DRAFT DECISION
TasNetworks distribution determination
2017−18 to 2018−19

Attachment 10 – Capital expenditure sharing scheme

September 2016

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

Note

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.

The draft decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Contents

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

Shortened form	Extended form
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

10 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.

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] 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.

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] We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB.[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.

10.1 Draft decision

1 AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, pp. 5–9. (AER, *Capex incentive guideline*, November 2013).

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.

3 The capex incentive guideline outlines how we may exclude capex from the RAB. AER, *Capex incentive guideline*, November 2013, pp. 13–20.

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] This is consistent with the proposed approach we set out in our framework and approach paper.[5]

10.2 TasNetworks' proposal

TasNetworks supported the application of the CESS as set out in the capex incentive guideline.[6]

10.3 Assessment approach

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]

- make that decision in a manner that contributes to the capex incentive objective[8]
- take into account the CESS principles,[9] the capex objectives,[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.

10.3.1 Interrelationships

The CESS relates to the incentives TasNetworks faces to incur efficient opex, conduct demand management and maintain or improve service levels.[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.

10.4 Reasons for draft decision

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

---

4 AER, *Capex incentive guideline*, November 2013, pp. 5–9.
5 AER, Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017, July 2015, p. 15.
6 TasNetworks, Tasmanian Distribution Regulatory Proposal, January 2016, p. 124.
7 NER, cl. 6.5.8A(e).
8 NER, cl. 6.4A(a); the capex criteria are set out in cl. 6.5.7(c) of the NER.
9 NER, cl. 6.5.8A(c).
10 NER, cl. 6.5.7(a)
11 Related schemes are the efficiency benefit sharing scheme (EBSS) for opex, and the service target performance incentive scheme (STPIS) for service levels.

The reasons for our preference for a CESS are set out in our capital expenditure incentive guideline.[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]

12 AER, *Capex incentive guideline*, November 2013.

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.