

# Attachment 11.2

Annual Pricing Escalation Mechanism

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# 1. Overview

This paper sets out our proposed mechanism for setting annual prices for the 2024-27 regulatory period. The Commission's decision paper did not comment on the annual price escalation mechanism proposed in NTESMO's initial regulatory proposal, however the Commission confirmed that NTESMO will be subject to a regulatory cap.

Our 2024-27 Revised Regulatory Proposal applies a building block method to calculate revenue each year, the Commission's determination provides the allowed revenue for each year in the regulatory period. The proposed pricing process is based on the annual revenue allowances set by the Commission through its determination process, and includes provisions for:

- Escalating revenue requirements for the actual consumer price index (CPI) movement since the determination using a lagged December indicator of CPI.
- Accounting for forecast energy consumption changes.
- Adjusting for under and over recovery amounts in previous years in accordance with a set formula.
- Enabling pass-through amounts to be provided in the year following an approved pass-through event.

For the 2025-26 regulatory year, a draft pricing proposal is to be submitted to the Commission by April 2025, with a final pricing proposal to be submitted by Power and Water at the Commission's request. For the third year of the regulatory period, we propose that Power and Water submits the NTESMO 2026-27 pricing proposal to the Commission at least three months before the commencement of the 2026-27 regulatory year. The formula to implement a revenue cap form of price control mechanism for the system control and market operator charges is outlined in the following sections.

## 2. Year one – 2024-25

### 2.1. Revenue requirement

The Commission approved the 2024-25 (the first year of the regulatory period) system control and market operator charges in November 2023. As the submission of the revised regulatory proposal was after November 2023, the year one charges do not incorporate the building block approach applied to year two and year three of the 2024-27 regulatory period.

The total allowed revenue (TAR) for 2024-25 is the system control (or market operator) prices approved and set by the Commission in its pricing determination multiplied by the forecast energy consumption.

$$TAR_{FY2024-25} = P_{2024-25} \times Q_{2024-25}$$

Where:

$P_{2024-25}$  – is the approved system control (or market operator) charge in 2024-25 (\$/kWh)

$Q_{2024-25}$  – is the system control (or market operator) forecast quantity of energy consumption (kWh) consistent with the energy consumption forecast in Power and Water's 2024-25 network pricing proposal submitted to the Australian Energy Regulator (AER). For system control, this is the sum of forecast quantity of energy consumption for tariffs 1, 2, 3a, 3b, 3c, 4, 5, and 6 for the three regulated networks. For market operator, forecast energy consumption is 86.4% of the energy consumption forecast for system control.

### 2.2. Unders and overs calculation

Unders and overs were not considered when setting year one charges but are accounted for in year two and year three charges.

## 2.3. Cost pass through

Cost pass throughs were not considered when setting year one charges but are accounted for in year two and three charges.

## 3. Year two – 2025-26

### 3.1. Revenue requirement

The TAR for 2025-26 is to be calculated as:

$$TAR_{FY2025-26} = AR_{2025-26} \times (1 + \Delta CPI_{2024-25}) * (1 + \Delta CPI_{2025-26}) + B_{2025-26} + C_{2025-26}$$

Where:

**AR<sub>2025-26</sub>** – is the annual revenue for 2025-26 as approved by the Commission in the determination (real \$2023-24)

**ΔCPI<sub>2024-25</sub>** – is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from December quarter 2022 to the December quarter 2023

**ΔCPI<sub>2025-26</sub>** – is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter 2023 to the December quarter 2024

**B<sub>2025-26</sub>** – is any overs and unders amounts from the previous regulatory period (2019-20 to 2023-24) adjusted for the time value of money. See section 3.2.

**C<sub>2025-26</sub>** – is the sum of approved cost pass through amounts approved to be included in prices in the 2025-26 regulatory year. See section 3.3.

### 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.

$$B_{2025-26} = CB_{2023-24}$$

Where:

**CB<sub>2023-24</sub>** – is the final under/over recovery closing balance as at 30 June 2024 for the 2019-24 regulatory period based on the calculation set out in the Commission's 2019-24 determination including adjustments for the time value of money using relevant allowed nominal vanilla weighted average cost of capital (WACC) approved by the AER

### 3.3. Cost pass through calculation

It is expected that the value of C<sub>2025-26</sub> will equal zero however the following formula is provided for completeness.

$$C_{2025-26} = G_{2023-24} \times (1 + WACC_{2023-24})^{1.5} \times (1 + WACC_{2024-25})$$

Where:

**G<sub>2023-24</sub>** – is the value of any cost pass through approved by the Commission in the 2023-24 year.

**WACC** – is the nominal vanilla WACC approved by the AER 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.

### 3.4. Price setting

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

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

Where:

$P_{2025-26}$  – is the system control (or market operator) charge in 2025-26 (\$/kWh)

$Q_{2025-26}$  – is the system control (or market operator) forecast quantity of energy consumption (kWh) consistent with the energy consumption forecast submitted in Power and Water's 2025-26 network pricing proposal to the AER. for system control, this is the sum of forecast quantity of energy consumption for tariffs 1, 2, 3a, 3b, 3c, 4, 5, and 6 for the three regulated networks. For market operator, forecast energy consumption is 86.4% of the energy consumption forecast for system control.

## 4. Year three – 2026-27

### 4.1. Revenue requirement

The TAR for 2026-27 is to be calculated as follows.

$$\text{TAR}_{\text{FY}2026-27} = \text{AR}_{2026-27} \times (1 + \Delta\text{CPI}_{2024-25}) * (1 + \Delta\text{CPI}_{2025-26}) * (1 + \Delta\text{CPI}_{2026-27}) + \text{B}_{2026-27} + \text{C}_{2026-27}$$

Where:

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

$\Delta\text{CPI}_{2024-25}$  – is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight. Capital Cities from December quarter 2022 to the December quarter 2023

$\Delta\text{CPI}_{2025-26}$  – is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter 2023 to the December quarter 2024

$\Delta\text{CPI}_{2026-27}$  – is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter 2024 to the December quarter 2025

$\text{B}_{2026-27}$  – is the true-up in 2026-27 for any under or over recovery of actual revenue collected and the TAR the 2024-25 year adjusted for the time value of money. See section 4.2.

$\text{C}_{2026-27}$  – is the sum of approved cost pass through amounts to be included in prices from the 2024-25 regulatory year. See section 4.3.

### 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.

$$\text{B}_{2026-27} = (\text{TAR}_{2024-25} - \text{D}_{2024-25}) \times (1 + \text{WACC}_{2024-25})^{1.5} \times (1 + \text{WACC}_{2025-26})$$

Where:

**TAR<sub>2024-25</sub>** – consistent with the calculation for first year revenue

**D<sub>2024-25</sub>** – is the actual system control (or market operator) revenue recovered in 2024-25.

**WACC** – is the allowed nominal vanilla WACC approved by the AER 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 year 2024-25 adjusted for the time value of money.

$$C_{2026-27} = H_{2024-25} \times (1 + WACC_{2024-25})^{1.5} \times (1 + WACC_{2025-26})$$

Where:

**H<sub>2024-25</sub>** – is any cost pass through value approved by the Commission in 2024-25.

**WACC** – is the nominal vanilla WACC approved by the AER 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 in accordance with the following equation:

$$P_{2026-27} = TAR_{2026-27} / Q_{2026-27}$$

Where:

**P<sub>2026-27</sub>** – is the system control (or market operator) charge in 2026-27 (\$/kWh)

**Q<sub>2026-27</sub>** – is the system control (or market operator) forecast quantity of energy consumption (kWh) consistent with the energy consumption forecast submitted in Power and Water's 2026-27 network pricing proposal to the AER. For system control, this is the sum of forecast quantity of energy consumption for tariffs 1, 2, 3a, 3b, 3c, 4, 5, and 6 for the three regulated networks. For market operator, forecast energy consumption is 86.4% of the energy consumption forecast for system control.

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