

Draft Decision

TasNetworks

Electricity Distribution

Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 8

Efficiency benefit sharing scheme

September 2023

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AER reference: AER212491

Amendment record

Version	Date	Pages
1	28 September 2023	8

Contents

8	Efficiency benefit sharing scheme	1
8.1	Draft decision.....	1
8.2	TasNetworks' proposal	2
8.3	AER's assessment approach	3
8.4	Reasons for draft decision	5
	Shortened forms	8

8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in operating expenditure (opex), and provide for a fair sharing of the benefits of these efficiencies between network service providers and users. Consumers benefit from improved efficiencies through lower regulated prices.

This attachment sets out our decision and reasons on the EBSS carryover calculations TasNetworks has accrued over the 2019–24 regulatory control period and how we will apply the EBSS to TasNetworks in the 2024–29 regulatory control period.

8.1 Draft decision

Our draft decision is to approve EBSS carryover amounts totalling –\$9.3 million (\$2023–24) from the application of the EBSS in the 2019–24 regulatory control period.¹ This is \$6.1 million (\$2023–24) lower than TasNetworks' proposal of –\$3.1 million (\$2023–24).² This difference reflects two adjustments we have made to correctly apply the scheme. In particular, in our draft decision we have:

- corrected the movement in opex provisions over the period 2019–20 to 2021–22
- updated actual and forecast inflation for 2022–23 and 2023–24 respectively.³

These corrections are further discussed in section 8.4.

We set out our draft decision on the EBSS carryover amounts TasNetworks accrued during the 2019–24 regulatory control period in Table 8.1, along with TasNetworks' proposal and the difference.

Table 8.1 Draft decision on carry over amounts (\$million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
TasNetworks proposal	–3.7	–3.2	3.8	–	–0.0	–3.1
AER draft decision	–5.2	–5.0	2.4	–	–1.5	–9.3
Difference	–1.5	–1.8	–1.4	–	–1.4	–6.1

Source: TasNetworks, *2024–2029 Post tax revenue model (PTRM) – Standard control*, December 2022; AER, *TasNetworks 2019–24 – Draft decision – PTRM*, September 2018; AER analysis.

Note: Numbers may not add up to total due to rounding. '–' represents zero.

¹ Increments or decrements in revenue from the application of any EBSS constitutes one of the building blocks that must be used to determine a distributor's annual revenue requirement: NER, cl. 6.4.3(a)(5).

² TasNetworks, *Combined proposal 2024–2029 Attachment 10 – EBSS*, January 2023.

³ The sources for our inflation forecasts are: Australian Bureau of Statistics (ABS), *Consumer Price Index, Australia*, released on 26 July 2023 (accessed on 27 July 2023: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/jun-quarter-2023>); Reserve Bank of Australia (RBA), *Statement on monetary policy, August 2023*, (accessed on 4 August 2023: <https://www.rba.gov.au/publications/smp/2023/aug/forecasts.html>).

Our draft decision is that we will continue to apply version 2 of the EBSS to TasNetworks in the 2024–29 regulatory control period.⁴

We will exclude the following cost categories from the scheme:

- debt raising costs
- Guaranteed Service Level (GSL) payments
- Electrical Safety Inspection (ESI) levy payments

We will also make other adjustments as permitted by the EBSS, such as removing demand management innovation allowance costs, and movements in provisions (as outlined in section 8.4).

National Energy Market (NEM) levy payments are payments TasNetworks makes to the Tasmanian state government. The NEM levy payments will not be excluded from the EBSS for the 2024–29 regulatory control period. This is different to the treatment in the current regulatory control period, where NEM levy costs were excluded from the EBSS models as they were included as category specific forecasts.⁵ This is because in the 2024–29 regulatory control period we have included NEM levy costs in the base year in our alternative opex assessment (see Attachment 6), on a revealed costs basis. As they are not being treated as a category specific forecast, there is no reason for them to be excluded from the EBSS. TasNetworks agreed to the inclusion of these costs in the base year through the information request process.⁶

We discuss the reasons for our decision on applying the EBSS in the 2024–29 regulatory control period in section 8.4.

8.2 TasNetworks' proposal

8.2.1 Carryover amounts accrued during the 2019–24 regulatory control period

TasNetworks proposed we include EBSS carryover amounts totalling –\$3.1 million (\$2024–29) in its revenue for the 2024–29 regulatory control period from the application of the EBSS in the 2019–24 regulatory control period.⁷

TasNetworks excluded the following cost categories in calculating its EBSS carryover amounts:

- debt raising costs

⁴ NER, cl. 6.12.1(9); AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

⁵ AER, *TasNetworks 2019–24 – Distribution – Draft decision – Attachment 8 Efficiency benefit sharing scheme*. September 2018. p. 8.

⁶ TasNetworks, *Response to information request #036, Opex, base, trend, category specific forecast and EBSS*, received 26 June 2023; TasNetworks, *AER information request meeting – TasNetworks response*, received 13 July 2023, pp. 4–5.

⁷ TasNetworks, *2024–2029 Distribution – Workbook 3 EBSS*, December 2022.

- GSL payments
- ESI levy payments
- NEM levy payments.

TasNetworks also adjusted its actual opex to reverse any movement in provisions for 2017–18 and 2018–19 for the purpose of calculating the EBSS. It did not make any adjustments to reverse movements in provisions for 2019–20, 2020–21 or 2021–22.⁸

8.2.2 Application in the 2024–29 regulatory control period

TasNetworks proposed we apply version 2 of the EBSS in the 2024–29 regulatory control period.⁹ It proposed we exclude the following cost categories from the scheme;

- debt raising costs
- GSL payments
- ESI levy payments
- NEM levy payments

TasNetworks also proposed we remove movements in provisions from forecast and actual opex.

8.2.3 Stakeholder submissions

We did not receive any submissions regarding TasNetworks' distribution EBSS proposal.

8.3 AER's assessment approach

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

- the revenue increments or decrements for each year of the 2024–29 regulatory control period arising from the application of the EBSS during the 2019–24 regulatory control periods.¹⁰
- how the EBSS will apply to TasNetworks in the 2024–29 regulatory control period.¹¹

The EBSS must provide for a fair sharing between service providers and network users of opex efficiency gains and efficiency losses.¹² We must also have regard to the following matters when implementing the EBSS:¹³

- the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme

⁸ TasNetworks, *Combined proposal 2024–2029 Attachment 10 – EBSS*, January 2023, p. 2.

⁹ TasNetworks, *Combined proposal 2024–2029 Attachment 10 – EBSS*, January 2023, p. 2.

¹⁰ These increments or decrements are one of the building blocks that must be used to determine the annual revenue requirement: NER, cl. 6.4.3(a)(5).

¹¹ NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

¹² NER, cl. 6.5.8(a).

¹³ NER, cl. 6.5.8(c).

- the need to provide TasNetworks with a continuous incentive to reduce opex
- the desirability of both rewarding the service providers for efficiency gains and penalising them for efficiency losses
- any incentives that service providers may have to capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non–network alternatives.

8.3.1 Interrelationships

The EBSS is closely linked to our opex revealed cost forecasting approach. When we assess or develop our opex forecast, the NER require us to have regard to whether the opex forecast is consistent with any incentive schemes.¹⁴

Our opex forecasting method typically relies on using the ‘revealed costs’ of the service provider in a chosen base year to develop a total opex forecast if the chosen base year opex is not considered to be 'materially inefficient'. Under this approach, a service provider would have an incentive to spend more opex in the expected base year. Also, a service provider has less incentive to reduce opex towards the end of the regulatory control period, where the benefit of any efficiency gains is retained for less time.

The application of the EBSS serves two important functions:

1. It removes the incentive for a service provider to inflate opex in the expected base year in order to gain a higher opex forecast for the next regulatory control period
2. It provides a continuous incentive for a service provider to pursue efficiency improvements across the regulatory control period.

The EBSS does this by allowing a service provider to retain efficiency gains (or losses) for a total of six years, regardless of the year in which the service provider makes them. Where we do not propose to rely on the single year revealed costs of a service provider in forecasting opex, this has consequences for the service provider's incentives and our decision on how we apply the EBSS.

When a business makes an incremental efficiency gain, it receives a reward through the EBSS, and consumers benefit through a lower revealed cost forecast for the subsequent regulatory control period. This is how efficiency improvements are shared between consumers and the business. If we subject costs to the EBSS that are not forecast using a revealed cost approach, a business would in theory receive a reward for efficiency gains through the EBSS (at a cost to consumers), but consumers would not benefit through a lower revealed cost forecast in the subsequent period. Therefore, we typically exclude costs that we do not forecast using a single year revealed cost forecasting approach.

For these reasons, our decision on how we will apply the EBSS to TasNetworks has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to the effect of our EBSS decision when making our opex decision, and our EBSS decision is

¹⁴ NER, cl. 6.5.6(e)(8). Further, we must specify and have regard to the relationship between the constituent components of our overall decision: NEL, s 16(1)(c).

made largely in consequence of (and takes careful account of) our past and current decisions on TasNetworks' opex.

8.4 Reasons for draft decision

This section provides the reasons for the carryover amounts that arise from applying the EBSS during the 2019–24 regulatory control period, and how we will apply the EBSS in the 2024–29 regulatory control period.

8.4.1 Carryover amounts from the 2019–24 regulatory control period

Our draft decision is to include EBSS carryover amounts totalling a \$9.3 million (\$2023–24) penalty from the application of the EBSS in the 2019–24 regulatory control period. This is \$6.1 million (\$2023–24) larger than the \$3.1 million (\$2023–24) penalty TasNetworks proposed. This difference reflects two adjustments we made to correctly apply the scheme, with the key differences to TasNetworks' proposal and our decision summarised in section 8.1, and discussed in more detail below.

We consider that the EBSS carryover amounts we have calculated provide for a fair sharing of efficiency gains and losses between TasNetworks and its network users. Over the 2019–24 regulatory control period it both rewards TasNetworks for any efficiency gains it has made and penalises it for any efficiency losses. Further, we consider that the benefit to networks users, through lower forecast opex, is sufficient to warrant the EBSS carryover amounts we have determined.

In our final decision, we will update our EBSS carryover calculations to reflect actual opex for 2022–23. Our draft decision is based on an estimate because actual data for 2022–23 is not yet available. We will also update inflation.

8.4.1.1 Movements in provisions

In our draft decision we have adjusted for movements in provisions for the period from 2019–20 to 2021–22 as TasNetworks did not include these adjustments in calculating its proposed EBSS carryovers.¹⁵ However, TasNetworks subsequently agreed through the information request process to the adjustment of actual opex to take account of the movement in provisions, in line with our standard approach.¹⁶ The movement in provisions values we have used reflect those included in TasNetworks 2019–20, 2020–21 and 2021–22 Economic Benchmarking Regulatory Information Notices.¹⁷ This resulted in a decrease in EBSS carryover amounts of \$6.1 million (\$2023–24) compared to TasNetworks proposal.

¹⁵ TasNetworks, *2024–2029 Distribution – Workbook 3 EBSS*. December 2022; TasNetworks, *Response to information request #036 – Opex, base, trend, category specific forecasts and EBSS*, received 9 June 2023.

¹⁶ TasNetworks, *Response to information request #036 – Opex, base, trend, category specific forecasts and EBSS*, received 9 June 2023

¹⁷ TasNetworks, *Distribution economic benchmarking – regulatory information notice response (EB RIN) 2019–20 to 2021–22*; AER analysis

8.4.1.2 Inflation

Consistent with our standard approach and opex forecast, we used unlagged inflation to convert opex amounts to 2023–24 real terms. This approach is also consistent with the approach TasNetworks adopted in its proposal.¹⁸

In our draft decision we have used updated consumer price index (CPI) values compared to those TasNetworks used in its proposal. For 2022–23, we used the actual headline June quarter 2023 CPI figure published by the Australian Bureau of Statistics, which was released after TasNetworks submitted its proposal.¹⁹ For 2023–24, we used the inflation forecast for the year to June 2024 in the Reserve Bank of Australia's August 2023 Statement on monetary policy,²⁰ which was also published after TasNetworks submitted its proposal.

8.4.2 Application in the 2024–29 regulatory control period

Our draft decision is to continue to apply version 2 of the EBSS to TasNetworks during the 2024–29 regulatory control period. We consider applying the scheme would result in benefits for electricity customers and it will provide continuous incentives for TasNetworks to reduce opex. Provided we forecast TasNetworks' future opex using its revealed costs in the 2024–29 regulatory control period, any efficiency gains that TasNetworks achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.²¹ We provide details on these below.

8.4.2.1 Adjustments to forecast or actual opex when calculating carryover amounts

The EBSS allows us to exclude categories of costs that we do not forecast using a single year revealed cost forecasting approach. We do this to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through the EBSS and network users receive a benefit through lower forecast opex in the next regulatory control period. This is the way network users and the service provider share in the benefits of an efficiency improvement.

If we do not use a single year revealed cost forecasting approach, we may not pass the revealed efficiency gains through to network users. It follows that network users should not pay for EBSS benefits where they do not receive the benefits of a lower opex forecast.

For the 2024–29 regulatory control period, we will exclude the following cost categories from the EBSS:²²

¹⁸ TasNetworks, *2024–2029 Operating Expenditure Model – Standard Control*, December 2022.

¹⁹ Australian Bureau of Statistics (ABS), *Consumer Price Index, Australia*, released on 26 July 2023 (accessed on 27 July 2023: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/jun-quarter-2023>).

²⁰ Reserve Bank of Australia (RBA), *Statement on monetary policy*, August 2023, (accessed on 4 August 2023: <https://www.rba.gov.au/publications/smp/2023/aug/forecasts.html>).

²¹ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

²² TasNetworks, *Combined proposal 2024–2029 Attachment 10 – EBSS*, January 2023, pp. 2–4.

- debt raising costs
- ESI levy payments
- GSL payments

We agree with TasNetworks' proposal to exclude the above costs from the EBSS because we have not forecast these costs using a single year revealed cost approach.

We will not exclude NEM payments from the EBSS as TasNetworks proposed.²³ As outlined in Attachment 6, for the 2024–29 regulatory control period, we have used revealed costs to forecast NEM levy payments rather than using a category specific forecast.²⁴ TasNetworks agreed to the inclusion of the NEM levy payments in its forecast as part of the base year expenditure rather than as a category specific forecast.²⁵ As a result, it follows that for the 2024–29 regulatory control period the NEM levy payments will be subject to the EBSS.

In addition to the excluded cost categories discussed above, and consistent with version 2 of the EBSS, we will also make the following adjustments when we calculate the EBSS carryover amounts accrued during the 2024–29 regulatory control period:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass through amounts or opex for contingent projects.
- adjust actual opex to remove any demand management innovation allowance opex because it is not included in the opex forecast (but is often reported by service providers as part of their standard control services opex).²⁶
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base.²⁷
- adjust forecast opex and actual opex for inflation.²⁸
- adjust actual opex to include any movements in provisions.
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning on 1 July 2029 where doing so better achieves the requirements of clause 6.5.8 of the NER.²⁹

²³ TasNetworks, *Response to follow up question to TasNetworks information request #036 – Category specific forecast (Question 15)*, received 26 June 2023.

²⁴ AER, *TasNetworks 2024–29 – Distribution – Draft decision – Attachment 6 Operating expenditure*, 27 September 2023, pp. 19–20.

²⁵ TasNetworks, *Response to information request #036 – Opex, base, trend, category specific forecasts and EBSS*, received 9 June 2023; TasNetworks, *AER information request meeting – TasNetworks response*, received 13 July 2023, pp. 4–5.

²⁶ Clause 6.5.8(c)(5) of the NER requires us to have regard to the possible effects of the scheme on incentives for the implementation of non-network options.

²⁷ Clause 6.5.8(c)(4) of the NER requires us to have regard to any incentives the service provider may have to capitalise expenditure.

²⁸ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

²⁹ AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 14.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
CPI	consumer price index
EBSS	efficiency benefit sharing scheme
ESI	Electrical Safety Inspection
GSL	Guaranteed Service Level
NEM	national electricity market
NER	national electricity rules
opex	operating expenditure
