

Combined Proposal 2024-2029

Attachment 11 Capital expenditure sharing scheme



Outline: This attachment to TasNetworks' Combined Proposal sets out how the Capital Expenditure Sharing Scheme will apply during the 2024-2029 regulatory control period.

Note

This attachment forms part of TasNetworks' Combined Proposal for the 2024-2029 regulatory control period and should be read in conjunction with the other parts of the proposal.

TasNetworks' Combined Proposal is made up of the documents and attachments listed below, as well as the supporting documents that are listed in Attachment 23.

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Attachment 1	Customer and stakeholder engagement summary
Attachment 2	Annual revenue requirement
Attachment 3	Regulatory asset base
Attachment 4	Rate of return
Attachment 5	Regulatory depreciation
Attachment 6	Capital expenditure
Attachment 7	Contingent projects
Attachment 8	Operating expenditure
Attachment 9	Corporate income tax
Attachment 10	Efficiency benefit sharing scheme
> Attachment 11	Capital expenditure sharing scheme
Attachment 12	Service target performance incentive scheme
Attachment 13	Demand management incentives and allowance
Attachment 14	Customer service incentive scheme
Attachment 15	Classification of services
Attachment 16	Control mechanisms
Attachment 17	Pass through events
Attachment 18	Alternative control services
Attachment 19	Negotiated services framework and criteria
Attachment 20	Distribution connection pricing policy
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11 Capital expenditure sharing scheme

11.1 Introduction

The Capital Expenditure Sharing Scheme (**CESS**) provides an incentive for network service providers (**NSPs**) to pursue efficiency improvements in capital works programs and provides for a fair sharing of efficiency gains between NSPs and customers.

The Australian Energy Regulator (**AER**) determines separate CESS rewards or penalties for TasNetworks' transmission and distribution networks. The AER applied its Capital Expenditure Incentive Guideline (**CESS Guideline**)¹ to TasNetworks' transmission and distribution networks in the 2019-2024 regulatory control period. Under the CESS Guideline, capital expenditure (**capex**) efficiencies are shared 70 per cent with customers and 30 per cent with the NSP.

TasNetworks' transmission network reward for the 2019-2024 regulatory control period is forecast to be \$3.17 million and for the distribution network the reward is forecast to be \$10.46 million (\$2023-24). These rewards will be applied as an additional building block adjustment to TasNetworks' revenue in the 2024-2029 regulatory control period. In turn, customers benefit because efficiency gains results in a lower regulatory asset base (**RAB**) which is a key driver of the return of capital and return on capital building blocks.² These benefits will also flow through to customers in future regulatory control periods.

The AER's Final Framework and Approach paper stated an intention to continue to apply the CESS to both of TasNetworks' networks in the 2024-2029 regulatory control period.³ TasNetworks supports the continued application of the CESS to its transmission and distribution networks. In combination with other incentive schemes, the CESS provides appropriate and balanced incentives for efficient expenditure while maintaining or improving service standards.

The Framework and Approach noted that the CESS is a focus of the AER's current Incentive Scheme Review and that any changes to the CESS would not apply retrospectively but to capex undertaken in the 2024-2029 regulatory control period to be applied as a reward or penalty in the 2029-2034 regulatory control period. Throughout the Incentive Scheme Review, TasNetworks has supported additional transparency regarding CESS outcomes.

11.2 Transmission network Reward / Penalty and CESS targets

TasNetworks has calculated capex efficiency rewards for our transmission network in the 2019-2024 regulatory control period and the target capex that will be used to assess capex efficiencies in the 2024-2029 regulatory control period.

11.2.1 Calculation of reward for the 2019-2024 regulatory control period

In accordance with the CESS Guideline, TasNetworks has calculated the transmission CESS outcome as follows:

- annual efficiency gains are calculated by subtracting actual capex from the capex allowance in each year of the 2019-2024 regulatory control period

1 AER, Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013

2 For more information on revenue building blocks refer to Attachment 2 of the Combined Proposal

3 AER, Final Framework and Approach for TasNetworks for the 2024-29 regulatory control period, July 2022, p. 50

- an estimate of capex based on current forecasts is used to calculate the impact for the final two regulatory years of the period as the Combined Proposal is made before those years have occurred
- the CESS sharing ratio of 30 per cent is applied to the adjusted efficiency gain to calculate TasNetworks' reward
- the financing benefit that has already accrued to TasNetworks in the 2019-2024 regulatory control period is calculated and subtracted from the annual efficiency gains.

Table 1 shows actual capex in the 2019-2024 regulatory control period compared to the capex allowance for the purposes of determining the CESS carryover amount. The CESS carryover for our transmission network arising from the 2019-2024 regulatory control period is shown in Table 2. The reward is included as a 'revenue adjustment' in our annual revenue requirement in each year of the 2024-2029 regulatory control period.

Table 1. Transmission historical cost performance for CESS carryover calculation (nominal, \$ million)

	2019-20	2020-21	2021-22	2022-23	2023-24	Total
Total capex allowance	58.04	56.20	54.57	49.70	46.14	264.65
Total actual capex	51.54	45.60	46.94	64.06	56.53	264.68
Less disposals	0.03	0.02	0.16	0.07	0.07	0.34
Less other capex	0.48	0.56	1.77	1.02	1.00	4.84
Net capex	51.03	45.01	45.01	62.98	55.46	259.49
(under) / over spend	(7.01)	(11.19)	(9.56)	13.27	9.33	(5.16)

Table 2. Transmission CESS carryover amounts for 2024-2029 regulatory control period (2023-24, \$ million)

	2024-25	2025-26	2026-27	2027-28	2028-29	Total
CESS carry over amount	0.63	0.63	0.63	0.63	0.63	3.17

11.2.1.1 Reasons for transmission CESS reward

The reward of \$3.17 million (\$2023-24) is largely driven by a true-up of the CESS outcome in the final year of the 2014-2019 regulatory control period. Transmission capex allowance is forecast to be almost (98 per cent) fully expended in the 2019-2024 regulatory control period. The minor underspend primarily results from the impact of the COVID-19 pandemic and resultant challenges with resource availability in the first three years of the regulatory control period. It is forecast that most of the underspend in the first three years will be reversed by the end of the 2019-2024 regulatory control period.

11.2.1.2 Adjustment for capex deferrals

The CESS Guideline provides that an adjustment be made to the CESS outcome where there is deferral of capex from the current regulatory period to the next regulatory period.

The adjustment applies where TasNetworks has deferred capex in the 2019-2024 regulatory control period and:

- the amount of deferred capex is material
- the total capex underspend is material
- total approved forecast capex in the 2024-2029 regulatory control period is materially higher than it is likely to have been if the capex was not deferred in the 2019-2024 regulatory control period.

TasNetworks has not applied an adjustment to the transmission CESS outcome as there is no material forecast underspend of capex in the 2019-2024 regulatory control period.

11.2.2 CESS target to apply for the 2024-2029 regulatory control period

TasNetworks' total CESS target for the 2024-2029 regulatory period is \$287.8 million (\$2023-24) and is shown in Table 3.

Table 3. Transmission CESS capital expenditure forecasts for 2024-2029 regulatory control period (2023-24, \$ million)

	2024-25	2025-26	2026-27	2027-28	2028-29	Total
Net capital expenditure forecast	52.05	67.80	58.72	57.67	51.56	287.80
Adjustments	0.00	0.00	0.00	0.00	0.00	0.00
Movement in provisions	0.00	0.00	0.00	0.00	0.00	0.00
CESS target	52.05	67.80	58.72	57.67	51.56	287.80

Consistent with the CESS Guideline, adjustments may be made during the 2024-2029 regulatory control period for any capex approved by the AER for pass-throughs, reopening of capex or contingent projects that are triggered. Our proposed transmission network pass-through events are outlined in Attachment 17 Pass through events and proposed contingent projects are outlined in Attachment 7 Contingent projects. Also consistent with the CESS Guideline, TasNetworks' will exclude any capex incurred in delivering a priority project approved under the network capability component of the service target performance incentive scheme for transmission network service providers.

TasNetworks considers that the CESS should not apply to actionable Integrated System Plan projects, including the North West Transmission Developments (NWTD) associated with Project Marinus.

NWTD' estimated cost is approximately three times more than TasNetworks' total 2024-2029 capex forecast. Therefore, a small percentage under / over spend on NWTD will significantly impact TasNetworks' 2024-2029 incentive scheme outcomes, weakening incentives to find efficiencies in the underlying program of work. This is not consistent with the objective of the scheme and can be resolved by excluding NWTD capex from the CESS if the AER approves a NWTD contingent project application during the 2024-2029 regulatory control period.

11.3 Distribution network carryover amounts and CESS targets

TasNetworks has calculated capex efficiency rewards for our distribution network in the 2019-2024 regulatory control period and the target capex that will be used to assess capex efficiencies in the 2024-2029 regulatory control period.

11.3.1 Calculation of reward for the 2019-2024 regulatory control period

TasNetworks has calculated the carryover amount for this period for its distribution network using the same approach as for its transmission network explained in section 11.2.1 above.

Table 4 shows our capex in the 2019-2024 regulatory control period compared to approved capex allowance for the purposes of determining the CESS carryover amount. The capex reward for our distribution network arising from the 2019-2024 regulatory control period is shown in Table 5. The reward will be included as a 'revenue adjustment' in our annual revenue requirement in each year of the 2024-2029 regulatory control period.

Table 4. Distribution historical cost performance for CESS carryover calculation (nominal, \$ million)

	2019-20	2020-21	2021-22	2022-23	2023-24	Total
Total capex allowance	146.09	136.96	128.67	148.54	160.39	720.64
Total actual capex	135.12	154.93	151.43	164.55	176.60	782.63
Less customer contributions	16.95	18.94	29.77	15.28	14.12	95.06
Less disposals	1.14	0.14	0.50	0.88	0.93	3.60
Net actual capex	117.03	135.84	121.16	148.39	161.54	683.96
(Under) / overspend	(29.07)	(1.11)	(7.50)	(0.15)	1.15	(36.68)

Table 5. Distribution CESS carryover amounts for 2024-2029 regulatory control period (2023-24, \$ million)

	2024-25	2025-26	2026-27	2027-28	2028-29	Total
CESS carry over amount	2.09	2.09	2.09	2.09	2.09	10.46

11.3.1.1 Reasons for distribution CESS reward

Distribution capex is forecast to be around 95 per cent of the capex allowance in 2019-2024 regulatory control period. The forecast underspend resulting in a reward of \$10.46 million (\$2023-24). The 2019-20 underspend is predominantly due to the impact of the COVID 19 pandemic and resultant challenges with resource availability. The impact of the COVID 19 pandemic underspend has been partially reversed in the remaining years of the regulatory control period, however this has been offset by underspends due to the deferral of the Market Data Management System (MDMS) replacement project. Further information on this project is found in Section 11.3.1.2.

11.3.1.2 Any adjustments for capex deferrals

The CESS Guideline provides that an adjustment be made to the CESS outcome where there is deferral of capex from the current regulatory period to the next regulatory period.

The adjustment applies where TasNetworks has deferred capex in the 2019-2024 regulatory control period and:

- the amount of the deferred capex is material
- the total capex underspend is material
- total approved forecast capex in the 2024-2029 regulatory control period is materially higher than it is likely to have been if the capex was not deferred in the 2019-2024 regulatory control period.

As noted in Section 11.3.1.1, the MDMS project has not commenced in the 2019-2024 regulatory control period. In TasNetworks' 2019-2024 Revenue Determination the MDMS replacement project was expected to be undertaken across the 2019-2024 and 2024-2029 regulatory control periods. In addition to the deferral, the MDMS replacement project forecast cost is now significantly lower. As a result, the deferral in the 2019-2024 regulatory control period does not materially impact the capex forecast in the 2024-2029 regulatory control period.

The deferral and significant reduction in forecast cost represent a significant efficiency gain that benefits TasNetworks' customers through a lower RAB in the 2024-2029 regulatory control period and beyond. An adjustment to the distribution CESS outcome has not been applied as the proposed capex in the 2024-2029 regulatory control period is not materially higher than it is likely to have been if the MDMS replacement project was not deferred in the 2019-2024 regulatory control period.

11.3.2 CESS target to apply for the 2024-2029 regulatory control period

TasNetworks' total CESS target for the 2024-2029 regulatory period is \$729.4 million (\$2023-24) and is shown in Table 6.

Table 6. Distribution CESS capital expenditure forecasts for 2024-2029 regulatory control period (2023-24, \$ million)

	2024-25	2025-26	2026-27	2027-28	2028-29	Total
Net capital expenditure forecast	155.55	160.68	141.86	136.91	134.38	729.38
Adjustments	0.00	0.00	0.00	0.00	0.00	0.00
Movement in provisions	0.00	0.00	0.00	0.00	0.00	0.00
CESS target	155.55	160.68	141.86	136.91	134.38	729.38

Consistent with the CESS Guideline, adjustments may be made during the 2024-2029 regulatory period for any capex approved by the AER for pass-throughs or reopening of capex. Our proposed distribution network pass-through events are outlined in Attachment 17 Pass through events.

