Directlink Transmission Determination 2020 to 2025

June 2020

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Summary

The Australian Energy Regulator (AER) makes a transmission determination for each transmission network service provider (TNSP) in accordance with chapter 6A of the NER.[1]

This document is our transmission determination for Directlink for the regulatory control period 1 July 2020 to 30 June 2025. Our reasons are included in the AER's final decision on Directlink’s transmission determination (May 2020) which should be read in conjunction with this document.

Our transmission determination for Directlink consists of:[2]

- a revenue determination in respect of the provision by Directlink of prescribed transmission services (section 1)
- a determination that specifies the pricing methodology that applies to Directlink (section 2)
- a determination that specifies pass through events that will apply to this determination in addition to those specified in the NER (section 3).

1 NER, cl. 6A.2.1.

2 NER, cll. 6A.2.2 and 6A.7.3(a1).

1 Revenue

We calculate the amount of revenue that Directlink requires each year of the regulatory control period in accordance with a building block approach.[3] This is referred to as the *annual building block revenue requirement*. The annual building block revenue is then used to calculate the expected maximum allowed revenue (MAR) for each year of the 2020–25 regulatory control period.

The annual MAR that Directlink may earn from providing prescribed transmission services is subject to adjustments to account for factors such as inflation, approved pass through costs and annual performance rewards or penalties.

Our revenue determination specifies the following matters:[4]

- the amount of the estimated total revenue cap for the regulatory control period and the method of calculating that amount
- the annual building block revenue requirement for each regulatory year of the regulatory control period
- the amount of the MAR for each regulatory year of the regulatory control period or the method of calculating that amount
- the regulatory asset base (RAB) as at the commencement of the regulatory control period
- the methodology that will be used for the indexation of the RAB
- the values that are to be attributed to the performance incentive scheme parameters for the purposes of the application to Directlink of the service target performance incentive scheme (STPIS) that applies in respect of the regulatory control period
- the values that are to be attributed to the efficiency benefit sharing scheme (EBSS) parameters for the purposes of the application to Directlink of the EBSS that applies in respect of the regulatory control period
- how the capital expenditure sharing scheme (CESS) is to apply to Directlink
- the commencement and length of the regulatory control period covered by this determination.

[3] NER, cl. 6A.5.4.

[4] NER, cl. 6A.4.2.

1.1 Method for calculating estimated total revenue cap

We determine an estimated total MAR of $77.3 million ($nominal) for Directlink for the 2020–25 regulatory control period as shown in Table 1. The estimated total MAR is also known as the total revenue cap. It is the sum of the expected MAR for each regulatory year.[5]

Table 1 AER's final determination on Directlink's annual expected maximum allowed revenue ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Annual expected MAR (smoothed)	**14.3**	**14.9**	**15.4**	**16.0**	**16.7**	**77.3**[a]
X factor (%)[b]	n/a[c]	–1.57%	–1.57%	–1.57%	–1.57%	n/a

Source: AER analysis.

(a) The estimated total revenue cap is equal to the total annual expected MAR.

(b) 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.

(c) Directlink is not required to apply an X factor for 2020–21 because we set the 2020–21 MAR in this decision. The MAR for 2020–21 is around 4.4 per cent lower than the approved MAR for 2019–20 in real terms, or 2.3 per cent lower in nominal terms.

We determine the annual expected MAR by using the X factors to smooth the annual building block revenue requirement, as set out below.

1.2 Annual building block revenue requirement

We determine the annual building block revenue requirement for Directlink as shown in Table 2.

5 NER, cl. 6A.5.3.

Table 2 AER's final determination on Directlink's annual building block revenue requirement ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Return on capital	6.6	6.6	6.5	6.4	6.3	32.4
Regulatory depreciation[a]	3.6	4.0	4.5	4.9	5.4	22.4
Operating expenditure[b]	4.7	4.8	5.0	5.2	5.3	25.0
Revenue adjustments[c]	–0.8	–1.5	–0.7	–0.3	0.0	–3.3
Net tax allowance	0.2	0.2	0.1	0.1	0.2	0.8
Annual building block revenue requirement (unsmoothed)	**14.3**	**14.1**	**15.5**	**16.4**	**17.2**	**77.4**

Source: AER analysis.

(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 the EBSS and the CESS.

1.3 Method for calculating maximum allowed revenue

We use an expected inflation rate in our post-tax revenue model (PTRM) to calculate the expected MAR (as shown in Table 1) in nominal dollar terms. Therefore, the calculation of the actual annual MAR will require an adjustment for actual inflation. The MAR is also subject to adjustments for updating the return on debt annually, a revenue increment or decrement determined in accordance with the STPIS, and any approved pass through amounts. This section sets out the method of this annual adjustment process.

We determine that the method for calculating Directlink's MAR for each year of the 2020–25 regulatory control period will be the sum of its allowed revenue (AR) for that year, adjustments arising from the STPIS and any approved pass through amounts.

We determine a 2020–21 AR of $14.3 million for Directlink. Directlink then applies an annual adjustment to determine its AR for each subsequent year of the 2020–25 regulatory control period, based on the previous year's AR and using the CPI–X methodology. That is, the subsequent year's AR is determined by adjusting the previous year's AR for actual inflation and the X factor determined after the annual return on debt update:

$$\mathrm{AR}_t = \mathrm{AR}_{t-1} \times (1 + \Delta\mathrm{CPI}) \times (1 - \mathrm{X}_t)$$

where:

AR = the allowed revenue

t	=	time period/financial year (for t = 2 (2021–22), 3 (2022–23), 4 (2023–24), 5 (2024–25))
$\Delta\mathrm{CPI}$	=	the annual percentage change in the ABS Consumer price index all groups, weighted average of eight capital cities from December in year $t-2$ to December in year $t-1$
X	=	the smoothing factor determined in accordance with the PTRM as approved in the AER's final decision, and annually revised for the return on debt update in accordance with the formula specified in the *Rate of return instrument* calculated for the relevant year.[6]

The MAR is determined annually in accordance with the NER by adding to (or deducting from) the allowed revenue:

- the service target performance incentive scheme revenue increment (or revenue decrement)[7]
- any approved pass through amounts.[8]

The annual MAR is established according to the following formula:

$\mathrm{MAR_t}$	=	(allowed revenue) + (performance incentive) + (pass through)
	=	$\mathrm{AR}_t + \left(\left(\mathrm{AR}_{t-2} \times \frac{1}{2}\right) + \left(\mathrm{AR}_{t-1} \times \frac{1}{2}\right)\right) \times \mathrm{S}_{ct} + \mathrm{P}_t$

where:

MAR	=	the maximum allowed revenue
AR	=	the allowed revenue
S	=	the revenue increment or decrement determined in accordance with the service target performance incentive scheme
P	=	the pass through amount (positive or negative) that the AER has determined in accordance with clauses 6A.7.2 and 6A.7.3 of the NER

6 AER, *Rate of return instrument*, December 2018, cl. 9.

7 NER, cl. 6A.7.4.

8 NER, cll. 6A.7.2 and 6A.7.3.

t	=	time period/financial year (for t = 2 (2021–22), 3 (2022–23), 4 (2023–24), 5 (2024–25))
ct	=	time period/calendar year (for ct = 2 (2020), 3 (2021), 4 (2022), 5 (2023)).

Directlink may also adjust the MAR for under or over-recovery amounts.[9] That is, if the revenue amounts earned from providing prescribed transmission services in previous regulatory years are higher or lower than the sum of the approved MAR for those years, the difference can be included in the subsequent year's MAR. In the case of an under-recovery, the amount is added to the subsequent year's MAR. In the case of an over-recovery, the amount is subtracted from the subsequent year's MAR.

Table 3 sets out the timing of the annual calculation of the AR and performance incentive.

Table 3 Timing of the calculation of allowed revenues and the performance incentive for Directlink

t	Allowed revenue (financial year)	*ct*	Performance incentive (calendar year)
2	1 July 2021–30 June 2022	2	1 January 2020–31 December 2020
3	1 July 2022–30 June 2023	3	1 January 2021–31 December 2021
4	1 July 2023–30 June 2024	4	1 January 2022–31 December 2022
5	1 July 2024–30 June 2025	5	1 January 2023–31 December 2023

Note: The performance incentive for 1 January 2019–31 December 2019 is to be applied to the AR determined for 2020–21 (AR_1).

1.4 Regulatory asset base

We determine an opening RAB value of $146.9 million as at the commencement of the 2020–25 regulatory control period for Directlink.

1.5 Method for indexation of the regulatory asset base

The method for indexing Directlink's RAB for each year of the 2020–25 regulatory control period will be the same as that used to escalate its AR for that relevant year. That is, by applying the annual percentage change in the published ABS CPI all groups, weighted average of eight capital cities.[10] For Directlink, this will be the December quarter CPI. This method will be used as part of the roll forward of

[9] NER, cl. 6A.23.3(e)(5).

[10] ABS, *Catalogue number 6401.0, Consumer price index*, Australia.

Directlink's opening RAB for the purposes of the AER's transmission revenue determination for the regulatory control period commencing on 1 July 2025.

1.6 Service target performance incentive scheme parameters

All relevant components of version 5 of the STPIS will apply to Directlink for the 2020–25 regulatory control period. The parameters applicable to Directlink are set out in the tables below. Our final decision calculates the performance targets for Directlink using its latest performance data including data for 2019.

Table 4 Final decision: Service component caps, floors and targets for 2020–2025

Parameter	Distribution	Floor	Target	Cap	Weighting (% of MAR)
Unplanned outage circuit event rate:					1.25
Circuit event rate – fault	Gamma	1352%	933%	582%	0.75
Circuit event rate – forced	Uniform	277%	147%	15%	0.50
Proper operation of equipment (number of events):					
Failure of protection system[a]	Poisson	6	3	0	0.00

Source: AER analysis.

(a) These measures are weighted at zero percent in terms of reward and penalty under the STPIS.

Table 5 Final decision: Market impact component (MIC) parameter values for 2020–25

MIC parameter values	
Performance target	1189
Unplanned outage event limit	499
Dollar per dispatch interval ($/DI)	117.7

Source: AER analysis.

1.7 Efficiency benefit sharing scheme parameters

We will continue to apply version two of the EBSS to Directlink in the 2020–25 regulatory control period. The values for the efficiency benefit sharing scheme (EBSS) parameters to apply to Directlink during the 2020–25 period, are set out in Table 6. These parameters are subject to adjustments as required by the EBSS.

Table 6 AER's decision on Directlink’s forecast opex for the EBSS ($million, 2019–20)

	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Forecast total opex	3.8	3.8	3.8	4.6	4.6	4.7	4.7	4.8
Less debt raising costs	–0.1	–0.1	–0.1	–0.1	–0.1	–0.1	–0.1	–0.1
Less insurance costs	–0.3	–0.3	–0.3	–0.5	–0.5	–0.6	–0.6	–0.6
Forecast total opex for the EBSS	**3.5**	**3.4**	**3.4**	**4.0**	**4.0**	**4.1**	**4.1**	**4.1**

Source: AER, *Directlink final decision—Post tax revenue model*, May 2020; AER analysis.

Note: Numbers may not add up to total due to rounding.

In calculating EBSS carryover amounts, the AER will exclude the following costs from the EBSS:

- debt raising costs
- network support costs

In addition to these excluded cost categories we will also:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the 2020–25 regulatory determination. This may include approved pass through amounts
- adjust actual opex to add capitalised opex that has been excluded from the RAB
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2025 where doing so better achieves the requirements of clause 6A.6.5 of the NER.

When calculating actual opex under the EBSS we will adjust reported actual opex for the 2020–25 period to reverse any movements in provisions.

1.8 Application of the capital expenditure sharing scheme

We will apply version one of the CESS as set out in the capital expenditure incentives guideline to Directlink's 2020−25 regulatory control period.[11] The guideline provides for the exclusion, from the CESS, of capital expenditure (capex) the service provider incurs in delivering a priority project approved under the network capability component of the STPIS.[12]

1.9 Commencement and length of the regulatory control period

The regulatory control period will be five years, commencing on 1 July 2020 and ending on 30 June 2025.

1.10 Depreciation for establishing the regulatory asset base as at the commencement of the next regulatory control period

The depreciation approach to be applied to establish Directlink's RAB at the commencement of the 2025–30 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capital expenditure at the asset class level approved for the 2020–25 regulatory control period.

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[11] AER, *Capex incentive guideline*, November 2013, pp. 5–9; NER, cl. 6A.6.5A(e).

[12] AER, *Capex incentive guideline*, November 2013, p. 6.

2 Pricing methodology

The pricing methodology that will apply to Directlink for the period of this determination is set out in Attachment A to the final decision.

The role of Directlink's pricing methodology is to answer the question 'who should pay how much'[13] in order for Directlink to recover its costs. Directlink's pricing methodology provides a 'formula, process or approach'[14] that when applied:

- allocates the aggregate annual revenue requirement to the categories of prescribed transmission services that a transmission business provides and to the connection points of network users[15]
- determines the structure of prices that a transmission business may charge for each category of prescribed transmission services.[16]

Directlink's pricing methodology relates to prescribed transmission services only.

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13 AEMC, *Rule determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p. 1.

14 NER, cl. 6A.24.1(b).

15 NER, cl. 6A.24.1(b)(1).

16 NER, cl. 6A.24.1(b)(2).

3 Pass through events

Our final decision is to approve Directlink's nominated transmission pass through events and associated definitions as set out in Table 7:[17]

- an insurer's creditor risk
- a terrorism event.

These will apply to Directlink throughout the regulatory control period in addition to the pass through events which are prescribed by the NER. These include events dealing with regulatory change, service standards, tax change, insurance, inertia and fault level shortfalls.[18]

Table 7 Approved nominated pass through events

Pass through event	Definition

Insurer's creditor risk	An insurer's credit risk event occurs if:
	• a nominated insurer of Directlink becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Directlink:
	  ○ is subject to a higher or lower claim limit, or a higher or lower deductable than would have otherwise applied under the insolvent insurer's policy; or
	  ○ incurs additional costs associated with funding an insurance claim, which otherwise would have been covered by the insolvent insurer.
	Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:
	• Directlink's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation
	• in the event that a claim would have been made after the insurance provider became insolvent, whether Directlink had reasonable opportunity to insure the risk with a different provider.

Terrorism	A terrorism event occurs if: An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any sections of the public, in fear) and which increases the costs to Directlink in providing prescribed transmission services. Note in assessing a terrorism event pass through application, the AER will have regard to, amongst other things: • whether Directlink has insurance against the event; • the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and • whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

17 For definitions of the nominated pass through events see: AER, *Draft Decision - Directlink transmission determination 2020–25 Attachment 12*, October 2019, p. 6.

18 NER, cl. 6A.7.3(a1)(1)–(7). Each of these prescribed events is defined in Chapter 10 (Glossary).

Shortened forms

Shortened form	Extended form
ABS	Australian Bureau of Statistics
AER	Australian Energy Regulator
AR	allowed revenue
capex	capital expenditure
CESS	capital expenditure sharing scheme
EBSS	efficiency benefit sharing scheme
MAR	maximum allowed revenue
MIC	market impact component
NER	National Electricity Rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
STPIS	service target performance incentive scheme
TNSP	transmission network service provider