electranet

27 June 2025

Mr Arek Gulbenkoglu
General Manager, Network Expenditure
Australian Energy Regulator
GPO Box 520, Melbourne, VIC, 3001
Email: AERenquiry@aer.gov.au

Dear Arek

Re: AER's Capital Expenditure Incentive Guideline Review – Draft decision

ElectraNet welcomes the opportunity to respond to the Australian Energy Regulator's (AER) draft decision on the Capital Expenditure Incentive Guideline (CEIG) Review.

ElectraNet is South Australia's principal electricity Transmission Network Service Provider (TNSP) and is a critical part of the electricity supply chain and is facilitating the transition to a clean energy future.

We have participated in the Energy Networks Australia (ENA) submission process and broadly support the content of the resulting submission. With that said, ElectraNet would like to expand on a few areas with some specific concerns and considerations for the AER to review.

Guiding principle: efficient capital expenditure should not be subject to penalties

Incentive based regulation is a core element of the regulatory regime and, in our view, delivers the best long term outcomes for consumers. It is therefore essential that all regulatory mechanisms operate in a coordinated and coherent manner. Where incentives are aligned and mutually reinforcing, they support efficient outcomes and timely investment. Conversely, where mechanisms conflict or overlap, they risk distorting investment signals, undermining confidence, and reducing the effectiveness of the overall regulatory framework.

Consistent with this, ElectraNet considers that a regulatory position that applies a Capital Expenditure Efficiency Sharing Scheme (CESS) penalty to investment after an ex post review has deemed that expenditure to be efficient would not offer consistent investment signals consistent with the long term interests of consumers.

This was echoed by the Australian Energy Market Commission (AEMC) in their rule change noting[1] *"…our final rule includes transitional rules to enable the AER to offset the effect of the CESS penalty based on conclusions from an ex post review. This ensures a TNSP is not penalised twice under the capex incentive framework or penalised inappropriately for efficient capex overspends."*

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[1] AEMC, Managing ISP project uncertainty through targeted ex post reviews – Final Determination, 1 August 2024, p.3-4.

We welcome the AER's recognition of this issue in its draft decision:[2] *"…it may be unreasonable to apply a CESS penalty where we have undertaken an extensive ex post review of an individual project and found that project to be efficient."* However, we remain concerned that the draft guideline grants the AER excessive discretion in both the application of the CESS and the conduct of ex post reviews. This discretion does not commit the AER to any action to ensure efficient expenditure is protected from penalties which leaves it open for a TNSP to be inappropriately penalised. It does not even give guidance as to when and how that discretion might be exercise.

This introduces unnecessary risk.

The ex post review and CESS are significant incentive arrangements

Any TNSP investment is made on the expectation of earning the regulated rate of return on that investment . TNSPs have limited appetite for the potential risk that a capital investment be deemed inefficient or imprudent during an ex post review and therefore be totally disallowed from the regulatory asset base (RAB) nor are they willing to take the risk of 30% of that investment being disallowed. In other words, the ex post review and the CESS are both significant factors in TNSP investment decisions.

Across the NEM there are significant cost pressures arising from unforeseen projects and unforeseeable pressure on input costs.

This combination of factors means that TNSPs are facing a period of significant capital constraints. We employ effective portfolio management, however, are now in a position where, due to factors beyond our control, the ex ante capital expenditure (capex) allowances are proving to be lower than necessary to meet the capex objectives in the National Electricity Rules (Rules).[3] We are then left with the choice between financial penalties or seeking to defer otherwise efficient investments to a later regulatory period.

Accordingly, efficient investments will be deferred until they can be approved as part of an ex ante forecast. These delays in efficient investment will cause consumers to bear risks and defer benefits where this is contrary to their interest, purely because of the mechanics of the regulatory process.

We consider that this outcome is reflective of a regulatory framework which is not incentivising behaviours which promote the National Electricity Objective (NEO). The limitations in scope, and the discretion allowed by the AER in the draft guideline, should be revised to ensure that the outcomes they deliver are in alignment with the intention of the NEO.

In particular, it seems inconsistent with the NEO to treat unforeseen projects differently to unforeseen increases in input costs.

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[2] AER, Capital Expenditure Incentive Guidelines Review - Explanatory Statement, 16 May 2025, p.21.
[3] Rules, Cl 6A.6.7(a).

Uncertainty arising from discretion in the guideline

The draft guideline offers limited transparency on what constitutes a significant overspend or the circumstances in which the AER will vary CESS outcomes. For example, it notes only that the AER[4] *"…may vary the application of the CESS for certain projects based on proposals submitted by TNSPs, in limited circumstances, at AER's discretion."* This lack of clarity introduces investment uncertainty and weakens the effectiveness of the incentive regime.

In practice, the interaction between the CESS and ex post review mechanisms, both of which are subject to broad AER discretion, means that TNSPs are exposed to two layers of risk:

1. That the entire overspend could be excluded from the RAB if deemed inefficient.
2. That, even if the expenditure is deemed efficient, the AER may not vary the application of the CESS and so apply financial penalties for no clear purpose.

This dual uncertainty creates an environment where TNSPs are more likely to adopt inefficiently risk averse investment behaviours. Where the pathway for regulatory treatment is unclear, TNSPs will understandably err on the side of caution, not on the basis of efficiency, but based on regulatory risk. This will lead TNSPs to defer or avoid projects that can be shown to be in the long-term interests of consumers, which is inherently contrary to the NEO.

To provide credible investment signals and support efficient capital decision-making, we consider that the final guideline must offer clearer and more consistent criteria for when and how CESS penalties may be adjusted following an ex post review. The framework should commit the AER to the principle that capex which is deemed efficient should not be subject to penalty through an incentive regime intended to encourage efficiency. The AER should make a firm policy commitment that it would not apply a CESS penalty to expenditure where a TNSP has demonstrated that expenditure was efficient through the ex post review process.

ElectraNet appreciates the AER's efforts to refine the capital expenditure incentive framework and acknowledges the complexity of balancing incentives with accountability. However, it is critical that the final guideline provides clear, consistent, and predictable treatment of efficient expenditure. This clarity is essential to ensure that TNSPs can continue to commit to efficient investment with confidence. We urge the AER to finalise the CEIG in a manner that eliminates ambiguity and avoids disincentivising prudent investment decisions.

If you would like to discuss this response, please contact me at
[redacted] or on [redacted]

[redacted]**on and Corporate Affairs**

[4] AER, Capital Expenditure Incentive Guidelines for Electricity Network Service Providers – Draft Guidelines for consultation, 16 May 2025, p.9.