



DRAFT DECISION
ElectraNet transmission
determination
2018 to 2023

Attachment 9 – Efficiency
benefit sharing scheme

October 2017

© Commonwealth of Australia 2017

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the:

Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 4141, Canberra ACT 2601

or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444

Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

Note

This attachment forms part of the AER's draft decision on ElectraNet's transmission determination for 2018–23. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Pricing methodology

Attachment 13 – Pass through events

Attachment 14 – Negotiated services

Contents

Note	9-2
Contents	9-3
Shortened forms	9-4
9 Efficiency benefit sharing scheme	9-6
9.1 Draft decision	9-6
9.2 ElectraNet’s proposal	9-8
9.2.1 Carryover amounts from the 2013–18 control period.....	9-8
9.2.2 Application in the 2018–23 control period.....	9-8
9.3 Assessment approach	9-8
9.3.1 Interrelationships.....	9-9
9.4 Reasons for draft decision	9-10
9.4.1 Carryover amounts from the 2013–18 control period.....	9-10
9.4.2 Application in the 2018–23 control period.....	9-11

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIA	demand management innovation allowance
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
NTSC	negotiated transmission service criteria
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice

Shortened form	Extended form
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

9 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) provides an additional incentive for service providers to pursue efficiency improvements in operating expenditure (opex).

To encourage a service provider to become more efficient, it is allowed to keep any difference between its approved total opex forecast and its actual opex in a regulatory control period. This is supplemented by the EBSS, which rewards efficiency gains and penalises efficiency losses by carrying them forward for a longer period of time. These rewards and penalties work together to provide a continuous incentive for a service provider to pursue efficiency gains over the regulatory control period. This continuous incentive also discourages a service provider from inflating its opex in the expected base year for the following regulatory control period in order to increase its forecast opex for that period.

Consumers benefit from any efficiency gains made by the service provider through lower forecast opex for the following regulatory control period, which is based on the lower revealed opex. This is how efficiency improvements are shared between consumers and the business.

During the 2013–18 regulatory control period, ElectraNet operated under version one of the electricity transmission network service providers' EBSS, released in September 2007.¹

9.1 Draft decision

Our draft decision is to approve EBSS carryover amounts totalling –\$2.2 million (\$2017–18) from the application of the EBSS in the 2013–18 regulatory control period. This is \$0.2 million lower than the –\$1.9 million (\$2017–18) ElectraNet proposed.² The primary reason for the difference is that we excluded defined benefit superannuation opex from reported opex. This is consistent with our final decision for the 2013–18 regulatory control period.³ ElectraNet only removed the movements in provisions for defined benefits superannuation.

We set out our draft decision on the EBSS carryover amounts ElectraNet accrued during the 2013–18 regulatory control period in Table 9.1.

¹ AER, *Electricity transmission network service providers—Efficiency benefit sharing scheme*, September 2007.

² ElectraNet, *Revenue proposal, Attachment 9 Efficiency Benefit Sharing Scheme*, 28 March 2017, Table 9.1, p. 7.

³ AER, *ElectraNet: Transmission determination: 2013–14 to 2017–18*, April 2013, p. 7.

Table 9.1 Draft decision on carryover amounts (\$ million, 2017–18)

	2018–19	2019–20	2020–21	2021–22	2022–23	Total
ElectraNet's proposal	-0.9	-1.2	-1.6	-	1.7	-1.9
AER draft decision	-1.4	-1.3	-1.6	-	2.0	-2.2

Source: ElectraNet, *Revenue proposal, PTRM*, March 2017; AER analysis.

We will apply version two of the EBSS to ElectraNet in the 2018–23 regulatory control period.⁴ When we apply the EBSS, we will exclude the following cost categories from the scheme:⁵

- debt raising costs
- network support costs
- network capability projects.

The opex forecasts we will use to calculate efficiency gains in the 2018–23 regulatory control period, subject to further adjustments permitted by the EBSS, are set out in Table 9.2.

Table 9.2 Forecast opex for the EBSS (\$ million, 2017–18)

	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23
Forecast total opex	92.98	97.99	98.37	86.79	87.21	88.06	88.83	89.26
Less debt raising costs	-1.35	-1.41	-1.42	-0.15	-0.15	-0.15	-0.15	-0.15
Less network support costs	-9.19	-9.48	-9.57	-9.02	-9.06	-9.12	-9.18	-9.25
Total opex for the EBSS target	82.44	87.10	87.37	77.62	78.00	78.79	79.50	79.86

Source: ElectraNet, *Revenue proposal*, March 2017; AER analysis.

Note: Numbers may not add up to total due to rounding. Forecast opex does not include the opex costs of network capability projects. These costs are funded through the network capability component of the transmission STPIS.

⁴ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

⁵ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, Section 1.4, pp. 9–10.

9.2 ElectraNet's proposal

9.2.1 Carryover amounts from the 2013–18 control period

ElectraNet proposed we deduct carryover amounts totalling –\$1.9 million (\$2017–18) from its revenue in the 2018–23 regulatory control period.⁶

9.2.2 Application in the 2018–23 control period

ElectraNet supported the application of version two of the EBSS in the 2018–23 regulatory control period.⁷ It proposed we exclude the following opex categories from the scheme on the basis that they are not forecast using a single year revealed cost approach:⁸

- debt raising costs
- network support costs
- insurance and self-insurance
- movements in provisions.

ElectraNet also proposed we adjust forecast opex to reflect any approved pass through amounts, consistent with version two of the EBSS.⁹

9.3 Assessment approach

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

1. the revenue increments or decrements for each year of the 2018–23 regulatory control period arising from the application of the EBSS during the 2013–18 regulatory control period¹⁰
2. how the EBSS will apply to ElectraNet in the 2018–23 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 provide the network service provider with continuous incentives to reduce opex

⁶ ElectraNet, *Revenue proposal, Attachment 9 Efficiency Benefit Sharing Scheme*, March 2017, Table 9.1, p. 7.

⁷ ElectraNet, *Revenue proposal, Attachment 9 Efficiency Benefit Sharing Scheme*, March 2017, p. 7.

⁸ ElectraNet, *Revenue proposal, Attachment 9 Efficiency Benefit Sharing Scheme*, March 2017, p. 7.

⁹ ElectraNet, *Revenue proposal, Attachment 9 Efficiency Benefit Sharing Scheme*, March 2017, p. 8.

¹⁰ NER, cl. 6A.5.4(a)(5).

¹¹ NER, cll. 6A.14.1(1)(iv), cl. 6A.14.3(d)(2).

¹² NER, cl. 6A.6.5(a).

¹³ NER, cl. 6A.6.5(b).

- 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 inappropriately capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

9.3.1 Interrelationships

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

Our opex forecasting method relies on using the ‘revealed costs’ of the service provider in a chosen base year to develop a total opex forecast. Under this approach, a service provider has 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 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 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 revealed cost forecasting approach.

¹⁴ NER, cl. 6A.6.6(e)(8).

9.4 Reasons for draft decision

9.4.1 Carryover amounts from the 2013–18 control period

Our draft decision is to approve EBSS carryover amounts totalling –\$2.2 million (\$2017–18) from the application of the EBSS during the 2013–18 regulatory control period. This is less than the –\$1.9 million (\$2017–18) ElectraNet proposed because ElectraNet did not exclude superannuation defined benefits from reported opex.¹⁵ We have also calculated movements in provisions differently to how ElectraNet did.

Movements in provisions

Typically, we remove the total movement in provisions from reported opex. We calculate movements in provisions by taking the difference between the amount set aside to provisions and expenditure incurred debited to provisions.

ElectraNet set aside provisions for:

- annual leave
- long service leave
- self-insurance
- defined benefits superannuation.

The total opex amounts ElectraNet reported in its regulatory accounts reflect the amounts set aside to these provisions rather than the expenditure incurred debited to provisions. We excluded two of these categories of opex from the operation of the EBSS in the current control period, namely defined benefit superannuation and self-insurance.¹⁶ Consequently we have removed the amounts set aside for defined benefit superannuation and self-insurance from reported opex (rather than the expenditure incurred debited to provisions).

Having removed the amounts set aside for defined benefit superannuation and self-insurance we did not need to remove the related movements in provisions for these provision accounts. For this reason we only removed movements in provisions for annual leave and long service leave.¹⁷

Defined benefits superannuation

In our previous determination, we stated that we would exclude defined benefits superannuation from forecast and actual opex for the 2013–18 regulatory control

¹⁵ ElectraNet, *Response to the AER information request IR#011 (2)*, 13 September 2017, pp. 6–7.

¹⁶ AER, *ElectraNet: Transmission determination: 2013–14 to 2017–18*, April 2013, p. 7.

¹⁷ We note that, alternatively, we could have removed the movements in provisions for all four provision accounts. In this case we would have removed the expenditure incurred debited to provisions for defined benefit superannuation and self-insurance to exclude these two categories from total opex. The net impact of this alternative approach is the same as the approach we have adopted.

period.¹⁸ This was because the contributions were not forecast using historical expenditure in an efficient base year.

ElectraNet, however, did not exclude defined benefit superannuation from the EBSS. It removed the amount set aside to provisions for defined benefit superannuation but added the expenditure incurred debited to provisions. In other words, it removed only the movement in provisions for defined benefits superannuation.¹⁹

We have excluded the total defined benefits superannuation expenditure included in reported opex, not just the movement in the provisions for this expenditure.

Updating actual opex for 2016–17

In our final decision, we will update our calculation of the carryover amounts using audited *actual* opex for 2016–17. We have based our draft decision on an estimate because audited actual data was not yet available for 2016–17. We will also update our estimate of inflation for 2017–18 to reflect the Reserve Bank of Australia's most recent forecast as published in its *Statement on monetary policy*.

9.4.2 Application in the 2018–23 control period

We will apply version two of the EBSS to ElectraNet during the 2018–23 regulatory control period. Version two of the EBSS specifies our approach to determining the length of the carryover period and adjusting forecast or actual opex when calculating carryover amounts. These are detailed below.

Length of carryover period

The length of the carryover period for the 2018–23 regulatory control period will be the same as the length of the regulatory control period commencing 1 July 2023. This aligns the EBSS carryover period with the total length of ElectraNet's regulatory control period and ensures continuous incentives.²⁰

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. This is designed to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through the EBSS and consumers receive a benefit through lower forecast opex in the next period. This is the way consumers and the service provider share in the benefits of an efficiency improvement.

¹⁸ AER, *ElectraNet: Transmission determination: 2013–14 to 2017–18*, April 2013, p. 7.

¹⁹ ElectraNet, *Response to the AER information request IR#011 (2)*, 13 September 2017, pp. 6–7.

²⁰ NER, cl. 6A.6.5(b)(1).

If we do not use a single year revealed cost forecasting approach, lower actual opex will not necessarily be passed through to consumers. Consumers should not pay for EBSS benefits where they do not receive the benefits of a lower opex forecast.

We will exclude the following categories of costs from the EBSS:

- debt raising costs
- network support costs²¹
- network capability projects.

We accept ElectraNet's proposal to exclude debt raising costs from the EBSS because we do not typically forecast them based on revealed expenditure in a single year. We forecast debt raising costs using a benchmark and not revealed expenditure.

We also forecast network support costs using a category specific forecast. This is because we are required under the NER to adjust a transmission network service provider's revenue when the actual amount of network support payments it incurs differs to the allowance we determined for that year. To facilitate this, we forecast network support costs separately.

The opex costs of network capability projects are funded through the network capability component of the transmission STPIS, not through forecast opex. We will also exclude these costs from the EBSS so that ElectraNet does not receive EBSS rewards or penalties for undertaking these projects. Including these costs in the EBSS would distort the incentive to undertake network capability projects provided by the STPIS.

We will not exclude the following categories of opex from the EBSS:

- defined benefits superannuation
- insurance
- self-insurance.

Because these costs are included in the total opex forecast based on revealed expenditure in a single year, there is no reason to exclude them from the EBSS.

By including costs such as defined benefits superannuation, insurance and self-insurance in the EBSS, uncontrollable cost increases or decreases are shared between service providers and network users in the same way as efficiency gains or losses (approximately 30:70). If we exclude such costs, the service provider's share of cost decreases or increases differs across the regulatory control period. We do not

²¹ Network support refers to non-network solutions used by transmission network service providers as a cost effective means of deferring network augmentation. We will exclude network support costs because they are passed through to network users via an annual pass through mechanism. They are forecast on a category specific basis to facilitate the pass through.

consider cost increases should be shared differently between service providers and network users in different regulatory years.²²

In addition to the excluded cost categories, we will adjust actual opex to reverse any movements in provisions. We consider actual opex net of movement in provisions best reflects the actual opex incurred by the service provider during the regulatory control period.

Consistent with version two of the EBSS we will also:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination. This may include approved pass through amounts or contingent projects.
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2023–24 where doing so better achieves the requirements of clause 6A.6.5 of the NER.

²² AER, *Efficiency benefit sharing scheme for electricity network service providers, Explanatory statement*, November 2013, pp. 25–29.