Draft Decision

AusNet Gas Services
Access Arrangement 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 13
Capital expenditure sharing scheme

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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to AusNet Gas Services (AusNet) for the 2023–28 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

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13 Capital expenditure sharing scheme

This attachment outlines our assessment of AusNet's proposal for a capital expenditure sharing scheme (CESS) for the 2023–28 access arrangement period. This includes CESS rewards or penalties to be applied next period based on AusNet's performance this period. The CESS is designed to incentivise efficient spending on capex by rewarding Network Service Providers (NSP) for lowering their capex below the amount approved for the access arrangement period. The rewards are shared between the NSPs and consumers. To ensure lower capex does not compromise service standards, the reward amounts are modified by a contingent payment factor (CPF). If service standards fall below target levels, reward amounts are reduced. Below a certain threshold, rewards are multiplied by zero. Conversely, the CESS will lead to a penalty if the NSP spends above its approved capex. The CPF does not apply to penalties, so if a penalty is incurred, it will not be reduced.

This draft decision requires updates to the design of AusNet's CESS for the next period. AusNet's proposed CESS design for the 2023-28 period is based on our approved CESS for the Victorian gas businesses (2018–2022). In line with our most recent decisions for AGN (SA), Jemena Gas Network (JGN) and Evoenergy, we require that the CESS will not apply to connections capital expenditure (capex).

13.1 Draft decision

AusNet spent less capex in the 2018-22 access arrangement period than our forecast in the final decision for the 2018-22 access arrangement period. This results in a CESS reward being added to AusNet's revenue in the 2023-28 access arrangement period. Our draft decision on CESS reward for the Victorian network is set out in Table 13.1. Our draft decision is to reject a CESS reward of $8.2 million ($2022/23) for AusNet's Victorian network. Our draft decision figure is a reward of $8.6 million ($2022/23).

Table 13.1 Our draft decision on AusNet's CESS amounts ($ million, $2022/23)

	2023-24	2024–25	2025–26	2026–27	2027–28	Total
AusNet's proposed CESS reward	1.6	1.6	1.6	1.6	1.6	8.2
AER draft decision reward	1.7	1.7	1.7	1.7	1.7	8.6

Source: AER analysis. AusNet, *ASG – GAAR 2024-28 CESS – 2 SEP 2022 – Public*, September 2022. Numbers may not add up due to rounding

The difference between our decision and AusNet's proposal owes to us updating CPI and real vanilla WACC figures.[1] We also updated actual total capex and actual asset disposal inputs consistent with our 2023-28 draft decision RFM. We require AusNet to use our updated inputs. We are otherwise satisfied that AusNet's application of the CESS is appropriate, and consistent with the CESS mechanism set out in its access arrangement.

[1] Attachment 2 on the capital base sets out our CPI draft decision, while Attachment 3 on rate of return details our vanilla WACC draft decision.

We accept AusNet's proposal to retain a CESS for the 2023-28 access arrangement period.[2] In line with our most recent decisions for AGN (SA), Jemena Gas Network (JGN) and Evoenergy, however, we require that the CESS will exclude connections capex. The rationale for this requirement is that new connections volume is largely outside of NSP control. As such, this may lead to large windfall gains or losses for the NSP that are unrelated to the incentive mechanism.

13.2 AusNet's proposal

13.2.1 CESS amounts from the 2018-22 access arrangement period

AusNet proposed a $8.2 million ($2022/23) reward be added to its revenue in the 2023–28 access arrangement period.[3]

AusNet has adopted measures to monitor service performance which adjust the CPF. The five target measures are:

- unplanned System Average Interruption Frequency Index (SAIFI) (weighting 25%)
- unplanned System Average Interruption Duration Index (SAIDI) (weighting 25%)
- mains leaks (weighting 20.4%)
- service leaks (weighting 23.0%)
- meter leaks (weighting 6.6%)

Performance targets for each measure have been set using the previous five years of historical data. The performance targets are weighted to produce a CPF. The CPF is used to scale down rewards if service performance is less than the target level. Consistent with the previous access arrangement period's CESS, the threshold of performance below which no reward is payable to AusNet for an under-spend is an index score of 80 (base is 100).

13.2.2 Application of CESS in the 2023-28 access arrangement period

AusNet proposes to continue using a CESS into the next access arrangement period. In its proposal, AusNet does not propose excluding connections capex from CESS calculations going forward.

13.3 Assessment approach

A full access arrangement may include (or we may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.[4] Incentive mechanisms may provide for carrying over increments for efficiency gains, or decrements for efficiency losses, from one access arrangement period into the next.[5] An incentive mechanism must be consistent with the revenue and pricing principles.[6]

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2 The operation of the CESS is set out in: AusNet, *AusNet - Gas Access Arrangement 2024-28, Part B of the Access Arrangement for the Distribution System Reference Tariffs and Reference Tariff Policy,* July 2022, Section 6, p.20-1.

3 AusNet, *ASG – GAAR 2024-28 CESS – 2 SEP 2022 – Public*, September 2022.

4 NGR, r. 98(1).

5 NGR, r. 98(2).

6 NGR, r. 98(3).

We consider the following revenue and pricing principle is most relevant for assessing AusNet's proposed incentive scheme:

> 'A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides.
>
> The economic efficiency that should be promoted includes—
>
> (a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and
>
> (b) the efficient provision of pipeline services; and
>
> (c) the efficient use of the pipeline.'[7]

13.4 Reasons for draft decision

13.4.1 CESS amounts from the 2018–22 access arrangement period

We consider AusNet's proposed reward of 8.2 million ($2022/23) is broadly consistent with the CESS mechanism in its 2018–22 access arrangement. However, as detailed in attachments 2 and 3 of this draft decision, we do not agree with AusNet's proposed CPI and vanilla WACC inputs. We also updated actual total capex and actual asset disposal inputs consistent with our 2023-28 draft decision roll forward model (RFM). Consequently, we have updated the CESS calculations to reflect our draft decision on CPI, real vanilla WACC, actual total capex and actual asset disposal.

These updates lead to a CESS reward of $1.7 million ($2022/23) per year and $8.6 million ($2022/23) overall. We require AusNet to use our updated CPI and real vanilla WACC inputs, as well as our updated capex inputs.

13.4.2 Updates to CESS in the 2023-28 access arrangement period

Although AusNet has *not* proposed to remove new connections capex from the CESS, in this draft decision we require AusNet to remove new connections from the CESS.

13.4.3 Submissions

The Energy User Association of Australia (EUAA) acknowledged and agreed with the exclusion of connections capex from the CESS. It does not believe this will have a material impact on efficiency incentives.[8]

The Brotherhood of St Laurence (BSL), however, disagreed with the exclusion of connections capex.[9] A draft report carried out by TRAC Partners explains BSL's reasons. It argued that NSPs do control some aspects of connections capex, such as unit rates for contractors. It also considered that the size of connections capex means its exclusion would not be a minor change to CESS. The report approved of AusNet *not* proposing to exclude

7 NGL, s. 24(3).

8 EUAA, *Submission: Victorian Gas Access Arrangement Proposal 2023-2028, 30 September 2022,* pg. 7

9 BSL, *2023-2028 Victorian Gas Distributors' Access Arrangement, Submission from the Brotherhood of St. Laurence,* Section 12, pg. 29

connection capex.[10] However, as we require that AusNet exclude connections capex, it is necessary to raise these criticisms.

While we agree that the cost of each actual connection can be controlled to some extent, we note that an NSP cannot control whether the volume of connections is higher or lower. This may lead to large windfall gains or losses for the NSP that are unrelated to the incentive mechanism. Consequently, we are of the view that connections capex is largely outside of its control, and so it is not responsive to incentive mechanisms. In line with our recent decisions for AGN (SA), JGN and Evoenergy, we require the exclusion of connections capex from the CESS.

13.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 13.2.

Table 13.2 AusNet's CESS revisions

Revision	Amendment
Revision 13.1	Make all necessary amendments to the access arrangement to remove forecast capex for new connections from the CESS calculation.
Revision 13.2	Make revisions necessary to update CPI, real vanilla WACC, and reported capex inputs in the calculation of the CESS, in line with our draft decision.

10 TRAC Partners, *[DRAFT] Response to VIC DBS' 2023-28 Access Arrangement Proposals, TRAC Partners, Prepared for Brotherhood of St Laurence*, pg. 51

Glossary

Term	Definition
AER	Australian Energy Regulator
AGN (SA)	Australian Gas Networks (South Australia)
AGN (VIC)	Australian Gas Networks (Victoria and Albury)
AusNet	AusNet Gas Services
BSL	Brotherhood of St Laurence
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
CPF	Contingent Payment Factor
CPI	Consumer price index
EUAA	Energy Users Association of Australia
JGN	Jemena Gas Networks (NSW) Ltd
NGL	National Gas Law
NGR	National Gas Rules
NSP	Network Service Provider
NSW	New South Wales
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
WACC	Weighted average cost of capital