FINAL DECISION

TasNetworks
Distribution Determination
2019 to 2024

Attachment 13
Control mechanisms

April 2019

Note

This attachment forms part of the AER's final decision on TasNetworks' 2019–24 distribution determination. It should be read with all other parts of the final decision.

The final determination includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment B – Negotiating framework

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CPI	consumer price index
distributor	distribution network service provider
DMIA/DMIAM	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DPPC	designated pricing proposal charges
DUoS	distribution use of system
F&A	framework and approach
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
STPIS	service target performance incentive scheme
TAR	total allowable revenue
WACC	weighted average cost of capital

13 Control mechanisms

A control mechanism imposes limits over the prices of both direct control services and alternative control services and/or the revenues that a distribution network service provider can recover from its customers.

TasNetworks' accepted our draft decision on control mechanism formulas. However, Endeavour Energy's revised proposal identified that the side constraint formula should be updated to include adjustments for incentive schemes in the revenue cap control mechanism.[1] We consider that this amendment is also appropriate for TasNetworks.[2] This attachment therefore sets out our final decision on TasNetworks' control mechanism formulas, including adjustments for incentive schemes in the side constraint formula (as identified by Endeavour Energy).

13.1 Final decision

Our final decision is to include variables representing incentive schemes in the side constraint formula for TasNetworks.

13.2 Assessment approach

Our assessment approach is unchanged from the description set out in our draft decision.

13.3 Reasons for final decision for side constraints

In their revised proposal, Endeavour Energy noted that the side constraint formula does not include the S factor or I factor adjustments that represent incentive schemes. Endeavour Energy proposed that the side constraint formula be updated to include adjustments for these factors relating to incentive schemes as calculated in the revenue cap control mechanism.[3]

We agree with Endeavour Energy's proposal to include these adjustments in the side constraint formula. These adjustments reflect the NER,[4] and for consistency, we have included them across all final decisions for NSW, ACT, TAS and NT.[5] Figure 13.1 sets out the revised side constraints formula.

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[1]   Endeavour Energy, *Revised regulatory proposal 01 July 2019 – 30 June 2024*, January 2019, p. 28.

[2]   NER, cl. 6.2.5(c)(4).

[3]   Endeavour Energy, *Revised regulatory proposal 01 July 2019 – 30 June 2024*, January 2019, p. 28.

[4]   NER, cl. 6.18.6(d)(1).

[5]   NER, cl. 6.2.5(c)(4).

Figure 13.1 Side Constraint formula[6]

$$\frac{\left(\sum_{i=1}^{n}\sum_{j=1}^{m}d_t^{ij}q_t^{ij}\right)}{\left(\sum_{i=1}^{n}\sum_{j=1}^{m}d_{t-1}^{ij}q_t^{ij}\right)} \leq (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) \times (1 + S_t) + I'_t + B'_t + C'_t$$

where:

d_t^{ij} is the proposed price for component 'j' of tariff 'i' for year t.

d_{t-1}^{ij} is the price charged for component 'j' of tariff 'i' in year t-1.

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[7] from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1
>
> divided by
>
> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2
>
> minus one.

For example, for 2020-21, year t-2 is the December quarter 2018 and year t-1 is the December quarter 2019.

X_t is the X factor for each year of the 2019-24 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the rate of return instrument,[8] applied for the relevant year. If X>0, then X will be set equal to zero for the purposes of the side constraint formula.

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[6]   All parameters are in nominal terms unless otherwise specified.

[7]   If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best alternative index.

[8]   AER, *2018 Rate of Return Instrument*, December 2018.

S_t is the S factor for regulatory year t.[9] It will also incorporate any adjustments required due to the application of the STPIS in the 2019–24 regulatory control period consistent with the AER's STPIS.[10]

I_t' is the annual percentage change from the sum of demand management incentive schemes and allowance adjustments in year t relating to:

- the final carryover amount from the application of the old demand management innovation allowance (DMIA/DMIAM) from the 2017–19 distribution determination. This amount will be deducted from/added to allowed revenue in the 2020–21 pricing proposal[11]

- approved demand management incentive scheme amounts from year t-2.

B_t' is the annual percentage change from the sum of the following annual adjustment factors for year t:

- true-up for any under or over recovery of actual revenue collected through DUoS charges calculated using the method in the revenue cap formula[12]

- Electrical Safety Inspection Service charge, calculated using the method in the revenue cap formula

- Any under or over recovery of the National Energy Market charge, calculated using the method in the revenue cap formula.

C_t' is the annual percentage change from the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

With the exception of the CPI, X factor, and S factor, the percentage for each of the other factors can be calculated by dividing the incremental revenues (as used in the total annual revenue formula) for each factor by the expected revenues for the regulatory year t-1 (based on the prices in year t-1 multiplied by the forecast quantities for year t).

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[9]   The meaning for year "t" under this formula is different to that in Appendix C of STPIS. Year "t+1" in Appendix C of STPIS is equivalent to year "t" in this formula.

[10] AER, *Electricity distribution network service providers – service target performance incentive scheme*, 1 November 2009.

[11] Rather than including a final carryover from the old DMIA/DMIAM, our subsequent distribution determination for TasNetworks will include a final carryover from the new demand management innovation allowance mechanism (Mechanism). Like the old DMIA/DMIAM, the new Mechanism will enter the control mechanism for a regulatory control period as a lump-sum carryover from the previous regulatory control period that will be deducted from/added to allowed revenue in the second regulatory year.

[12] AER, *TasNetworks draft decision 2019-2024 - Attachment 13*, September 2018, pp. 14–15