AEMC Review: Differences between actual and forecast demand in network regulation

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Revenue Recovery

- NSPs recover revenue through control mechanisms that expose the NSP and consumers to different levels of risk and incentives when actual demand is higher or lower than demand forecast at the time of the determination.
- For TNSPs, the AER is required by the NER to apply a revenue cap.
- For DNSPs, the AER can exercise its discretion in selecting the form of control.
  - For DNSPs, the AER must have regard to a number of factors set out in the NER in deciding on a control mechanism.
  - To date, the price control mechanisms applied by the AER have continued to reflect the mechanisms applied by previous regulators for each DNSP.

Revenue Recovery – revenue and price caps

- Under a revenue cap and price cap the amount of revenue earned will differ from allowed revenues when actual demand is higher or lower than forecast demand at the time of the determination.
- **Revenue cap:** under a revenue cap the risk of actual demand below forecast demand rests with the consumer, as the ‘true-up’ mechanism allows the NSP to raise prices in the following year to recover lost revenue.
  - When demand is rising a ‘true-down’ mechanism applies where the NSP lowers prices in the following year to return excess revenues to consumers.
- **Price cap:** under a price cap changes in actual demand compared to forecast demand directly affect an NSP’s revenues as these depend on its approved tariffs and quantities sold at those tariffs.
  - If demand is falling the NSP bears the risk of earning less revenue, although if demand is rising the NSP sees actual revenue increase above expected revenue.

Revenue Recovery – Discussion questions

1. How does each form of control mechanism permitted in the current framework affect an NSP's risk of recovering its allowed revenues?
    a) How does revenue cap and price cap approach balance the volume risks from changes in demand?
2. Is there appropriate consideration of consumer impacts in the choice of control mechanism under the current arrangements?
3. Is the current framework adequate to recognise the costs and benefits of volume risks?
    a) Are the control mechanisms criteria for DNSPs appropriate?
    b) How do other aspects of the regulatory framework manage the revenue recover risks?

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