PowerWater

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Ms Clare Savage
Chair
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3001

Dear ~~Ms Savage~~ Clare

Request to amend the Framework and Approach Paper applicable to Power and Water Corporation (PWC)

I am writing to formally request the Australian Energy Regulator (AER) make an amended Framework and Approach Paper to apply to PWC for the 2024-2029 period.

As you are aware, the relevant rules provide for DNSPs to request the AER to make an amended or replacement framework and approach paper at least 32 months prior to the end of a regulatory control period. There are a number of changes to PWC's operating and regulatory environment (which have either already occurred, or which are anticipated to be in place for the next regulatory control period) which have led PWC to make this request to the AER.

At a high level the key reasons for the request are:

- ***In relation to the classification of services***, the AER has published it Service Classification Guideline since the 2019-2024 determination. This, together with the changes to PWC's service offerings and new or emerging distribution services necessitates that the current approach to service classification be revisited.
- ***In relation to the application of the Expenditure Forecast Assessment Guideline***, we propose that the application of the guideline to PWC be modified.
- ***In relation to the depreciation approach for the regulatory assets base*** we propose that this continue to be on the basis of forecast depreciation.

In relation to the incentive schemes, we will generally be seeking a continuation of the approach to incentives schemes applying in the current determination. We will also be seeking to continue to work with the AER on a tailored approach to benchmarking and the application of the Expenditure Forecast Assessment Guideline, consistent with the approach outlined in your letter dated 30 September 2021.

Our position in relation to each of the elements of the Framework and Approach paper are set out in the Table at Attachment 1, together with the reasons for our position. We will present our fully developed position as part of the AER's formal engagement over the coming months, which will address the matters raised in your aforementioned letter.

We look forward to the continuation of the positive and constructive engagement we have undertaken to date.

Yours sincerely

[redacted]

Djuna Pollard
Chief Executive Officer

29 October 2021

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Attachment 1

PWC Proposed Approach to Framework and Approach and Reasons

Elements of Framework and Approach (Rule 6.8.1(b)(2)	Change Required to approach from 2019-2024 period?	Reasons
Control Mechanisms and formulae to give effect	No	The current control mechanisms and formulae appear to be operating as required. However, the AER may wish to clarify how it intends the side constraint formula to be applied given the updates that were made as part of PWC's 2021-22 pricing proposal.
Classification of Services	**Yes**	Since the 2019-2024 Determination was made, the AER has published a new classification guideline which has a different approach to some services to that which apply in that Determination. We expect to make minor changes to the service classifications in order to be consistent with the guideline. Where appropriate, PWC will be also seeking to depart from the guideline and the 2019-2024 approach for some existing services. Along with other DNSPs, PWC will be seeking recognition and classification for new and emerging services.
Application of STPIS	No	The reasons supporting the AER decision not to apply a STPIS to the 2019–2024 regulatory period apply equally to the 2024–2029 period. PWC's systems and data collection are still not at a level of maturity to accurately report most of the service performance measures needed to apply the STIPS. Imposing the incentive mechanisms risks rewarding or penalising us for data errors rather than actual changes in our performance – either when setting targets or when measuring performance against them – which would significantly undermine the intent behind the scheme and overall benefit for customers.
Application of EBSS	No Did not apply 2019-2024 and this should continue.	The AER did not apply the EBSS to the 2019–24 period because it did not use revealed costs to set the opex for that allowance. This is consistent with its standard practice. We support this continued approach given that the EBSS and base, step and trend opex forecasting method should be considered together to ensure that appropriate incentives are applied. If revealed costs were to be used without adjustment to set the opex allowance for the 2024–2029 regulatory period (as part of a standard base, step and trend forecast method), then we consider it would be appropriate to apply the EBSS to that period as well.

Elements of Framework and Approach (Rule 6.8.1(b)(2)	Change Required to approach from 2019-2024 period?	Reasons
		We have been in preliminary discussions with the AER regarding the approach to assessing our operating expenditure, which includes an alternative approach to assessment of the reasonableness of our forecasts. We expect the approach to the application of the EBSS would need to be considered as part of the broader consideration of expenditure assessment.
Application of CESS	No The CESS applied in the 2019-2024 period and should continue to apply.	The justification for applying the CESS over the 2019–2024 regulatory period continues to apply. The incentive mechanism helps promote efficient capex, which benefits both us and our customers.
Application of DMIS or DMIA	No	The justification for applying the DMIA over the 2019–2024 regulatory period – to promote demand management innovation and solutions that benefit our customers – continues to apply. This is even more so given the energy transition that is currently underway in the Northern Territory and across the country. In relation to the DMIS, our systems and processes are not sufficiently mature to appropriately apply the DMIS at this time.
Application of Small Scale Incentive Scheme	No (The scheme did not apply in 2019-2024 and this should continue for the 2024-2029 period.)	The justification for not applying the small-scale scheme to the 2019–2024 period continues to apply. We also observe that the small scale incentive scheme applies to very few jurisdictions in Australia. Given PWC is still in the early stages of economic regulation under NER framework, we consider it would be inappropriate to apply the scheme while we are still in the process of fully implementing the existing suite of incentive schemes.

Elements of Framework and Approach (Rule 6.8.1(b)(2)	Change Required to approach from 2019-2024 period?	Reasons
Application of Expenditure Forecast Assessment Guidelines	Yes Guidelines should only apply in modified form	PWC has been in early discussions with the AER regarding the approach to the assessment of forecast operating expenditure. We appreciate the early engagement with AER staff on this important issue. Whilst there has been some improvement in PWC information and reporting abilities since the time of the last determination, there will still be considerable work and costs in properly considering and quantifying operating environmental factors in a way suitable for AER assessment. On this basis, the AER's preferred top-down assessment approach applied to most DNSPs will be difficult to undertake without significant investment to ensure all operating environmental factors are properly taken into account. Even if the investment is made, the differences between our businesses and peers may be too great to provide any confidence in the results. While not preferable, a more detailed bottom up level of review will be the most efficient approach at this stage of PWC's economic regulatory development, particularly given the differences between its own network and other networks regulated by the AER. This was the consequence of the 2019-24 Distribution Determination process after the AER was unable to place confidence in the data underlying the benchmarking results and the quantification of other environmental factors. For these reasons PWC considers the best approach would be to develop a criteria and methodology to be applied to determine the relative efficiency of PWC, having regard to the non-benchmarking assessment methods and principles already recognised in the assessment guideline. An up-front methodology may also look at areas where benchmarking may be usefully applied. For instance unit rate, volume or activity benchmarking. Alternatively category level benchmarking of activity and cost may also be useful and informative.
Depreciation on Actual or Forecast capex	**No** Forecast depreciation applied over the current period	Given our proposal that the CESS should continue to apply, we consider it appropriate to continue to also use forecast depreciation to roll-forward the RAB over the 2024–2029 regulatory period. This will ensure that the 70%/30% sharing embedded within the CESS can continue to hold to capex over and underspends realised over that period.