Draft Decision

Power and Water Corporation Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 9
Capital expenditure sharing scheme

September 2023

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

AER reference: AER212492

Amendment record

Version	Date	Pages
1	28 September 2023	6

Contents

9 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers (NSP) whose capital expenditures (capex) becomes more efficient and financial penalties for those that become less efficient. Customers benefit from improved efficiency through lower regulated prices. This is the first time we have applied the CESS to PWC.

This attachment sets out our decision for both the determination of the revenue impacts as a result of the CESS applying in the 2019–24 regulatory control period, and the application of the CESS for PWC in the 2024–29 regulatory control period.

The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between service providers and consumers.

The CESS mechanism was recently updated in April 2023. The changes to the CESS only apply to its application in the 2024–29 period and onwards. In this attachment, our decision on the CESS revenue increments for the 2024–29 period uses the CESS mechanism before it was updated.[1]

For spending in the current period, the CESS applies as follows:

- we calculate the cumulative efficiency gains or losses for the current regulatory control period in net present value terms
- we apply the sharing ratio of 30% to the cumulative underspend or overspend to work out what the service provider's share of the underspend or overspend should be
- we calculate the CESS payments taking into account the financing benefit or cost to the service provider of the underspend or overspend.[2] We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the regulatory asset base (RAB)[3]
- the CESS payments will be added or subtracted to the service provider's regulated revenue as a separate building block in the next regulatory control period.

1 That is, for CESS revenue increments based on spending in the 2019–24 regulatory period, we follow this guideline: AER, *AER capital expenditure incentive guideline - November 2013*, November 2013. However, in applying the CESS in the 2024–29 period, we refer to this guideline: AER*, AER - Final decision - Capital expenditure incentive guideline - 28 April 2023*, April 2023.

2 We calculate benefits as the benefits to the service provider of financing the underspend since the amount of the underspend can be put to some other income generating use during the period. Losses are similarly calculated as the financing cost to the service provider of the overspend.

3 AER, *AER - Final decision - Capital expenditure incentive guideline - 28 April 2023*, April 2023, pp. 7–9.

9.1 Draft decision

9.1.1 Revenue impacts in the 2024–29 period

Our draft decision is to apply a CESS revenue decrement amount of $2.81 million ($2023–24) to be paid across the 2024–29 regulatory control period.[4] This is from the application of the CESS in the 2019–24 regulatory control period. This is $0.12 more than PWC's forecast of $2.69 million.

The CESS decrement arises as a result of overspend in capex against the forecast for the 2019–24 period. Our draft decision on the revenue impact of the application of the CESS in the 2019–24 period is summarised in **Error! Reference source not found.**.

Table 9.1 CESS revenue decrements from 2024–29 ($ million, 2023–24)

	2024-25	2025-26	2026-27	2027-28	2028-29	Total
AER draft decision	-0.56	-0.56	-0.56	-0.56	-0.56	-2.81

Source: AER analysis. PWC, *Revenue Proposal 2024–28, Attachment 10.07 - 2024-29 SCS CESS Model*, 31 January 2023.
Note: Numbers may not sum due to rounding.

Given the timing of this draft decision, we calculated the CESS revenue decrements in Table 9.1 using estimates of PWC's capex for 2022–23 and 2023–24 regulatory years. The CESS revenue decrement we calculated ($2.81 million) is different to the revenue decrement that PWC proposed ($2.69 million) because we applied updated modelling inputs, including inflation and the rate of return.

9.1.2 Application of the CESS in the 2024–29 period

We will apply the CESS as set out in the updated capital expenditure incentives guideline.[5] The reasons for adopting this updated CESS are set out in our final decision for the review of incentive schemes for networks, and the final decision for capital expenditure incentive guideline.[6] This is consistent with the proposed approach we set out in our framework and approach paper.[7]

---

4 NER, cl. 6.12.1(9).

5 AER, *AER - Final decision - Capital expenditure incentive guideline*, April 2023, pp. 3–9.

6 AER, *AER - Final decision - Review of incentive schemes for networks*, April 2023, pp. 14-22; AER, *AER - Final decision - Capital expenditure incentive guideline*, April 2023.

7 AER, *AER - Final framework and approach for PWC for the 2024-29 regulatory control period - July 2022, 29 July 2023*, pp. 41–42.

9.2 Power and Water Corporation’s proposal

9.2.1 CESS revenue increments from the 2019–24 regulatory control period

PWC proposed a $2.69 million ($2023–24) CESS revenue decrement to its regulated revenue in the 2024–29 regulatory control period.[8] This reflects an overspend of $7.07 million.

9.2.2 Application of CESS in the 2024–29 regulatory control period

PWC proposed to apply the CESS in the 2024–29 regulatory period.[9]

9.3 Assessment approach

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

- the revenue impacts on PWC arising from applying the CESS in the 2019–24 regulatory control period[10]
- whether or not to apply the CESS to PWC in the 2024–29 regulatory control period and how any applicable scheme will apply.[11]

We must determine the appropriate revenue increments or decrements (if any) for each year of the 2024–29 regulatory control period arising from the application of the CESS during the 2019–24 regulatory control period.[12]

In deciding whether to apply a CESS to PWC for the 2024–29 period, and the nature and details of the scheme, we must:[13]

- make that decision in a manner that contributes to the capex incentive objective[14]
- take into account the CESS principles,[15] the capex objectives and, where relevant, the operating expenditure (opex) objectives,[16] the interaction with other incentive schemes,[17] and the circumstances of the service provider.[18]

---

8 PWC*, Revenue Proposal 2024–28, Capital Expenditure Sharing Scheme Model*, 31 January 2023.

9 PWC*, Revenue Proposal 2024–28, Incentive Schemes Attachment 12.01*, 31 January 2023, p. 6.

10 NER, cl. 6.4.3(a)(5).

11 NER, cl. 6.12.1(9).

12 Increments or decrements arising from the application of applicable incentive mechanisms, including any capital expenditure sharing scheme, form one of the building blocks that must be used to determine the annual building block revenue requirement for distribution network service providers for each regulatory year of a regulatory control period: NER, cl. 6.4.3(a)(5).

13 NER cl. 6.5.8A(e).

14 NER, cl. 6.5.8A(e)(3); the capex incentive objective is set out in cl. 6.4(a).

15 NER, cl. 6.5.8A(e)(4)(i); the CESS principles are set out in cl.6.5.8A(c).

16 NER, cll. 6.5.8A(e)(4)(i) and 6.5.8A(d)(2); the capex objectives are set out in cl. 6.5.7(a); the opex objectives are set out in cl. 6.5.6(a).

17 NER, cl.6.5.8A(d)(1).

18 NER, cl. 6.5.8A(e)(4)(ii).

Broadly, the capex incentive objective is to ensure that only capex that meets the capex criteria enters the RAB used to set prices. Therefore, consumers only fund capex that is efficient and prudent.

9.3.1 Interrelationships

The approval of CESS revenue increment/decrement determines the associated CESS building block as part of PWC's overall forecast revenue requirement for the 2024–29 regulatory control period.

The CESS relates to other incentives PWC faces to incur efficient opex, conduct demand management, and maintain or improve service levels. Related schemes include the efficiency benefit sharing scheme (EBSS) for opex, the service target performance incentive scheme (STPIS) for service levels and demand management incentive allowance mechanism (DMIAM). We aim to incentivise network service providers to make efficient decisions on when and what type of expenditure to incur and to balance expenditure efficiencies with service quality.

9.4 Reasons for draft decision

Our draft decision is to include an overall CESS revenue decrement of $2.81 million ($2023–24). This is a $0.12 million increase from PWC's proposed CESS revenue decrement of $2.69 million ($2023–24). We set out our reasons in the sections below.

9.4.1 CESS revenue increments from the 2019–24 regulatory control period

We are broadly satisfied with PWC's calculation of CESS revenue decrements for capex in the 2019–24 period. The difference between its proposal and our draft decision reflects adjustments for modelling inputs such as CPI and the WACC to reflect more up-to-date information. We will also update these inputs, where relevant, in our final decision.

9.4.2 Application of CESS in the 2024–29 regulatory control period

9.4.2.1 Updates to the CESS Guideline in April 2023

After PWC submitted its proposal, the AER published its final decision on its review of incentive schemes for regulated networks in April 2023. This included an update to the workings of the CESS mechanism.[19]

The changes to the CESS mechanism will affect the application of the CESS to PWC starting in the 2024–29 period.

The new guideline contains the following main changes to the CESS mechanism:

- application of a lower sharing factor of 20% to any underspend amount greater than 10% of the approved forecast capital expenditure allowance

19 AER, *AER - Final decision - Capital expenditure incentive guideline - 28 April 2023*, 28 April 2023.

- new transparency measures which require NSPs to explain variations between capital expenditure forecasts and outcomes.[20]

More information on the application of the updated CESS is available in our April 2023 capital expenditure incentive guideline.

20 AER, *AER - Final decision - Capital expenditure incentive guideline - 28 April 2023*, 28 April 2023, p. 1.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
NEO	national electricity objective
NER	national electricity rules
opex	operating expenditure
RAB	regulatory asset base
STPIS	service target performance incentive scheme