customer impacts and administration costs.

Ownership changes

The original contracting party would be paid any refund, unless there was adequate evidence to indicate that the Distributor's contractual obligation had been novated to another party.