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By email: AERPricing@aer.gov.au

19 November 2021

Dear Warwick

Submission on preliminary standardised models for regulated metering services

Jemena welcomes the opportunity to provide feedback on the preliminary standardised models for regulated metering services models published by the Australian Energy Regulator (**AER**) for consultation.

We support the use of standardised regulatory models across businesses as it will improve consistency in reporting and decision making and allow stakeholders to engage more constructively during price resets. We present below our feedback on the new metering models with further details of its application in the **Annexure.**

Metering Capex and Opex Model

1. **Inflation series** – The model includes two inflation series, an unlagged series for opex and a lagged series for capex. This could be counterintuitive as the time value of money at a point in time should be the same regardless of whether it is capitalised or expensed. We recommend applying one inflation series consistently across opex and capex for simplicity and to avoid valuing the same expenditure differently between opex and capex. Using a single inflation series is consistent with the way financial models are generally developed. The AER's Roll Forward Model (**RFM**) applies an 18-month lagged inflation series – to be consistent with the RFM we recommend the AER adopts the same lagged inflation series for both opex and capex in this model.

   Additionally, the formula for lagged inflation index (cells J33:P33 and I39:P39 in sheet 'Input| Prices') is currently linked to the unlagged inflation rates which could be amended by linking to the lagged rates.

2. **Real escalation –** The model includes real price escalation for the 'internal labour' component of costs only and not the 'external labour' and 'non-labour' components. For completeness, we recommend including inputs for external labour and non-labour real price escalations.

3. **Opex specific forecast –** The model applies a base-step-trend method consistent with opex for Standard Control Services (**SCS**). The AER's SCS opex model includes

an additional section for specific forecast to account for uncontrollable opex categories which require to be estimated separately. However, this metering model currently does not allow users to enter specific forecasts. We recommend the model allows for specific forecasts by relabelling the step changes section to 'step changes and specific forecasts'.

4. **Opex economies of scale factor** – This model includes an 'economies of scale factor' category under productivity change section of the opex forecast. The AER has not consulted on this with the businesses or included it in any of the AER's previous SCS opex models. We recommend the AER remove this input as there is no basis for measuring this input and maintain consistency with the SCS opex model.

5. **Circular reference in capex calculations –** The model allows users to choose a base year for capex forecast from a dropdown list in the 'Input|General' sheet. However, when year 4 or 5 in the current period is selected, a circular reference is triggered. The Excel notification indicates that the source of the circular reference cannot be identified, which we believe is due to the use of array formulae in sheets 'Input | Meters Vols & Costs' and 'Calc | Capex Meters'. We recommend using simpler formulae instead of arrays to identify the reason for circular references.

6. **Regulatory Asset Base (RAB) asset classes –** The model currently includes only three asset classes - meters, comms and IT. However, JEN's RAB includes more asset classes in the Post-tax Revenue Model (**PTRM**) of its 2021-26 determination such as inhouse software, other and equity raising costs. JEN splits the IT costs into asset classes 'inhouse software' and 'IT' and this is essential allows for splitting IT costs into inhouse software and other IT costs and also provide additional space for entering other asset classes to better align with the PTRM requirements.

7. **Cash flow timing of capex inputs –** The model requires the cash flow timing of capex inputs to be <u>end-year</u> in sheet 'Input|General'. However, JEN uses <u>mid-year</u> capex inputs in Jemena's capex model in the 2021-26 determination. The AER's standardised SCS capex model[1] also allows capex inputs to be entered in mid-year terms. We recommend including the optionality for businesses to choose between mid-year and end-year cash flow timing for capex inputs in this model.

8. **RFM outputs –** The RFM output sheet in this model contains forecast capex data for the <u>next</u> regulatory period. However, the capex inputs required by the RFM are for the last two years of the <u>current</u> regulatory period. We recommend the RFM output sheet includes capex data for years 4 and 5 of the current period instead of forecast capex for the next regulatory period.

<u>**Metering Pricing Model**</u>

We provide feedback only on the exit fee section of this model as JEN operates under the revenue cap form of control for metering services.

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[1] AER, *AER standardised SCS capex model - preliminary - August 2021.xlsm,* sheet 'Input| Escalations'

1. **Tax allowance** – The proposed exit fee calculation does not recognise that distributors pay tax on any income received from exit fees. This means distributors will not be able to recover all their efficient costs. We recommend the AER includes calculations for tax allowance in this model. The AER could consider adopting the calculations in JEN's Exit Fee Model approved by the AER in the 2021-26 determination[2].

2. **RAB asset classes –** This model only allows for RAB inputs in three asset categories meters, comms and IT. However, the exit fee calculations in the AER's 2021-26 decision for JEN include more RAB asset classes such as inhouse software, buildings, other and equity raising costs. To better align the RAB calculations in this model to the AER's current decision for JEN, we recommend the model allows for more RAB asset classes by relabelling the 'RAB Comms & IT' to 'RAB Comms & IT and other'.

3. **RAB per meter calculation –** The model calculates the RAB per meter for each year by using the mid-year RAB of the <u>previous year</u> divided by the <u>end-year</u> meter population of the current year. We believe that this should instead be calculated as the mid-year RAB of the <u>current year</u> divided by the <u>mid-year</u> meter population of the current year. The current formula creates an 18-month timing mis-alignment between the RAB and the meter population. Our recommendation elaborated in points 1 and 2 of the annexure will rectify this timing mis-alignment.

<u>**General recommendations for both models**</u>

We recommend the AER consider the following recommendations for both models –

1. **Model checks** – We recommend including a centralised check sheet that summarises the outcomes of all the checks in the model. This would help users identify and trace errors more easily when checks are triggered. An overall workbook check can then be presented on each worksheet so that model users are made aware of any errors as soon as possible. JEN's capex model in the AER's 2021-26 determination provides an example of the centralised check sheet and a way to present the overall check on each sheet[3].

2. **Labelling of inputs and outputs** – We recommend that the model specify the unit, basis and cash flow timing for each input, calculation and output in the model to improve model clarity. We provide some examples in points 3 and 4 of the annexure.

3. **Other minor recommendations** – Points 5 to 6 of the annexure include other minor recommendations in relation to best modelling practices.

We recommend the AER undertaking a further review of the model before finalisation to ensure the feedback from us and other stakeholders is appropriately addressed.

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[2] AER, *Final decision - Jemena distribution determination 2021–26 - Metering exit fees - April 2021 Confidential.xlsb,* sheet 'Calc|Exit Fee', section 'Tax allowance' in rows 38 to 63

[3] AER, *Final decision - Jemena distribution determination - 2021-26 - Capex model - April 2021 - updated 11 May 2021.xlsb,* refer to the centralised check sheet in sheet 'Check|List' and a presentation of check status on each sheet in range E1:F2.

We are committed to working constructively with the AER and welcome any further queries in relation to the above feedback. If you wish to discuss this submission please contact Jerrie Li on ██████████ or ████████████████ .

Yours sincerely

[signed]

Sandeep Kumar
Group Manager Regulatory Analysis and Strategy

Annexure – Application of recommendations

Standardised Metering Pricing Model

No	Topic	Type	Worksheet	Cell reference	Recommendation
1	RAB per meter	Calculation	Input | Exit Fees Calc | Exit Fees	Various	To calculate the mid-year RAB for the <u>current year</u>, it first needs a closing RAB for each year in the next regulatory period. This is currently missing for year 5. We recommend calculating the closing RAB for meters in row 12 and other RAB asset classes in row 19 of sheet 'Input | Exit Fees'. After this step, the mid-year Meter RAB can be calculated by updating the formula in cell K57 of sheet 'Calc | Exit Fees' to – *=AVERAGE('Input | Exit Fees'!G\$12:H\$12)*K41* This formula can then be copied across the range K57:O66 in 'Calc | Exit Fees'. The mid-year Comms & IT RAB can be calculated by updating the formula in cell K89 of sheet 'Calc | Exit Fees' to – *=(AVERAGE('Input | Exit Fees'!G\$19:H\$19)*10^6)/K\$21* This formula can then be copied across the range K89:O89 in 'Calc | Exit Fees'.
2	RAB per meter	Calculation	Calc | Exit Fees	K11:O20 K26:O35	To calculate the <u>mid-year</u> meter population for the current year, we recommend updating the formula in cell K11 to – *=IF(\$F11=0,0, SUMPRODUCT('Input | Exit Fees'!K\$69:K\$83 + 'Input | Exit Fees'!J\$69:J\$83, ('Input | Exit Fees'!\$D\$49:\$D\$63=\$F11)/1)/2)* This formula can then be copied across the range K11:O20. To calculate the mid-year 'Cost-Weighted Volume of Meters' for the current year, we recommend updating the formula in cell K26 to – *=SUMPRODUCT('Input | Exit Fees'!\$M\$49:\$M\$63,'Input | Exit Fees'!K\$69:K\$83 +'Input | Exit Fees'!J\$69:J\$83,('Input | Exit Fees'!\$D\$49:\$D\$63= \$F26)/1)/2* This formula can then be copied across the range K26:O35.
3	General	Labelling	Input | Exit Fees	N/A	The input sections requires dollar basis (nominal or real) and cash flow timing (mid-year or end-year) to be specified to avoid confusion when entering data inputs. For instance, in rows 9 to 18, it is unclear whether the RAB inputs are required in real or nominal dollar basis. Similarly, it is unclear what dollar basis are required for the inputs of allowed exit fees in range G29:G38. We recommend specifying the dollar basis and cash flow timing for all inputs on this sheet to provide clarity on requirements.

Standardised Metering Capex and Opex Model

No	Topic	Type	Worksheet	Cell reference	Recommendation
4	General	Labelling	Input | Meter-Opex BST	N/A	The input sections requires the timing of the required inputs to be specified. For example, when nominal cost inputs are required in rows 12 to 15, it is unclear whether inputs are required in mid-year or end-year terms. We understand from the inflation formula that it is intended for nominal mid-year inputs. However, it would be helpful to specify the mid-year requirement to avoid any confusion. Similarly, the input for customer numbers in rows 31 to 34 require clarity that these are to be entered in end-year terms. We recommend adding an extra column after column H to specify the timing of inputs (either mid-year or end-year) to provide clarity on input requirements.
5	General	Calculation	Input | Comms & IT	K142	The formula in cell K142 is missing. We recommend populating K142 by copying the formula from cell K143 to K142. We also recommend including more checks in this model to help identify calculation errors.
6	General	Best modelling practice	Input|General	I15	We observe that the 'notation adjustment' input in cell I15 does not appear to have any dependents and could be removed. We recommend the AER reviews the model and remove any redundant calculations with no dependents to improve model efficiency.