FINAL DECISION

TasNetworks
Distribution Determination
2019 to 2024

Attachment 9
Capital expenditure sharing scheme

April 2019

AUSTRALIAN ENERGY REGULATOR

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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 decision 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

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Shortened forms

Shortened form	Extended form
ACS	alternative control services
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP 13	Consumer Challenge Panel, sub-panel 13
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIAM	demand management innovation allowance (mechanism)
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

Shortened form	Extended form
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
SCS	standard control services
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

9 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. We first applied the CESS to TasNetworks in the 2017–19 regulatory control period. This attachment sets out our decision for both the determination of the revenue impacts as a result of the CESS applying in the 2017–19 regulatory control period, and the application of the CESS for TasNetworks in the 2019–24 regulatory control period.

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. 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 or 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.

The CESS works as follows:

1. We calculate the cumulative efficiency gains or losses for the current regulatory control period in net present value terms.
2. We apply a ratio of 30 per cent to the cumulative under-spend or over-spend to work out what the service provider's share of the under-spend or over-spend should be.
3. We calculate the CESS payments taking into account the financing benefit or cost to the service provider of the under-spends or over-spends.[1] We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB.[2]
4. 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.

[1] We calculate benefits as the benefits to the service provider of financing the under-spend since the amount of the under-spend 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 over-spend.

[2] The capex incentive guideline outlines how we may exclude capex from the RAB. AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, pp. 13–20.

9.1 Final decision

Revenue impacts in the 2019–24 regulatory control period from applying the CESS in the 2017–19 regulatory control period

Our final decision is to apply a CESS revenue decrement amount of $11.9 million ($2018–19) in the 2019–24 regulatory control period.[3] Our final decision is consistent with TasNetworks' revised proposal, but applies updated modelling inputs for forecast inflation and WACC in line with our final decisions on those parameters.

Our final decision on the revenue impact of the application of the CESS in the 2019–24 regulatory control period is summarised in Table 9.1.

Table 9.1 AER's final decision on TasNetworks' CESS revenue decrement ($million, 2018–19)

	2019-20	2020-21	2021-22	2022-23	2023-24	Total
TasNetworks' revised proposal	-2.37	-2.37	-2.37	-2.37	-2.37	-11.87
AER final decision	-2.37	-2.37	-2.37	-2.37	-2.37	-11.87

Note: Numbers may not add up due to rounding.

CESS revenue decrements arise as a result of an over-spend in capex against the forecast for the relevant period (in this case, the 2017–19 regulatory control period).

Given the timing of this final decision, the CESS revenue increments in Table 9.1 reflect TasNetworks' actual capex for the 2017-18 regulatory year, and estimated capex for the 2018-19 regulatory year.

Application of scheme in the 2019–24 regulatory control period

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline to TasNetworks in the 2019–24 regulatory control period.[4] This is consistent with our draft decision, and TasNetworks' revised proposal.[5]

3 NER, cl. 6.12.1(9).

4 AER, *Capital Expenditure Incentive Guideline*, November 2013, pp. 5–9.

5 AER, *Draft Decision, TasNetworks Distribution Determination 2019 to 2024 - Attachment 9: Capital expenditure sharing scheme*, September 2018, p. 9-7; and TasNetworks, *Transmission and Distribution Revised Proposals 2019–2024*, 29 November 2018, pp. 95–96.

9.2 TasNetworks' revised proposal

Revenue impacts in the 2019–24 regulatory control period from applying the CESS in the 2017–19 regulatory control period

TasNetworks proposed a CESS revenue decrement of $11.9 million ($2018–19) in the 2019–24 regulatory control period. TasNetworks updated the CESS calculation inputs from our draft decision to reflect the actual capex incurred in the 2017-18 regulatory year. TasNetworks otherwise applied the CESS calculations in accordance with our approved scheme and draft decision CESS model.[6]

Application of scheme in the 2019–24 regulatory control period

TasNetworks proposed that we apply the CESS as set out in the capital expenditure incentive guideline for the 2019–24 regulatory control period. This is consistent with our draft decision.[7]

9.3 AER's assessment approach

Our assessment approach is the same as that set out in our draft decision.[8]

9.4 Reasons for final decision

CESS revenue impacts from application of the CESS in the 2017–19 regulatory control period

We consider that TasNetworks should receive a CESS revenue decrement of $11.9 million ($2018-19) from the application of version 1 of the CESS during the 2017–19 regulatory control period. This means that total revenue to be recovered from customers in the 2019–24 regulatory control period is $11.9 million less than it would otherwise have been due to the application of the CESS to TasNetworks in the 2017–19 regulatory control period.

The final decision CESS revenue decrement is larger than the $1.2 million decrement applied in our draft decision. This difference is driven by the inclusion of actual capex for the 2017-18 year and an updated estimate of capex for the 2018-19 year in the final decision CESS model. TasNetworks' actual distribution capex was $36.2 million higher than forecast for this year, primarily due to higher than forecast replacement capex.[9]

The timing of our final decision means that the 2018-19 regulatory year capex figure used to calculate the CESS revenue decrement is an estimate. Given this, we may

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6 TasNetworks, *Transmission and Distribution Revised Proposals 2019–2024*, 29 November 2018, pp. 95–96.

7 TasNetworks, *Transmission and Distribution Revised Proposals 2019–2024*, 29 November 2018, p. 94.

8 AER, *Draft Decision, TasNetworks Distribution Determination 2019 to 2024 - Attachment 9: Capital expenditure sharing scheme*, September 2018, p. 9-8.

9 TasNetworks, *Response to AER information request IR#046*, 7 February 2019, p. 5.

need to make further adjustments to the revenue amount where actual under-spending or over-spending in the 2018-19 regulatory year is different to the estimate. These adjustments will be made when we undertake our regulatory determination for the 2024–29 regulatory control period.[10]

Our calculation of the CESS is in accordance with section 2.3 of version 1 of the capital expenditure incentive guideline.[11]

In the 2017–19 regulatory control period, TasNetworks was subject to version 1 of the CESS. Under this scheme the CESS revenue increments are to be based on the difference between:

- approved forecast capex set out in our determination for TasNetworks for the 2017–19 regulatory control period; and
- actual capex for the 2017–19 regulatory control period.[12]

The formulas for calculating the revenue decrements are set out in our final decision CESS model.[13]

Application of the CESS in the 2019–24 regulatory control period

The reasons for our preference for a CESS are set out in our capital expenditure incentive guideline.[14] In developing the guideline we took into account the capex incentive objective, capex criteria, capex objectives and the NEO.

We will apply version 1 of the CESS to TasNetworks in the 2019–24 regulatory control period.[15] We consider the CESS is needed to provide TasNetworks with a continuous incentive to pursue efficiency gains. This approach is consistent with TasNetworks' revised regulatory proposal.[16]

10 AER, *Explanatory Statement - Capital Expenditure Incentive Guideline*, November 2013, p. 21.

11 AER, *Capital Expenditure Incentive Guideline*, November 2013, p. 6.

12 An estimate of capex for the 2018-19 regulatory year has been used for the final decision.

13 AER, *TasNetworks distribution final decision 2019–24 CESS model*, April 2019.

14 AER, *Capital Expenditure Incentive Guideline*, November 2013.

15 AER, *Capital Expenditure Incentive Guideline*, November 2013.

16 TasNetworks, *Transmission and Distribution Revised Proposals 2019–2024*, 29 November 2018, pp. 95–96.