Combined Proposal 2024-2029

Attachment 16
Control mechanisms

Outline: This attachment to TasNetworks' Combined Proposal sets out the proposed control mechanisms for TasNetworks' Standard Control Services and Alternative Control Services during the 2024-2029 regulatory control period, in TasNetworks' capacity as Tasmania's distribution network service provider.

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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 4	Rate of return
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16 Control mechanisms

16.1 Introduction

The Australian Energy Regulator (**AER**) is responsible for regulating the revenues and/or prices of distribution network service providers (**DNSPs**) in the National Electricity Market (**NEM**). In its capacity as an economic regulator, the AER first classifies the distribution services that DNSPs provide, and then determines the control mechanisms for the revenue that DNSPs may earn and/or the prices they charge for each class of service.

Based on the AER's Final Framework and Approach Paper[1] this attachment sets out the control mechanisms that TasNetworks expects will apply to TasNetworks' regulated distribution services[2] in the 2024–2029 regulatory control period.

Under section 6.2.1 of the National Electricity Rules (**NER**) the AER may classify a distribution service provided by a DNSP as either a direct control service or a negotiated distribution service.[3]

16.1.1 Direct control services

Direct control services are those services for which the AER imposes controls over the prices or revenue recovered by DNSPs in relation to those services.

The control mechanisms available to the AER in relation to direct control services include price schedules, caps on the prices of individual services, revenue caps, weighted average price caps and combinations of the various mechanisms set out in the NER.[4] Clause 6.12.3(b) of the NER requires the form of control mechanisms applying to a DNSP's services to be set out by AER in a Framework and Approach paper.

16.1.2 Negotiated distribution services

TasNetworks does not currently provide any negotiated distribution services and is not proposing to do so in the 2024-2029 regulatory period. Any emergent negotiations with Service Applicants regarding negotiated distribution services provided by TasNetworks will be undertaken in accordance with the negotiating framework provided at Attachment 19 of the Combined Proposal.

16.2 Standard control services

16.2.1 Revenue cap

Consistent with the AER's Framework and Approach, TasNetworks agrees that a revenue cap should continue to be the control mechanism for TasNetworks' standard control services in the 2024–2029 regulatory control period. The continued application of a revenue cap for standard control services promotes consistency between regulatory control periods for our customers.

Under a revenue cap form of control, the AER will set the total allowed revenue for TasNetworks' distribution network in each regulatory year of the 2024–2029 regulatory control period.

TasNetworks cannot recover more revenue in total from its customers in any given regulatory year than the annual revenue allowance set by the AER for that year. To comply with this requirement, TasNetworks will set its prices annually based on forecasts of variables such as customer numbers and their consumption of, and demand for, electricity, so that the expected revenue recovered in any given year will be equal to or less than the total revenue allowed for that year by the AER.

1 AER, *Final Framework and Approach for TasNetworks for the 2024-29 regulatory control period*, July 2022

2 This document does not address the control mechanism for TasNetworks' prescribed transmission services because the Rules (cl. 6A.3.1) require prescribed transmission services to be subject to a revenue cap

3 If the AER decides against classifying a distribution service, the service is not regulated under the NER

4 NER, cl. 6.2.5(b)

However, the differences between actual consumption and customer numbers in any given year, for example, and the forecasts that informed our price setting for that year can lead to an over or under recovery of TasNetworks' annual revenue allowance. Therefore, each year, TasNetworks reconciles the revenue recovered from customers for that year with our approved revenue allowance and adjusts prices in future years to account for any difference. In this way, any over or under recovery of revenue in relation to standard control services in any regulatory year will be either deducted from, or added to, TasNetworks' total revenue allowance in future regulatory years, and passed through to customers.

TasNetworks' annual revenue allowances also will be adjusted for the outcomes of the Service Target Performance Incentive Scheme (**STPIS**) and Customer Service Incentive Scheme (**CSIS**). The annual revenue allowance applying to TasNetworks' standard control services may also sometimes incorporate cost adjustments in recognition of the occurrence of 'pass through events' that are beyond our control, such as changes in regulated service standards, that result in a material increase or decrease in TasNetworks' costs.

For standard control services, NER section 6.2.6(a) requires that the control mechanism must be of the prospective CPI minus X form, or some incentive-based variant of the prospective CPI minus X form.

The following formulae is the proposed control mechanism for TasNetworks' standard control services in the 2024-2029 regulatory control period.

Formula 1 - Revenue cap formula[5]

1	$TAR_t \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{ij} q_t^{ij}$	$i = 1, \ldots, n \text{ and } j = 1, \ldots, m \text{ and } t = 1,2,3,4,5$
2	$TAR_t = AAR_t + I_t + B_t + C_t$	$t = 1,2,3,4,5$
3	$AAR_t = AR_t$	$t = 1$
4	$AAR_t = AAR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t)$	$t = 2,3,4,5$

Where:

t	is the regulatory year with *t = 1* being the 2024-2025 financial year.
TAR_t	is the total allowable revenue in year *t*.
p_t^{ij}	is the price of component '*j*' of tariff '*i*' for year *t*.
q_t^{ij}	is the forecast quantity of component '*j*' of tariff '*i*' for year *t*.
AR_t	is the annual smoothed revenue requirement in the Post Tax Revenue Model (**PTRM**) for year *t*.
AAR_t	is the adjusted annual smoothed revenue requirement for year *t*.
I_t	is the sum of incentive scheme adjustments for year *t*. To be decided in the distribution determination.
B_t	is the sum of annual adjustment factors to balance the unders and overs account for year *t*. To be decided in the distribution determination.
C_t	is the sum of approved cost pass-through amounts (positive or negative) for year *t*, as determined by the AER. It will also include any annual or end-of-period adjustments for year *t*. To be decided in the distribution determination.
ΔCPI_t	is the annual percentage change in the Australian Bureau of Statistics (**ABS**) Consumer Price Index (**CPI**) All Groups, Weighted Average of Eight Capital Cities[6] from December in year *t – 2* to December in year *t – 1*, calculated using the following method: The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1 divided by The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2 minus one. For example, for the 2024-2025 year, t-2 is December 2022 and t-1 is December 2023.
X_t	is the X-factor in year , incorporating annual adjustments to the PTRM for the trailing cost of debt where necessary. To be decided in the distribution determination.

5 All parameters are in nominal terms unless otherwise specified

6 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index

The B-factor (B_t) will include a true-up for:

- The net present value of under or over recovered revenue and will be calculated based upon the Distribution Use of System (**DUoS**) unders and overs account as specified in the AER's Annual Pricing Model which is issued to TasNetworks annually. This true-up will be calculated based upon the DUoS unders and overs account (Formula 2).
- The Electrical Safety Inspection Charge (Formula 3).
- The National Energy Market charge (Formula 4).

Under a revenue cap, TasNetworks' revenue in year t will be adjusted annually to true-up any under or over recovery of actual revenue collected through DUoS charges in year t-2 and any estimated under or over recovery of revenues in year t-1. In regulatory year 1, TasNetworks will base the level of this adjustment on the opening balance of the DUoS unders and overs account.

The true-up for any under or over recovery of actual revenue collected through DUoS charges are calculated using the following method.

Formula 2 – DUoS unders and overs true-up

$$DUoS\ unders\ and\ overs\ true-up_t = -(Opening\ balance_t)(1+WACC_t)^{0.5}$$

Where:

$DUoS\ unders\ and\ overs\ true-up_t$	Is the true-up for the balance of the DUoS unders and overs account in year t.
$Opening\ balance_t$	Is the opening balance of the DUoS unders and overs account in year t.
$WACC_t$	Is the approved weighted average cost of capital use in regulatory year t in the DUoS unders and overs account.

Formula 3 – True-up for the Electrical Safety Inspection Service charge

TasNetworks will continue to apply the true-up for the Electrical Safety Inspection Service Charge (**ESISC**). The formula for the ESIS charge is:

$$ESISC = (ESISCa_{t-1} - ESISCe_{t-1}) \times (1 + Nominal\ vanilla\ WACC)$$

Where:

$ESISCa_{t-1}$	Is the actual ESISC for year $t-1$.
$ESISCe_{t-1}$	Is the estimated ESISC for year $t-1$ as per the amount to be set in the final distribution determination.
$Nominal\ vanilla\ WACC$	is the approved nominal weighted average cost of capital (**WACC**) for the relevant regulatory year, calculated as follows: $Nominal\ vanilla\ WACC_t = ((1 + real\ vanilla\ WACC_t)\ x\ (1 + \Delta CPI_t)) - 1$ Where the $real\ vanilla\ WACC_t$ is as set out in our final decision PTRM and updated annually.
ΔCPI_t	Is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[7] from the December quarter in year $t-2$ to the December quarter in year $t-1$, calculated using the following method: The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t – 1 divided by The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t – 2 Minus one For example, for the 2024-2025 year, t-2 is December 2022 and t-1 is December 2023

7 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index

Formula 4 – True-up for the National Electricity Market charge

TasNetworks will continue to apply the true-up for the National Electricity Market Charge (**NEMC**). The formula for the NEMC is:

$$NEMC_t = (NEMCa_{t-1} - NEMCe_{t-1}) \times (1 + Nominal\ vanilla\ WACC_t)$$

Where:

$NEMCa_{t-1}$	Is the actual NEMC for year .
$NEMCe_{t-1}$	Is the estimated NEMC for year as per the amount to be set in the final distribution determination.
$Nominal\ vanilla\ WACC_t$	is the approved nominal weighted average cost of capital (WACC) for the relevant regulatory year, calculated as follows: $Nominal\ vanilla\ WACC_t = ((1 + real\ vanilla\ WACC_t)\ x\ (1 + \Delta CPI_t)) - 1$ Where the $real\ vanilla\ WACC_t$ is as set out in our final decision PTRM and updated annually.
ΔCPI_t	Is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[8] from the December quarter in year to the December quarter in year, calculated using the following method: The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year $t - 1$ divided by The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year $t - 2$ Minus one For example, for the 2024-2025 year, t-2 is December 2022 and t-1 is December 2023.

16.2.2 Side constraints[9]

The below formula sets out the side constraints formula. For each regulatory year after the first year of a regulatory control period, side constraints apply to the weighted average revenue raised from each tariff class. In accordance with the NER, the permissible percentage increase is the greater of CPI-X plus 2 per cent or CPI plus 2 percent.[10] Recovery of certain revenues, such as those to accommodate pass throughs, is disregarded in deciding whether the permissible percentage has been exceeded.[11]

8 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index

9 All parameters are in nominal terms unless otherwise specified

10 NER, clause 6.18.6(c)

11 NER, clause 6.18.6(d)

Formula 5 – Side constraint formula

1. $$PP_t \geq \frac{SCR_t}{SCR_{t-1}}$$

2. $$PP_t = \left((1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) - 1 \right) \times D_t + AA_t + Q_t + 1$$

3. $$SCR_t = \sum_{i=1}^{m} \sum_{j=1}^{n} p_t^{ij} q_t^{ij}$$

4. $$SCR_{t-1} = \sum_{i=1}^{m} \sum_{j=1}^{n} p_{t-1}^{ij} q_t^{ij}$$

5. $$D_t = \frac{AAR_{t-1}}{SCR_{t-1}}$$

6. $$AA_t = \frac{(I_t + C_t + B_t) - (I_{t-1} + C_{t-1} + B_{t-1})}{SCR_{t-1}}$$

7. $$Q_t = \left(\frac{TAR_{t-1}}{SCR_{t-1}} - 1 \right)$$

Where each tariff class has "n" tariffs, with each up to "m" components, and where:

PP_t	Is the permissible percentage for year *t*, calculated as per formula 2 above.
SCR_t	Is the side constraint revenue for year *t*, calculated as the sum of the products of proposed prices and forecast quantities for year *t*, calculated as per formula 3 above.
SCR_{t-1}	Is the side constraint revenue for year *t – 1*, calculated as the sum of the products of prices charged for year and forecast quantities for year *t – 1*, calculated as per formula 4 above.
ΔCPI_t	Is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[12] from the December quarter in year to the December quarter in year *t – 2* , calculated using the following method: The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t – 1 divided by The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t – 2 Minus one For example, for the 2024-2025 year, t-2 is December 2022 and t-1 is December 2023
X_t	Is the *X* factor for each year of the regulatory control period as determined in the post-tax revenue model, and annually revised for the return of debt update. If $X > 0$, then *X* will be set equal to zero for the purposes of the side constraint formula.
2%	Is the additional threshold defined in the NER.
D_t	Is the adjustment made to the base threshold to create a common base, calculated as per formula 5 above.
AA_t	Is the annual percentage change in the sum of all annual adjustment factors (*I*, *C*, and *B* factors). This is calculated by dividing the total incremental revenues (the difference between the factors used in the total annual revenue formula for the regulatory year and) by the expected revenues for the year *t – 1* (SCR_{t-1}). This calculation is provided at formula 6 above.
Q_t	Is the adjustment made each year to account for changes in quantities from the preceding year. The factor calculation is provided at formula 7 above.

12 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index

p_t^{ij}	Is the proposed price for component 'j' of tariff 't' for year t.
q_t^{ij}	Is the forecast quantity for component 'j' of tariff 't' for year t.
$p^i t\text{-}1^j$	Is the price charged for component 'j' of tariff 't' for year $t-1$.
AAR_{t-1}	Is the adjusted annual revenue requirement for year $t-1$, as used in the revenue cap price control formulae in the preceding and current years.
I_{t-1}	Is the sum of incentive scheme adjustments in year t .
C_{t-1}	Is the sum of approved cost pass through amounts (positive or negative) in year t, as determined by the AER. It will also include any end-of-period adjustments to be made in year t.
B_{t-1}	Is the sum of annual adjustment factors for year t. It includes adjustments to balance the unders/overs account, relating to previous under/over-recoveries of revenue.
I_{t-1}	Is the sum of incentive scheme adjustments in year t-1. This is as per the approved $t-1$ pricing proposal.
C_{t-1}	Is the sum of approved cost pass through amounts (positive or negative) in year $t-1$, as determined by the AER. This is as per the approved $t-1$ pricing proposal.
B_{t-1}	Is the sum of annual adjustment factors for year t. It includes adjustments to balance the unders/overs account, relating to previous under/over-recoveries of revenue. This is as per the approved $t-1$ pricing proposal. For the avoidance of doubt, the B factor for $t-1$ should be equal to that used to calculate $t-1$ revenue in the previous pricing proposal and should not be updated for movements in the unders/overs accounts in the year $t-1$ pricing proposal.
TAR_{t-1}	Is the total allowable revenue for year $t-1$, calculated using the revenue cap control formula in the preceding year.
t	Is the forecast regulatory year.

16.3 Alternative control services

In its Framework and Approach Paper, the AER decided to apply a cap on the prices of individual services as the form of control mechanism for TasNetworks' alternative control services, which maintains the pricing approach applying to the current regulatory control period. TasNetworks accepts the AER's decision, as well as the formulas set out in the Framework and Approach paper that give effect to price caps for:

- type 5 and 6 metering services (legacy meters)
- public lighting services
- fee based ancillary services
- quoted ancillary services

Prices for quoted ancillary services will vary based on quantities of labour and the materials involved with provision of the relevant service. Therefore, our proposed price cap formula for quoted services differs to that proposed to apply to metering, public lighting and fee-based services. This is consistent with the approach TasNetworks has adopted in the current regulatory control period.

Following are TasNetworks' proposed control mechanisms for alternative control services in the 2024—2029 regulatory control period.

16.3.1 Price cap formula for legacy metering, public lighting and fee based ancillary services

$$\bar{p}_t^i \geq p_t^i \qquad i = 1,\ldots, n \text{ and } t = 1, 2, 3, 4, 5$$

$$\bar{p}_t^i = \bar{p}_{t-1}^i \times (1 + \Delta CPI_t) \times (1 - X_t^i) + A_t^i \qquad i = 1,\ldots, n \text{ and } t = 1, 2, 3, 4, 5$$

Where:

$\bar{p}_t^i$	is the cap on the price of service 'i' in year t.
p_t^i	is the price of service 'i' in year t. The initial value is to be decided in the distribution determination.
$\bar{p}_{t-1}^i$	is the cap on the price of service 'i' in year t–1.
t	is the regulatory year, with t = 1 being the 2024–2025 financial year.
ΔCPI_t	is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[13] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method: The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1 divided by The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2 minus one. For example, for the 2024–2025 year, t–2 is December 2022 and t–1 is December 2023.
X_t^i	is the X factor for service 'i' in year t. The X factors are to be decided in the distribution determination and will be based on the approach the distributor undertakes to develop its initial prices.
A_t^i	is the sum of any adjustments for service 'i' in year t. Likely to include, but not limited to adjustments for any approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

13 If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index

16.3.2 Price cap formula to apply to TasNetworks' quoted services

TasNetworks is required to provide itemised quotes to customers prior to them consenting to the provision of a quoted ancillary service.

$$Price = Labour + Contractor\ Services + Materials + Margin + Tax$$

Where:

Labour	consists of all labour costs directly incurred in the provision of the service, which may include labour on-costs, fleet on-costs and overheads. Labour is escalated annually by $(1 + \Delta CPI_t)\,(1 - X_t^i)$
ΔCPI_t	is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities[14] from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method: The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1 divided by The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2 minus one. For example, for the 2024–2025 year, t–2 is December 2022 and t–1 is December 2023.
X_t^i	is the X factor for service i in year t. The X factor is to be decided in the distribution determination and will be based on the approach the distributor undertakes to develop its initial prices.
Contractor services	reflects all costs associated with the use of external labour including overheads and any direct costs incurred. The contracted services charge applies the rates under existing contractual arrangements. Direct costs incurred are passed on to the customer.
Materials	reflects the cost of materials directly incurred in the provision of the service, material storage and logistics on-costs and overheads.
Margin	a regulated profit margin set by the AER and added to quoted service pricing to ensure that the prices paid by customers are reasonable and efficient, but not anti-competitive. A margin of 5.93 per cent – the average Weighted Average Cost of Capital forecast to apply to TasNetworks over the 2024–2029 regulatory control period – will be applied to the sum of Labour, Contractor Services and Materials costs, before the application of tax.
Tax	Tax is an amount, if any, equal to the tax costs in present value terms arising from the provision of the service to a customer, netting off the net present value of the reverse cash flow resulting from any income tax deduction (including depreciation) of the capital contribution.

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