Final Decision

TasNetworks Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 1
Annual revenue requirement

April 2024

AUSTRALIAN ENERGY REGULATOR

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1	30 April 2024	16

List of attachments

This attachment forms part of the AER's final decision on the distribution determination that will apply to TasNetworks for the 2024–29 period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The final decision attachments have been numbered consistently with the equivalent attachments to our draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

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1 Annual revenue requirement

This attachment sets out our final decision on TasNetworks' annual revenue requirement (ARR) and expected revenues for the provision of standard control services (SCS) over the 2024–29 regulatory control period (period). Specifically, it sets out our final decision on:[1]

- the ARRs (unsmoothed), which are the sum of the annual building block costs
- the total revenue requirement, which is the sum of the ARRs
- the annual expected revenues (smoothed)
- the X factors.

We determine TasNetworks' ARRs using a building block approach. We determine the X factors by smoothing the ARRs over the period. The X factor is used in the CPI–X methodology to determine the annual expected revenue (smoothed).

1.1 Final decision

We determine a total ARR for TasNetworks of $1,842.8 million ($ nominal, unsmoothed) for the 2024–29 period. This is an increase of $20.4 million ($ nominal) or 1.1% to TasNetworks' revised proposal. This is largely driven by our final decision approving a higher regulatory depreciation building block, which is $13.8 million higher than TasNetworks' revised proposal. The regulatory depreciation amount is the net total of the straight-line depreciation, less the inflation indexation of the regulatory asset base (RAB). Our final decision indexation component is lower than the revised proposal by $17.5 million due to a lower expected inflation rate applied in our final decision compared to the revised proposal. Our final decision straight-line depreciation is $3.7 million lower than the revised proposal. This results in a higher regulatory depreciation amount compared to the revised proposal. See Attachment 4 for further details.

In addition to the higher regulatory depreciation building block, our final decision revenue adjustment building block is $7.2 million higher than the revised proposal. This is due to our final decision applying a lower efficiency benefit sharing scheme (EBSS) penalty compared to the revised proposal. See section 3.1.2 of the Overview for further details.

We determine the annual expected revenue (smoothed) and X factor for each regulatory year of the 2024–29 period by smoothing the ARRs. Our final decision is to approve total expected revenues of $1,850.3 million ($ nominal) for TasNetworks for the 2024–29 period. Our approved X factors are –8.50% for 2025–2026, –8.80% for 2026–2027, –4.05% for 2027–2028, and 2.16% for 2028–2029.[2]

Table 1.1 sets out our final decision on the building block costs, the ARR, annual expected revenue, and X factors for TasNetworks over the 2024–29 period.

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1 NER, cll. 6.3.2(a)(1), 6.5.9(a) and 6.5.9(b)(1)–(2).

2 TasNetworks is not required to apply an X factor for 2024–25 because we set the 2024–25 expected revenue in this decision.

Table 1.1 AER's final decision on TasNetworks' ARR, annual expected revenue and X factor for the 2024–29 period ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Return on capital	130.5	135.9	141.5	145.8	150.7	704.5
Regulatory depreciation[a]	88.2	97.0	103.8	106.3	109.5	504.8
Operating expenditure[b]	108.8	113.5	117.7	121.1	124.8	586.0
Revenue adjustments[c]	–2.9	–2.7	5.2	2.7	–5.1	–2.9
Cost of corporate income tax	10.1	10.0	9.5	10.1	10.7	50.4
Annual revenue requirement (unsmoothed)	334.7	353.7	377.7	386.1	390.6	1,842.8
Annual expected revenue (smoothed)	**307.3**	**342.2**	**382.3**	**408.3**	**410.2**	**1,850.3**
X factor[d]	n/a[e]	–8.50%	–8.80%	–4.05%	2.16%	n/a

Source: AER analysis.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening regulatory asset base (RAB).

(b) Includes debt raising costs.

(c) Includes revenue adjustments from the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), shared asset revenue adjustment, and the demand management innovation allowance mechanism (DMIAM).

(d) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.

(e) TasNetworks is not required to apply an X factor for 2024–25 because we set the 2024–25 expected revenue in this decision. The expected revenue for 2024–25 is around 8.3% higher than the approved total annual revenue for 2023–24 in real terms, or 11.2% higher in nominal terms.

1.2 TasNetworks' revised proposal

TasNetworks' revised proposal included total expected revenues (smoothed) of $1,825.6 million ($ nominal) for the 2024–29 period.

Table 1.2 sets out TasNetworks' revised proposed building block costs, the ARR, annual expected revenue and X factor for each year of the 2024–29 period.

Table 1.2 TasNetworks' revised proposed ARR, annual expected revenue and X factor for the 2024–29 period ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Return on capital	129.0	135.3	141.8	147.1	153.0	706.2
Regulatory depreciation[a]	85.3	94.1	101.0	103.6	106.9	490.9
Operating expenditure[b]	109.0	113.9	118.2	121.8	125.6	588.5
Revenue adjustments[c]	–2.9	–2.8	5.2	2.6	–12.2	–10.1
Cost of corporate income tax	9.4	9.2	8.8	9.4	10.0	46.8
Annual revenue requirement (unsmoothed)	329.7	349.8	375.0	384.5	383.3	1,822.4
Annual expected revenue (smoothed)	**316.4**	**346.9**	**380.3**	**387.4**	**394.7**	**1,825.6**
X factor	n/a[d]	–6.65%	–6.65%	0.90%	0.91%	n/a

Source: TasNetworks, *TasNetworks-Revised Proposal-Distribution-PTRM-Nov 2023-Public,* November 2023.
(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.
(b) Includes debt raising costs.
(c) Includes revenue adjustments from EBSS, CESS, shared asset revenue adjustment, and DMIAM.
(d) TasNetworks is not required to apply an X factor for 2024–25 because we set the 2024–25 expected revenue in this decision.

1.3 Assessment approach

We did not change the building block approach we use to determine the expected revenue from our draft decision. Attachment 1 (section 1.3) of our draft decision details that approach.[3]

1.4 Reasons for final decision

For this final decision, we determine a total ARR of $1,842.8 million ($ nominal, unsmoothed) for TasNetworks for the 2024–29 period. This is an increase of $20.4 million ($ nominal) or 1.1% to TasNetworks' revised proposed total ARR of $1,822.4 million ($ nominal) for this period. This reflects the impact of our final decision on the various building block costs.

Figure 1.1 shows the building block components in this final determination that comprise the ARR for TasNetworks, and the corresponding components from its revised proposal and our draft decision.

The changes we made to TasNetworks' revised proposal are (in nominal terms):

- an increase in the regulatory depreciation of $13.8 million (2.8%) (Attachment 4). This is driven largely by a lower expected inflation rate for the 2024–29 period, which reduces the indexation adjustment to regulatory depreciation.[4] This has more than offset the reduction we made to the straight-line depreciation amount

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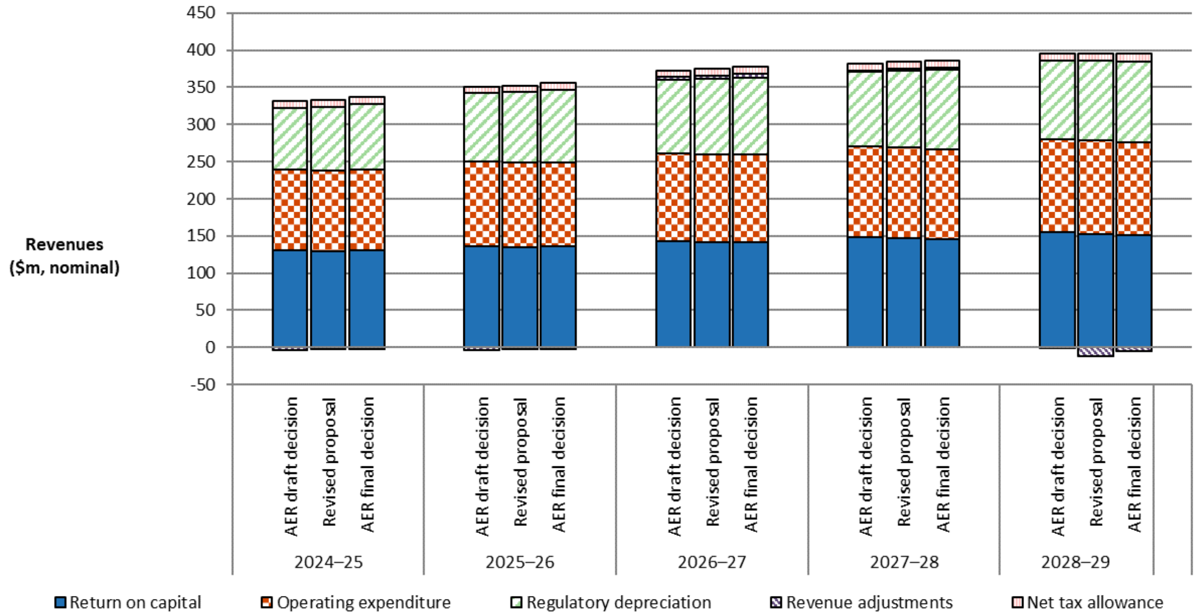
[3] AER, *Draft decision, Attachment 1 – Annual revenue requirement – TasNetworks – 2024 Distribution revenue proposal*, September 2023, pp. 3–6.

[4] Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB. A lower indexation amount increases the regulatory depreciation, all else being equal.

- an increase in the revenue adjustments of $7.2 million (71.1%) (section 2.7 of the Overview). This is largely due to the higher revenue adjustment from lower EBSS penalties (section 3.1.2 of the Overview) in this final decision compared to TasNetworks' revised proposal as well as a slightly higher revenue adjustment from CESS rewards (section 3.1.1 of the Overview)
- an increase in the cost of corporate income tax of $3.6 million (7.7%) (Attachment 7). This is largely driven by a higher regulatory depreciation amount[5] and a higher return on equity amount (section 2.2 of the Overview)[6]
- a reduction in the return on capital of $1.7 million (0.2%) (sections 2.1, 2.2 and 2.4 of the Overview). This is largely driven by our final decision establishing a lower opening RAB as at 1 July 2024 (Attachment 2)
- a reduction in the operating expenditure (opex) forecast of $2.5 million (0.4%). This is due to the lower expected inflation rate applied in this final decision compared to TasNetworks' revised proposal. Our final decision has accepted TasNetworks' revised proposed total opex in real 2023–24 dollar terms (section 2.5 of the Overview).

Figure 1.1 AER's draft and final decisions, and TasNetworks' revised proposed ARR ($million, nominal)



Source: AER analysis; TasNetworks, *TasNetworks-Revised Proposal-Distribution-PTRM-Nov 2023-Public,* November 2023.

Note: Revenue adjustments include EBSS, CESS, shared asset revenue adjustment, and DMIAM amounts. Opex includes debt raising costs.

5 The higher regulatory depreciation is driven by a lower expected inflation rate applied in our final decision compared to TasNetworks' revised proposal. All else being equal, a higher regulatory depreciation increases the cost of corporate income tax as it is a component of revenue for tax purposes.

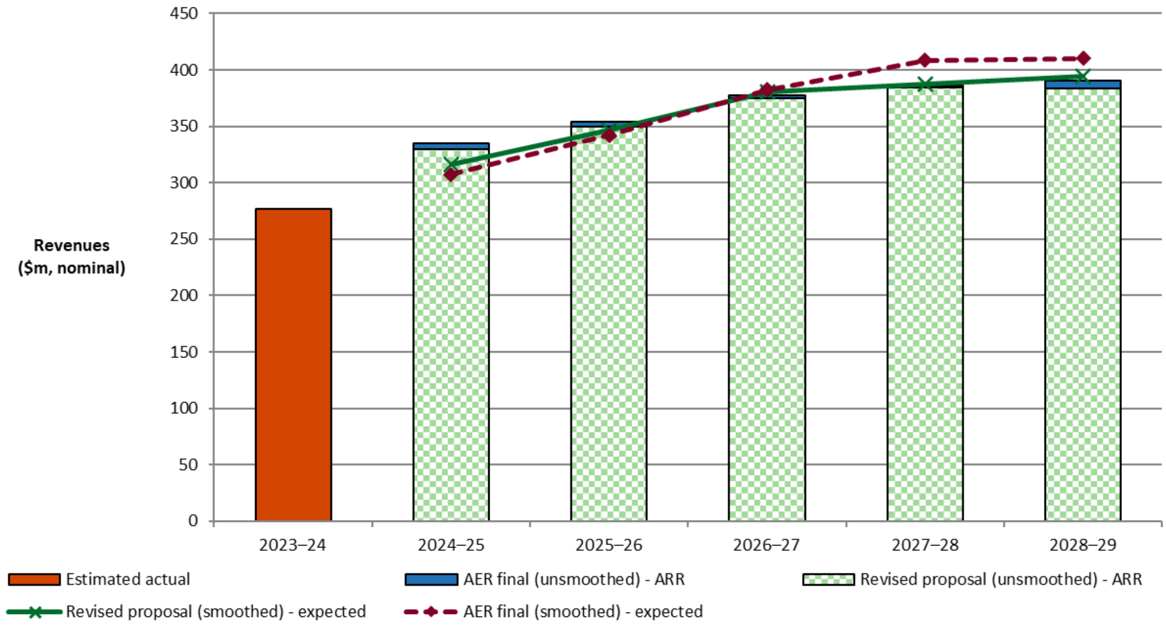
6 The higher return on equity amount is driven by a higher rate of return on equity determined in our final decision compared to TasNetworks' revised proposal. All else being equal, a higher return on equity amount increases the cost of corporate income tax as it is a component of revenue for tax purposes.

1.4.1 X factor and annual expected revenue

For this final decision, we determine X factors for TasNetworks as set out in Table 1.1.[7] The net present value (NPV) of the ARRs is $1,548.0 million ($2023–24) as at 1 July 2024. Based on this NPV and applying the CPI–X method, we determine that the annual expected revenue (smoothed) for TasNetworks is $307.3 million in 2024–25 increasing to $410.2 million in 2028–29 ($ nominal). The resulting total expected revenue for TasNetworks is $1,850.3 million for the 2024–29 period.

Figure 1.2 shows our final decision on TasNetworks' annual expected revenue (smoothed revenue) and the ARR (unsmoothed revenue) for the 2024–29 period.

Figure 1.2 AER's final decision on TasNetworks' revenue for the 2024–29 period ($million, nominal)



Source: AER analysis; TasNetworks, *TasNetworks-Revised Proposal-Distribution-PTRM-Nov 2023-Public,* November 2023.

To determine the profile of expected revenue for TasNetworks over the 2024–29 period, we have considered the stakeholder's submission to our draft decision and TasNetworks' revised proposal and set the expected revenue for the first regulatory year at $307.3 million ($ nominal). This is $27.4 million lower than the ARR for that year. We then apply an expected inflation rate of 2.66% per annum and a profile of X factors to determine the expected revenue in subsequent years.[8]

The X factors we set must be such as to minimise, as far as reasonably possible, the variance between the expected revenue (smoothed) and the ARR (unsmoothed) in the last year of the 2024–29 period.[9] This helps to minimise any potential large revenue variance (and thus price shocks) at the commencement of the 2029–34 period. Our standard

7 TasNetworks is not required to apply an X factor for 2024–25 because we set the 2024–25 expected revenue in this decision.

8 NER, cl. 6.5.9(a).

9 NER, cl. 6.5.9(b)(2).

approach has been to keep a divergence of up to +/–3% between the smoothed and unsmoothed revenues for the last year of the regulatory period, if this can achieve smoother price changes across the regulatory control periods.

Our draft decision smoothing profile provided a final year revenue difference of 3%, as did TasNetworks' revised proposal.

We received one submission from Tasmanian Small Business Council supporting a revenue smoothing approach that avoids a large jump in revenue in the first year of the 2024–29 period, even though this comes at the expense of higher revenue (and prices) in the subsequent years.[10]

For this final decision, the approved higher revenues than in the draft decision and TasNetworks' revised proposal are primarily driven by movement in a market parameter, namely the expected inflation rate. Consequently, to accommodate these higher revenues we have allowed the difference between the expected revenue and ARR in the last year of the 2024–29 period for TasNetworks to diverge more than would be usual. This approach smooths the bulk of the increase in expected revenues over the first three regulatory years (2024–25 to 2026–27). In the present circumstances, based on the X factors we have determined for TasNetworks, the final year revenue difference is 5.0%.

On balance, we consider that our profile of X factors for this final decision results in an expected revenue in the last year of the regulatory control period that is as close as reasonably possible to the ARR for that year.[11] We are satisfied that our revenue smoothing approach balances the need of promoting smoother price changes for customers across the 2024–29 period and minimising a large revenue variance at the commencement of the subsequent regulatory control period (2029–34).

Our final decision results in an average increase of 8.2% per annum ($ nominal) in the expected revenue over the 2024–29 period.[12] This consists of increases of 11.2% for 2024–25, 11.4% for 2025–26, 11.7% for 2026–27, 6.8% for 2027–28, and 0.4% for 2028–29.[13]

Our final decision also results in the total ARR to be 21.1% higher than that allowed in the 2019–24 period, in real terms ($2023–24). This is because we have determined a higher return on capital, higher regulatory depreciation amount, and higher revenue adjustments in this final decision for the 2024–29 period than those approved in the 2019–24 determination.

Figure 1.3 compares our final and draft decision building blocks for TasNetworks' 2024–29 period with its proposed and revised proposed revenue requirement for the same period, and the approved unsmoothed revenue for the 2019–24 period.

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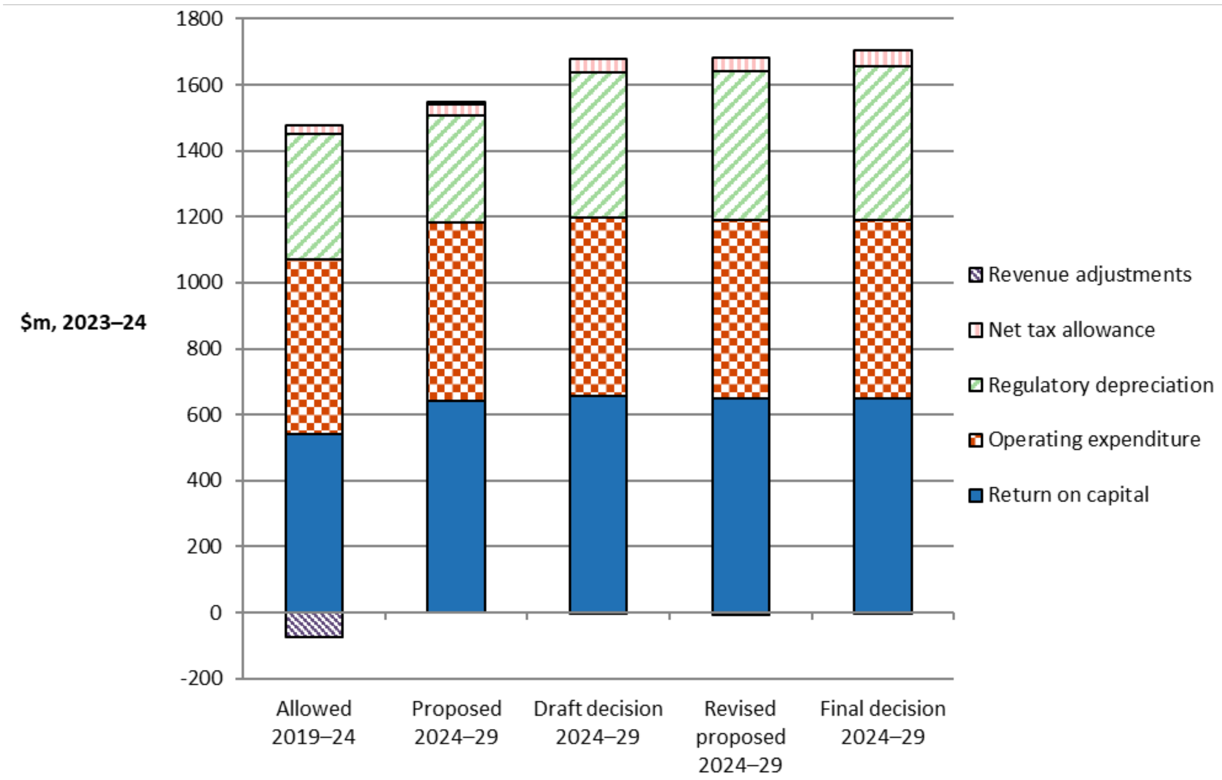
10 Tasmanian Small Business Council, *Submission AER Draft Determination TasNetworks Combined Regulatory Proposal 2024–29*, p. 17.

11 NER, cl. 6.5.9(b)(2).

12 In real 2023–24 dollar terms, our approved expected revenue for TasNetworks results in an average increase of 5.1% per annum over the 2024–29 period.

13 In real 2023–24 dollar terms, this consists of increases of 8.3% for 2024–25, 8.5% for 2025–26, 8.8% for 2026–27 and 4.05% for 2027–28, followed by a reduction of 2.16% for 2028–29.

Figure 1.3 Total revenue by building block components ($million, 2023–24)



Source: AER analysis.

1.4.2 Shared assets

Our final decision is to apply a shared asset revenue adjustment to TasNetworks' total expected revenue for the 2024–29 period.

In our draft decision, we accepted TasNetworks' proposal to apply a shared asset revenue adjustment to its revenues using the method from our shared asset guideline.[14] Our draft decision shared asset adjustment was consistent with the amounts TasNetworks calculated in its initial proposal.

TasNetworks' revised proposal adopted the shared asset revenue adjustment amounts set out in our draft decision. Consistent with the draft decision, we confirm our assessment that TasNetworks' forecast unregulated revenues from shared assets for the 2024–29 period are reasonable. Our final decision will see $2.1 million ($2023–24) shared with customers across the 2024–29 period.

Error! Reference source not found. compares the shared asset revenue adjustment in TasNetworks' revised proposal and our final decision.

14 AER, *Draft decision, Attachment 1 – Annual revenue requirement – TasNetworks – 2024 Distribution revenue proposal*, September 2023, pp. 9–10.

Table 1.3 AER's final decision on TasNetworks' shared asset revenue adjustment ($million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
TasNetworks' revised proposal	–0.4	–0.4	–0.4	–0.4	–0.4	–2.1
AER final decision	**–0.4**	**–0.4**	**–0.4**	**–0.4**	**–0.4**	**–2.1**

Source: AER analysis. TasNetworks, *TasNetworks-Revised Proposal-Distribution-PTRM-Nov 2023-Public*, November 2023.
Note: Totals may not add up due to rounding.

1.4.3 Indicative average distribution price impact

Our final decision on TasNetworks' expected revenues ultimately affects the prices customers pay for electricity. There are several steps required in translating our revenue decision into indicative distribution price impacts.

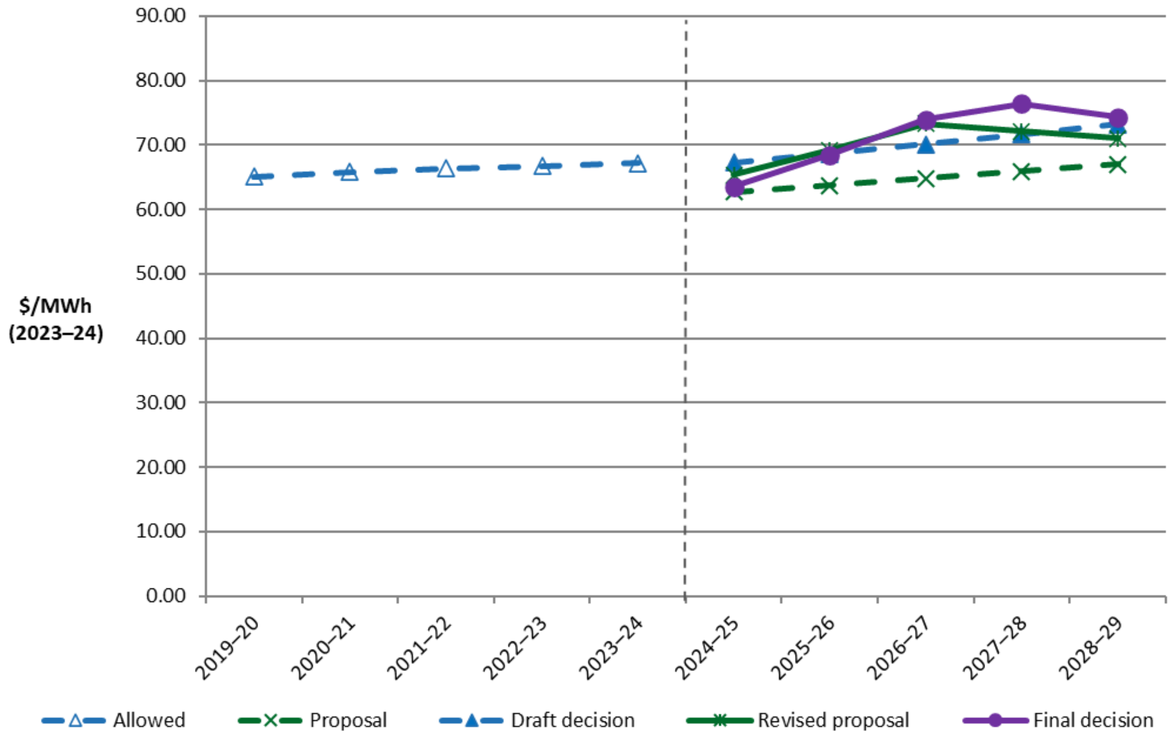
We regulate TasNetworks' SCS under a revenue cap form of control. This means our final decision on TasNetworks' expected revenues does not directly translate to price impacts. This is because TasNetworks' revenue is fixed under the revenue cap form of control, so changes in the consumption of electricity will affect the prices ultimately charged to customers.

For these reasons, we are not required to establish the distribution prices for TasNetworks as part of this determination. However, we will assess TasNetworks' annual pricing proposals before the commencement of each regulatory year within the 2024–29 period. In each assessment we will administer the pricing requirements set in this distribution determination.

For this final decision, we have estimated some indicative average distribution price impacts flowing from our final determination on the expected revenues for TasNetworks over the 2024–29 period. In this section, our estimates only relate to SCS (that is, the core electricity distribution charges), not alternative control services (such as metering charges). These indicative price impacts assume that actual energy consumption across the 2024–29 period matches TasNetworks' forecast energy consumption, which we have adopted for this final decision. We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

Figure 1.4 shows TasNetworks' indicative average price path over the period 2019–20 to 2028–29 in real 2023–24 dollar terms based on the expected revenues established in our final decision, compared to TasNetworks' revised proposed revenue requirement. The indicative price path is estimated using the approved expected revenue and dividing by forecast energy consumption for each year of the 2024–29 period.

Figure 1.4 Indicative distribution price path for TasNetworks ($/MWh, 2023–24)



Source: AER analysis.

We estimate that our final decision on TasNetworks' annual expected revenue will result in an increase to average distribution charges by about 4.7% per annum over the 2024–29 period in real 2023–24 dollar terms.[15] TasNetworks' revised proposal provided for an average real increase of approximately 3.7% per annum over the 2024–29 period for its distribution charges.[16] These high-level estimates reflect the aggregate change across the entire network and do not reflect the particular tariff components for specific end users.

15 In nominal terms we estimate average distribution charges to increase by 7.2% per annum. This amount reflects an expected inflation rate of 2.66% per annum as determined in this final decision.

16 In nominal terms TasNetworks' revised proposal would increase distribution charges by 6.8% per annum. This amount reflects an expected inflation rate of 2.80% per annum as proposed by TasNetworks in its revised proposal and an update for 2023–24 estimated revenue.

Table 1.4 displays in nominal terms the comparison of the revenue and price impacts of TasNetworks' revised proposal and our final decision.

Table 1.4 Comparison of revenue and price impacts of TasNetworks' revised proposal and the AER's final decision ($ nominal)

	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29
AER final decision						
Revenue ($ million)	276.4	307.3	342.2	382.3	408.3	410.2
Price path ($/MWh)[a]	59.12	65.23	72.12	80.02	84.89	84.75
Revenue (change %)	–	11.2%	11.4%	11.7%	6.8%	0.4%
Price path (change %)	–	10.3%	10.6%	11.0%	6.1%	–0.2%
TasNetworks revised proposal						
Revenue ($ million)	276.4	316.4	346.9	380.3	387.4	394.7
Price path ($/MWh)[a]	59.12	67.17	73.10	79.61	80.54	81.55
Revenue (change %)	–	14.5%	9.6%	9.6%	1.9%	1.9%
Price path (change %)	–	13.6%	8.8%	8.9%	1.2%	1.2%

Source: AER analysis; TasNetworks, *TasNetworks-Revised Proposal-Distribution-PTRM-Nov 2023-Public,* November 2023.

(a) The price path is in nominal terms and is constructed by dividing nominal expected revenue for SCS by forecast energy consumption for each year of the period.

1.4.4 Expected impact of final decision on electricity bills

The annual electricity bill for customers in Tasmania reflects the combined costs of all the electricity supply chain components—wholesale energy generation, transmission, distribution, metering, and retail costs. This final decision primarily relates to the distribution charges for TasNetworks' SCS, which represent approximately 28% on average for residential customers' and 30% on average for small business customers' annual electricity bills in Tasmania.[17]

We estimate the expected bill impact by varying the distribution charges in accordance with our final decision in this attachment, while holding all other components constant—including the metering component.[18] This approach isolates the effect of our final decision on the core distribution charges only for TasNetworks. However, this does not imply that other components will remain unchanged across the period.[19]

Based on this approach, we expect that our final decision on the distribution component will increase the average annual residential electricity bill in 2028–29 by about $264 ($ nominal) or 12.2% from the 2023–24 total bill level.

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17 TasNetworks, *TasNetworks-(D) Workbook 5 Indicative Bill-Dec-22-Public*, January 2023.

18 We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

19 It also assumes that actual energy consumption will equal the forecast adopted in our final decision. Since TasNetworks operates under a revenue cap, changes in energy consumption will also affect annual electricity bills across the 2024–29 period.

Similarly, we expect that our final decision will result in the distribution component of the average annual electricity bill for a small business customer in 2028–29 to increase by about $376 ($ nominal) or 13.0% from the 2023–24 total bill level.

Our estimated bill impact is based on the typical annual electricity usage of 7,428 kWh and 8,782 kWh for residential and small business customers in Tasmania, respectively.[20] Therefore, customers with different usage will experience different changes in their bills. We also note that there are other factors which we have not considered here, such as metering, wholesale and retail costs, which affect electricity bills.

Table 1.5 shows our estimated impact of our final decision and TasNetworks' revised proposal on the average annual electricity bills for residential and small business customers in Tasmania over the 2024–29 period.

Table 1.5 Estimated impact of TasNetworks' revised proposal and AER's final decision on annual electricity bills for the 2024–29 period ($ nominal)

	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29
AER final decision						
Residential annual electricity bill	2,170[a]	2,233	2,303	2,385	2,435	2,434
Annual change[b]	–	63 (2.9%)	71 (3.2%)	81 (3.5%)	50 (2.1%)	–1 (–0.1%)
Small business annual electricity bill	2,882[a]	2,971	3,072	3,188	3,259	3,257
Annual change[b]	–	90 (3.1%)	101 (3.4%)	116 (3.8%)	71 (2.2%)	–2 (–0.1%)
TasNetworks revised proposal						
Residential annual electricity bill	2,170[a]	2,252	2,314	2,381	2,390	2,401
Annual change[b]	–	83 (3.8%)	61 (2.7%)	67 (2.9%)	10 (0.4%)	10 (0.4%)
Small business annual electricity bill	2,882[a]	3,000	3,086	3,182	3,196	3,210
Annual change[b]	–	118 (4.1%)	87 (2.9%)	95 (3.1%)	14 (0.4%)	15 (0.5%)

Source: AER analysis; TasNetworks, *TasNetworks-(D) Workbook 5 Indicative Bill-Dec-22-Public*, January 2023

(a) TasNetworks, *TasNetworks-(D) Workbook 5 Indicative Bill-Dec-22-Public*, January 2023, Office of the Tasmanian Economic Regulator, *Typical Electricity Customers in Tasmania*, September 2022.

(b) Annual change amounts and percentages are indicative. They are derived by varying the distribution component of the 2023–24 bill amounts in proportion to yearly expected revenue divided by forecast energy as provided by TasNetworks. Actual bill impacts will vary depending on electricity consumption and tariff class.

[20] TasNetworks, *TasNetworks-(D) Workbook 5 Indicative Bill-Dec-22-Public*, January 2023. Office of the Tasmanian Economic Regulator, *Typical Electricity Customers in Tasmania*, September 2022.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
ARR	annual revenue requirement
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
kWh	kilowatt hour
MWh	megawatt hour
NER	National Electricity Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
SCS	standard control services