

DRAFT DECISION

TasNetworks distribution determination

2017−18 to 2018−19

Attachment 10 – Capital expenditure sharing scheme

September 2016

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Inquiries about this publication should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne Vic 3001

Tel: 1300 585 165  
Email: [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au)

1. Note
2. This attachment forms part of the AER's draft decision on TasNetworks' distribution determination for 2017–19. It should be read with all other parts of the draft decision.
3. The draft decision includes the following documents:
4. Overview
5. Attachment 1 – Annual revenue requirement
6. Attachment 2 – Regulatory asset base
7. Attachment 3 – Rate of return
8. Attachment 4 – Value of imputation credits
9. Attachment 5 – Regulatory depreciation
10. Attachment 6 – Capital expenditure
11. Attachment 7 – Operating expenditure
12. Attachment 8 – Corporate income tax
13. Attachment 9 – Efficiency benefit sharing scheme
14. Attachment 10 – Capital expenditure sharing scheme
15. Attachment 11 – Service target performance incentive scheme
16. Attachment 12 – Demand management incentive scheme
17. Attachment 13 – Classification of services
18. Attachment 14 – Control mechanisms
19. Attachment 15 – Pass through events
20. Attachment 16 – Alternative control services
21. Attachment 17 – Negotiated services framework and criteria
22. Attachment 18 – Connection policy
23. Attachment 19 – Tariff structure statement

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1. Shortened forms

| Shortened form | Extended form |
| --- | --- |
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| augex | augmentation expenditure |
| capex | capital expenditure |
| CCP | Consumer Challenge Panel |
| CESS | capital expenditure sharing scheme |
| CPI | consumer price index |
| DRP | debt risk premium |
| DMIA | demand management innovation allowance |
| DMIS | demand management incentive scheme |
| distributor | distribution network service provider |
| DUoS | distribution use of system |
| EBSS | efficiency benefit sharing scheme |
| ERP | equity risk premium |
| Expenditure Assessment Guideline | Expenditure Forecast Assessment Guideline for Electricity Distribution |
| F&A | framework and approach |
| MRP | market risk premium |
| NEL | national electricity law |
| NEM | national electricity market |
| NEO | national electricity objective |
| NER | national electricity rules |
| NSP | network service provider |
| opex | operating expenditure |
| PPI | partial performance indicators |
| PTRM | post-tax revenue model |
| RAB | regulatory asset base |
| RBA | Reserve Bank of Australia |
| repex | replacement expenditure |
| RFM | roll forward model |
| RIN | regulatory information notice |
| RPP | revenue and pricing principles |
| SAIDI | system average interruption duration index |
| SAIFI | system average interruption frequency index |
| SLCAPM | Sharpe-Lintner capital asset pricing model |
| STPIS | service target performance incentive scheme |
| WACC | weighted average cost of capital |

# Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers whose capex becomes more efficient and financial penalties for those that become less efficient. Consumers benefit from improved efficiency through lower regulated prices. This attachment sets out how we will apply the CESS to TasNetworks in the 2017–19 regulatory control period.

1. As part of the Better Regulation program we consulted on and published version 1 of the capital expenditure incentive guideline (capex incentive guideline), which sets out the CESS.[[1]](#footnote-1) The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between service providers and consumers.
2. The CESS works as follows:

* We calculate the cumulative underspend or overspend for the current regulatory control period in net present value terms.
* We apply the sharing ratio of 30 per cent to the cumulative underspend or overspend to work out what the service provider's share of the under-spend or overspend should be.
* We calculate the CESS payments taking into account the financing benefit or cost to the service provider of the under-spends or over-spends.[[2]](#footnote-2) We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB.[[3]](#footnote-3)
* The CESS payments will be added or subtracted to the service provider's regulated revenue as a separate building block in the next regulatory control period.

Under the CESS a service provider retains 30 per cent of an under-spend or over-spend, while consumers retain 70 per cent of the under-spend on over-spend. This means that for a one dollar saving in capex the service provider keeps 30 cents of the benefit while consumers keep 70 cents of the benefit.

## Draft decision

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline to TasNetworks in the 2017–19 regulatory control period.[[4]](#footnote-4) This is consistent with the proposed approach we set out in our framework and approach paper.[[5]](#footnote-5)

## TasNetworks' proposal

TasNetworks supported the application of the CESS as set out in the capex incentive guideline.[[6]](#footnote-6)

## Assessment approach

1. In deciding whether to apply a CESS to a network service provider, and the nature and details of any CESS to apply to a service provider, we must:[[7]](#footnote-7)

* make that decision in a manner that contributes to the capex incentive objective[[8]](#footnote-8)
* take into account the CESS principles,[[9]](#footnote-9) the capex objectives,[[10]](#footnote-10) other incentive schemes, and, if relevant, the opex objectives, as they apply to the particular service provider, and the circumstances of the service provider.

Broadly, the capex incentive objective is to ensure that only capex that meets the capex criteria enters the RAB used to set prices. Therefore, consumers only fund capex that is efficient and prudent.

### Interrelationships

1. The CESS relates to the incentives TasNetworks faces to incur efficient opex, conduct demand management and maintain or improve service levels.[[11]](#footnote-11) We aim to incentivise network service providers to make efficient decisions on when and what type of expenditure to incur and to balance expenditure efficiencies with service quality. We discuss these interrelationships where relevant in our capex attachment.

## Reasons for draft decision

1. We are satisfied with TasNetworks' proposal to apply the CESS as set out in the capex incentives guideline.

The reasons for our preference for a CESS are set out in our capital expenditure incentive guideline.[[12]](#footnote-12) In developing the guideline we took into account the capex incentive objective, capex criteria, capex objectives and the NEO. The Consumer Challenge Panel submitted that we should apply the CESS to TasNetworks as set out in our guideline.[[13]](#footnote-13)

1. AER, Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013, pp. 5–9. (AER, Capex incentive guideline, November 2013). [↑](#footnote-ref-1)
2. We calculate benefits as the benefits to the service provider of financing the underspend since the amount of the underspend can be put to some other income generating use during the period. Losses are similarly calculated as the financing cost to the service provider of the overspend. [↑](#footnote-ref-2)
3. The capex incentive guideline outlines how we may exclude capex from the RAB. AER, Capex incentive guideline, November 2013, pp. 13–20. [↑](#footnote-ref-3)
4. AER, Capex incentive guideline, November 2013, pp. 5–9. [↑](#footnote-ref-4)
5. AER, Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017, July 2015, p. 15. [↑](#footnote-ref-5)
6. TasNetworks, Tasmanian Distribution Regulatory Proposal, January 2016, p. 124. [↑](#footnote-ref-6)
7. NER, cl. 6.5.8A(e). [↑](#footnote-ref-7)
8. NER, cl. 6.4A(a); the capex criteria are set out in cl. 6.5.7(c) of the NER. [↑](#footnote-ref-8)
9. NER, cl. 6.5.8A(c). [↑](#footnote-ref-9)
10. NER, cl. 6.5.7(a) [↑](#footnote-ref-10)
11. Related schemes are the efficiency benefit sharing scheme (EBSS) for opex, and the service target performance incentive scheme (STPIS) for service levels. [↑](#footnote-ref-11)
12. AER, Capex incentive guideline, November 2013. [↑](#footnote-ref-12)
13. Consumer Challenge Panel 4 (David Headberry), Response to the proposal from Tasmania’s electricity distribution network service provider (TasNetworks – TND) for a revenue reset for the 2017-2019 regulatory period, 4 May 2016, p. 40. [↑](#footnote-ref-13)