Draft Decision

TasNetworks Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 9
Capital expenditure sharing scheme

September 2023

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

AER reference: AER212491

Amendment record

Version	Date	Pages
1	28 September 2023	7

Contents

9 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers (NSP) whose capital expenditures (capex) becomes more efficient and financial penalties for those that become less efficient. Customers 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 2019–24 regulatory control period, and the application of the CESS for TasNetworks in the 2024–29 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.

The CESS mechanism was recently updated in April 2023. The changes to the CESS only apply to its application in the 2024–29 period and onwards. In this attachment, our decision on the CESS revenue increments for the 2024–29 period uses the CESS mechanism before it was updated.[1]

For spending in the current period, the CESS applies as follows:

- We calculate the cumulative efficiency gains or losses for the current regulatory control period in net present value terms.
- We apply the sharing ratio of 30% to the cumulative underspend or overspend to work out what the service provider's share of the underspend or overspend should be.
- We calculate the CESS payments taking into account the financing benefit or cost to the service provider of the underspend or overspend.[2] We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the regulatory asset base (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.

9.1 Draft decision

9.1.1 Revenue impacts in the 2024–29 period

Our draft decision is to apply a CESS revenue increment amount of $5.41 million ($2023–24) to be paid across the 2024–29 regulatory control period. This is from the application of the

---

1 That is, for CESS revenue increments based on spending in the 2019–24 regulatory control period, we follow this guideline: AER, *Capital expenditure incentive guideline - November 2013*, November 2013. However, in applying the CESS in the 2024–29 regulatory control period, we refer to this guideline: AER, *Final decision - Capital expenditure incentive guideline - 28 April 2023*, April 2023.

2 We calculate benefits as the benefits to the service provider of financing the underspend 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 overspend.

3 AER, *Final decision - Capital expenditure incentive guideline - 28 April 2023*, April 2023, pp. 7–9.

CESS in the 2019–24 regulatory control period and the corresponding CESS carryover true-up for the 2018–19 period. This is $5.05 million less than TasNetworks' forecast of $10.46 million.

The CESS increment arises as a result of an underspend in capex against the forecast for the 2019–24 period. Our draft decision on the revenue impact of the application of the CESS in the 2019–24 period and the corresponding CESS carryover true-up in the 2018–19 period is summarised in Table 9.1.

Table 9.1 CESS revenue increments in 2024–29 ($m, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
CESS revenue increment as per NER 6.4.3(a)(5)	1.52	1.52	1.52	1.52	1.52	7.6
CESS carryover true-up for 2018–19	-0.44	-0.44	-0.44	-0.44	-0.44	-2.18
AER draft decision CESS	1.08	1.08	1.08	1.08	1.08	5.41

Source: AER analysis. TasNetworks, *TasNetworks-(D) Workbook 4 CESS - December 2022*, 31 January 2023. Numbers may not sum due to rounding.

Given the timing of this draft decision, we calculated the CESS revenue increments in Table 9.1 using estimates of TasNetworks' capex for the 2022–23 and 2023–24 regulatory years. The CESS revenue increment we calculated ($5.41 million) is different to the revenue increment that TasNetworks proposed ($10.46 million) because we applied updated modelling inputs, including inflation, rate of return and an adjustment for 2018–19 to reflect the difference between actual and estimated capex.

9.1.2 Application of CESS in the 2024–29 regulatory control period

We will apply the CESS as set out in the updated capital expenditure incentives guideline in the 2024–29 period.[4] The reasons for adopting this updated CESS are set out in our final decision for the review of incentive schemes for networks, and the final decision for capital expenditure incentive guideline.[5] This is consistent with the proposed approach we set out in our framework and approach paper.[6]

4 AER, *Final decision - Capital expenditure incentive guideline - 28 April 2023*, April 2023, pp. 3–9.

5 AER, Final decision - Review of incentive schemes for networks - 28 April 2023, April 2023, pp. 14-22; AER, *Final decision - Capital expenditure incentive guideline - 28 April 2023*, April 2023.

6 AER, Final framework and approach for TasNetworks for the 2024-29 regulatory control period, 29 July 2022, p. 50.

9.2 TasNetworks' proposal

9.2.1 CESS revenue increments from the 2019–24 regulatory control period

TasNetworks proposed a CESS increment of $10.46 million ($2023–24) for the 2024–29 regulatory control period. This reflects an underspend of $36.68 million. TasNetworks considered its underspend was predominantly due to the impact of COVID-19 and the resultant challenges with resource availability.

TasNetworks noted that it deferred its Market Data Management System (MDMS) replacement project. However, it considered the MDMS cost was now significantly lower and does not have a material impact on the 2024–29 capex forecast.[7]

9.2.2 Final year actual capex true-up for 2018–19

Using its own true-up calculation method, TasNetworks proposed a true-up decrement of $1.09 million ($2023–24) to be added to its CESS revenue increments in the 2024–29 period.[8]

9.2.3 Application of CESS in the 2024–29 regulatory control period

TasNetworks proposed to apply the CESS in the 2024–29 regulatory control period.[9]

9.3 Assessment approach

Under the National Electricity Rules (NER) we must decide:

- the revenue impacts on TasNetworks arising from applying the CESS in the 2019–24 regulatory control period;[10] and
- whether or not to apply the CESS to TasNetworks in the 2024–29 regulatory control period and how any applicable scheme will apply. [11]

We must determine the appropriate revenue increments or decrements (if any) for each year of the 2024–29 regulatory control period arising from the application of the CESS during the 2019–24 regulatory control period.[12]

---

7 TasNetworks, Combined Proposal Attachment 11 - Capital expenditure sharing scheme, 31 January 2023, p. 5.

8 TasNetworks' true-up calculation method is contained in: TasNetworks, Distribution Capital Expenditure Sharing Scheme [spreadsheet], December 2022. Its method presents revenue increments from 2019-24 and the 2018-19 true-up as a single, summed figure.

9 TasNetworks, *Combined Proposal Attachment 11 - Capital expenditure sharing scheme*, 31 January 2023, p. 6.

10 NER, cl 6.4.3(a)(5).

11 NER, cl. 6.12.1(9).

12 Increments or decrements arising from the application of applicable incentive mechanisms, including any capital expenditure sharing scheme, form one of the building blocks that must be used to determine the annual revenue requirement for distribution network service providers for each regulatory year of the regulatory control period. NER, cl. 6.4.3(a)(5).

In deciding whether to apply the CESS to TasNetworks for the 2024–29 regulatory control period, and the details of the scheme, we must: [13]

- make that decision in a manner that contributes to the capex incentive objective; and[14]
- take into account the CESS principles,[15] the capex objectives and, where relevant, the operating expenditure (opex) objectives,[16] the interaction with other incentive schemes,[17] and the circumstances of the service provider.[18]

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.

9.3.1 Interrelationships

The approval of CESS revenue increment determines the associated CESS building block as part of TasNetworks' overall forecast revenue requirement for the 2024–29 regulatory control period.

The CESS relates to other incentives TasNetworks faces to incur efficient opex, conduct demand management, and maintain or improve service levels. Related schemes include the efficiency benefit sharing scheme (EBSS) for opex, the service target performance incentive scheme (STPIS) for service levels and demand management incentive allowance mechanism (DMIAM). 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.

9.4 Reasons for draft decision

Our draft decision is to include an overall CESS revenue increment of $5.41 million ($2023–24). This is a $5.05 million decrease from TasNetworks' proposed CESS revenue increment of $10.46 million ($2023–24). We set out our reasons in the sections below.

9.4.1 CESS revenue increments from the 2019–24 regulatory control period

We are broadly satisfied with TasNetworks' calculation of CESS revenue increments for capex in the 2019–24 period. The difference between its proposal and our draft decision reflects adjustments for modelling inputs such as CPI and the WACC to reflect more up-to-date information. We will also update these inputs, where relevant, in our final decision.

We have examined TasNetworks' claims that although it has deferred its MDMS, that this deferral is not material.

---

13 NER cl. 6.5.8A(e).

14 NER, cl. 6.5.8A(e)(3); the capex incentive objective is set out in cl. 6.4A(a).

15 NER, cl. 6.5.8A(e)(4)(i); the CESS principles are set out in cl.6.5.8A(c).

16 NER, cll. 6.5.8A(e)(4)(i) and 6.5.8A(d)(2); the capex objectives are set out in cl. 6.5.7(a); the opex objectives are set out in cl. 6.5.6(a).

17 NER, cl. 6.5.8A(d)(1).

18 NER, cl. 6.5.8A(e)(4)(ii).

The CESS requires the following three criteria must be satisfied before we apply a CESS adjustment:[19]

1. the amount of the estimated underspend in capex in the current regulatory control period is material;
2. the amount of the deferred capex in the current regulatory control period is material; and
3. total approved capex in the next regulatory control period is materially higher than it is likely to have been if a material amount of capex was not deferred in the current regulatory control period.

TasNetworks underspent its capex allowance by $56.15 million or 7.2% of its capex forecast. TasNetworks also identified that it deferred its MDMS from the current period to the forecast period, albeit at lower cost.

TasNetworks considered this was not a material deferral as the total cost of the project was lower, despite the deferral.

We have assessed TasNetworks' claims and we are satisfied that the forecast capex is not materially higher, despite the MDMS deferral. The MDMS project was expected to be undertaken over the 2019–24 and 2024–29 regulatory control periods. We have compared TasNetworks' forecast against its 2019–24 revised capex proposal. The amount of capex expected to be incurred when we assessed this project as part of our 2019–24 determination[20] is not materially different to the amount included in TasNetworks 2024–29 proposal. Overall, we are satisfied that the total cost over the two periods of the MDMS project has decreased by the amount that was underspent in the current period and that the forecast for MDMS in the 2024–29 has not materially increased as a result of the deferral.

Based on this, we are satisfied that this deferral does not meet the three criteria set out above to require an adjustment to TasNetworks' CESS.

9.4.2 Final year actual capex true-up for 2018–19

We consider that TasNetworks should receive a true-up adjustment of -$2.18 million ($2023–24). This is $1.09 million less than TasNetworks forecast true-up adjustment of $1.09 million.

TasNetworks' incorporated its true-up calculation by adding it into the 2019–24 CESS model. TasNetworks has incorrectly included the difference between actual capex and the capex estimate from our previous decision.

We have amended the calculation to take into account the difference in CESS payments between using estimated 2018–19 capex and actual 2018–19 capex. We then include the NPV of any CESS benefit or cost as a result of the difference between the estimate and actual capex.

[19] AER, *Capital expenditure incentive guideline - November 2013*, November 2013, p. 9.

[20] AER, *Final decision - TasNetworks distribution determination 2019-24 - Attachment 5 - Capital expenditure* , April 2019, p. 48.

9.4.3 Application of CESS in the 2024–29 regulatory control period

9.4.3.1 Updates to the CESS Guideline in April 2023

After TasNetworks submitted its initial proposal, the AER published its final decision on its review of incentive schemes for regulated networks in April 2023. This included an update to the workings of the CESS mechanism.[21]

The changes to the CESS mechanism will affect the application of the CESS to TasNetworks starting in the 2024–29 period.

The new guideline contains the following main changes to the CESS mechanism:

- application of a lower sharing factor of 20%to any underspend amount greater than 10% of the approved forecast capital expenditure allowance; and
- new transparency measures which require NSPs to explain variations between capital expenditure forecasts and outcomes.[22]

More information on the application of the updated CESS is available in our April 2023 capital expenditure incentive guideline.

21 AER, *Final decision - Capital expenditure incentive guideline - 28 April 2023*, 28 April 2023.

22 AER, *Final decision - Capital expenditure incentive guideline - 28 April 2023*, 28 April 2023, p. 1.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
RAB	regulatory asset base
STPIS	service target performance incentive scheme
TasNetworks	TasNetworks distribution
WACC	weighted average cost of capital