# Attachment 11.2

Annual Pricing Escalation Mechanism

# 1 Contents

# 1. Overview

This paper sets out our proposed mechanism for setting annual prices for the last two years of the regulatory period.

The process relies on the revenue allowance set by the Commission through the determination process, but which includes provisions for:

- Escalating revenue requirements for the actual CPI movement since the determination.
- Adjusting for under and over recovery amounts in previous years in accordance with a set formula.
- Account for changes in forecast energy consumption.
- Enable pass through amounts to be provided in the year following an approved pass through event.

We propose that NTESMO submit an annual pricing proposal to the Commission at least three months before the commencement of the 2025-26 and 2026-27 regulatory years.

The formulae to implement a revenue cap form of price control mechanism for the system control (or market operator) charge is set out below.

# 2. Year One – 2024-25

The tariffs for the first year of the regulatory period (2024-25) have been approved by the Commission and this paper does not relate to their calculation.

The expected revenue $E_{2024\text{-}25}$ is outlined in the final determination and is the product of the approved tariffs and the forecast demand. This value should be used for under/over calculations in year three (2026-27).

# 3. Year Two – 2025-26

## 3.1. Revenue Requirement

The adjusted annual revenue requirement ($AR_{2025\text{-}26}$) in the **second year** of the period (2025-26) in which the charge is to be determined is the annual revenue requirement ($AR_{2025\text{-}26}$) approved in the final determination (real $2023-24) adjusted for approved cost pass through amounts, under / over recoverieds from the previous regulatory period and adjusted for the time value of money. The annual revenue requirement value includes the retrospective recovery from the previous regulatory period and the true up of 2024-25 revenue shortfall as approved by the Commission in the final determination.

$$AAR_{2025\text{-}26} = AR_{2025\text{-}26} \times \Delta CPI_{2025\text{-}26} + B_{2025\text{-}26} + C_{2025\text{-}26}$$

Where:

$AAR_{2025\text{-}26}$ - is the adjusted annual revenue requirement for year 2025-26

$AR_{2025\text{-}26}$ - is the annual revenue requirement for 2025-26 as approved by the Commission in the determination (real $2023-24)

$B_{2025\text{-}26}$ – is any overs and unders carried over from the previous period (2019-20 to 2023-24) adjusted for the time value of money. See section 2.2.

$C_{2025\text{-}26}$ – is any cost pass through approved by the Commission in the previous period (2019-20 to 2023-24) adjusted for the time value of money. See section 2.3.

$\Delta CPI_{2025\text{-}26}$ - is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in 2023-24 to the December quarter in 2024-25, calculated as follows:

$$\Delta CPI_{2025\text{-}26} = CPI_{2024\text{-}25}/CPI_{2023\text{-}24} - 1$$

## 3.2. Unders/overs Calculation

This calculation seeks to adjust for the balance of under / over recoveries in the 2019-20 to 2023-24 regulatory period adjusted for the time value of money.

$$B_{2025\text{-}26} = F_{2023\text{-}24} \times (1 + WACC_{2023\text{-}24})^{.5} \times (1 + WACC_{2024\text{-}25})$$

Where:

$F_{2023\text{-}24}$ – is the under/over recovery closing balance as at 30 June 2024 as detailed in Power and Water's overs and unders account.

$WACC$ – is the allowed nominal vanilla weighted average cost of capital (WACC) approved by the Australian Energy Regulator that the under / over recovery is adjusted for to account for the time value of money for the 18 months between when the under or over recovery occurred and when it is recovered.

## 3.3. Cost Pass Through Calculation

This calculation seeks to adjust for any cost pass-throughs approved in the 2019-20 to 2023-24 regulatory period adjusted for the time value of money.

$$C_{2025\text{-}26} = G_{2023\text{-}24} \times (1 + WACC_{2023\text{-}24})^{.5} \times (1 + WACC_{2024\text{-}25})$$

Where:

$G_{2023\text{-}24}$ – is any cost pass through approved by the Commission in the previous period (2019-20 to 2023-24).

$WACC$ – is the nominal vanilla WACC approved by the Australian Energy Regulator applied to the approved cost pass through values approved in the previous period to account for the time value of money for the 18 months between the middle of the final year of the previous period and when it is recovered.

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## 3.4. Price Setting

The total allowable revenue is converted to a system control (or market operator) charge which is calculated in accordance with the following equation:

$$P_{2025\text{-}26} = AAR_{2025\text{-}26} / Q_{2025\text{-}26}$$

Where:

$P_{2025\text{-}26}$ – is the System Control (or Market Operator) charge in 2025-26 ($/kWh)

$Q_{2025\text{-}26}$ – is the System Control (or Market Operator) forecast quantity of energy consumption (kWh)

# 4. Year Three – 2026-27

## 4.1. Revenue Requirement

The adjusted annual revenue requirement ($AAR_{2026\text{-}27}$) in the **third year** of the period (2026-27) in which the charge is to be determined is the annual revenue requirement ($AR_{2026\text{-}27}$) approved in the final determination (real $2023-24) adjusted for approved cost pass through amounts, under / over recoveries from the 2024-25 expected revenue ($E_{2024\text{-}25}$) to actual revenue and adjusted for the time value of money. The annual revenue requirement value includes the retrospective recovery from the previous regulatory period and the true up of 2024-25 revenue shortfall as approved by the Commission in the final determination.

$$AAR_{2026\text{-}27} = AR_{2026\text{-}27} \times \Delta CPI_{2026\text{-}27} + B_{2026\text{-}27} + C_{2026\text{-}27}$$

Where:

$AAR_{2026\text{-}27}$ - is the adjusted annual revenue requirement for year 2026-27

$AR_{2026\text{-}27}$ - is the annual revenue requirement for 2026-27 as approved by the Commission in the determination (real $2023-24)

$\Delta CPI_{2026\text{-}27}$ - is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in 2024-25 to the December quarter in year2025-26, calculated as follows:

$$\Delta CPI_{2026\text{-}27} = CPI_{2025\text{-}26} / CPI_{2024\text{-}25} - 1$$

$B_{2026\text{-}27}$ - is the true-up in 2026-27 for any under or over recovery of actual revenue collected and the expected revenue in the 2024-25 year adjusted for the time value of money. See section 3.2 for further detail.

$C_{2026\text{-}27}$ - is the sum of approved cost pass through amounts in 2024-25 to account for the time value of money.

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## 4.2. Unders / Overs Calculation

This calculation seeks to true up the difference between the 2024-25 approved expected revenue and the actual revenue recovered adjusted for the time value of money.

$$B_{2026\text{-}27} = (E_{2024\text{-}25} - D_{2024\text{-}25}) \times (1 + WACC_{2023\text{-}24})^{.5} \times (1 + WACC_{2024\text{-}25})$$

Where:

$E_{2024\text{-}25}$ – is the expected revenue requirement approved by the Commission through the determination process for 2024-25, which would be the product of the approved charges and forecast demand (kWh).

$D_{2024\text{-}25}$ – is the actual revenue recovered in 2024-25.

$WACC$ – is the allowed nominal vanilla weighted average cost of capital (WACC) approved by the Australian Energy Regulator that the under / over recovery is adjusted for to account for the time value of money for the 18 months between when the under or over recovery occurred and when it is recovered.

## 4.3. Cost Pass Through Calculation

This calculation seeks to adjust for any cost pass-throughs value approved in the 2024-25 year adjusted for the time value of money.

$$C_{2062\text{-}27} = H_{2024\text{-}25} \times (1 + WACC_{2024\text{-}25})^{.5} \times (1 + WACC_{2025\text{-}26})$$

Where:

$H_{2024\text{-}25}$ – is any cost pass through value approved by the Commission in 2024-25.

$WACC$ – is the nominal vanilla WACC approved by the Australian Energy Regulator applied to the approved cost pass through values approved in the previous period to account for the time value of money for the 18 months between the middle of the final year of the previous period and when it is recovered.

## 4.4. Price Setting

The total allowable revenue is converted to a system control (or market operator) charge which is calculated in accordance with the following equation:

$$P_{2026\text{-}27} = AAR_{2026\text{-}27} / Q_{2026\text{-}27}$$

Where:

$P_{2026\text{-}27}$ – is the System Control (or Market Operator) charge in 2026-27 ($/kWh)

$Q_{2026\text{-}27}$ – is the System Control (or Market Operator) forecast quantity of energy consumption (kWh)

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