FINAL DECISION
AusNet Services transmission determination 2017–22

Attachment 9 – Efficiency benefit sharing scheme

April 2017

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on AusNet Services' revenue proposal 2017–22. It should be read with other parts of the final decision.

The final 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

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
DNSP	distribution network service provider
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

Shortened form	Extended form
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
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 opex forecast and its actual opex during a regulatory control period. This is supplemented by the EBSS which provides the service provider with an additional reward for reductions in opex it makes, and additional penalties for increases in opex. In total, these rewards and penalties work together to provide a continuous incentive for a service provider to pursue efficiency gains over the regulatory control period. The EBSS also discourages a service provider from inflating its opex in the expected base year in order to receive a higher opex allowance in the following regulatory control period.

During the 2014–17 regulatory control period, AusNet Services operated under the Electricity transmission network service providers' EBSS, released in September 2007.[1]

9.1 Final decision

We approve a total EBSS carryover amount of $1.0 million ($2016–17) from the application of the EBSS in the 2014–17 regulatory control period.[2] This is consistent with AusNet Service' revised proposal.[3] Our final decision on the EBSS carryover amounts from the 2014–17 regulatory control period is outlined in Table 9.1.

Table 9.1 AER's final decision on AusNet Services' EBSS carryover amounts ($ million, 2016–17)

	2017-18	2018-19	2019-20	2020-21	2021-22	Total
AusNet Services proposal	1.7	1.7	1.7	0.5	-	**5.6**
AER draft decision	1.3	1.3	1.3	0.0	1.1	**5.1**
AusNet Services revised proposal	1.3	1.3	1.3	0.0	-3.0	**1.0**
AER final decision	**1.3**	**1.3**	**1.3**	**0.0**	**-3.0**	**1.0**

Source: AusNet Services, *Revenue proposal*, October 2015, p.169; AusNet Services, *Revised revenue proposal*, September 2016, p. 221; AER analysis.

Note: Numbers may not add up due to rounding.

1 AER, *Electricity transmission network service providers - Efficiency benefit sharing scheme*, September 2007.
2 AER, *Electricity transmission network service providers - Efficiency benefit sharing scheme*, September 2007.
3 AusNet Services, *Revised revenue proposal*, 21 September 2016, p. 221.

Our final decision is to apply version two of the EBSS to AusNet Services in the 2017–22 regulatory control period.[4] When we apply version two of the EBSS, we will exclude the cost categories listed in section 9.4.2 from forecast and actual opex used to calculate EBSS carryover amounts. Table 9.2 sets out our final decision on AusNet Services' target opex for the EBSS (total opex less excluded categories[5]), against which we will calculate efficiency gains in the 2017–22 regulatory control period.

Table 9.2 AER's final decision on AusNet Services' forecast opex for the EBSS ($ million, 2016–17)

	2017-18	2018-19	2019-20	2020-21	2021-22
Total forecast opex	226.9	227.4	228.0	228.5	229.0
Less debt raising costs	–1.6	–1.6	–1.6	–1.6	–1.5
Less easement land tax	–135.0	–135.0	–135.0	–135.0	–135.0
Target opex for the EBSS	90.3	90.8	91.4	91.9	92.4

Source: AER, *Final decision AusNet Services transmission determination- Operating expenditure model*.

Note: Forecast opex does not include AIS rebates or priority projects under the STPIS network capability function.

9.2 AusNet Services' revised proposal

9.2.1 Carryover amounts from the 2014–17 regulatory control period

AusNet Services proposed a $1.0 million ($2016–17) carryover amount to be added to its regulated revenue in the 2017–22 regulatory control period.[6]

AusNet Services accepted our draft decision approach to calculating the EBSS carryover. As foreshadowed in its initial proposal,[7] it replaced its estimated data with actual data where available. It updated estimated opex for 2015–16 with actual opex and estimated inflation with recent actual inflation.

9.2.2 Application of the EBSS in the 2017–22 regulatory control period

AusNet Services accepted the EBSS exclusions set out in our draft decision, with the exception of self-insurance.[8] Consistent with its initial proposal, AusNet Services

[4] AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.
[5] Easement land tax and debt raising costs.
[6] AusNet Services, *Revised revenue proposal*, 21 September 2016, p. 221.
[7] AusNet Services, *Revenue proposal 2017-2022*, 30 October 2015, p. 168.
[8] AusNet Services, *Revised revenue proposal*, 21 September 2016, p. 221.

included a category specific forecast of self-insurance costs in its opex forecast. On that basis, it considered self-insurance costs should be excluded from the EBSS.[9]

9.3 Assessment approach

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

1. the revenue increments or decrements (if any) for each year of the 2017–22 regulatory control period arising from the application of the EBSS during the 2014–17 regulatory control period[10]

2. how the EBSS will apply to AusNet Services in the 2017–22 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 factors when implementing the EBSS:[13]

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

9.3.1 Interrelationships

The EBSS is intrinsically linked to our opex revealed cost forecasting approach. Our opex forecasting method relies on identifying an efficient opex amount in the base year (the 'revealed costs' of the service provider), which we use 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 gain is retained for less time.

The application of the EBSS serves two important functions:

- it reduces 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

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9 AusNet Services, *Revised revenue proposal*, 21 September 2016, p. 221.
10 NER, cl. 6A.5.4(a)(5).
11 NER, cll. 6A.14.1(1)(iv) and 6A.14.3(d)(2).
12 NER, cl. 6A.6.5(a).
13 NER, cl. 6A.6.5(b).

- it provides a continuous incentive for a service provider to pursue efficiency improvements across the regulatory control period. This is because the EBSS allows a service provider to retain efficiency gains for a total of six years, regardless of the year in which it was made.

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. That is, we typically exclude costs where we do not rely on a revealed cost forecasting approach to forecast those costs. The rationale for this is explained in the following paragraph.

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. Attachment 7 of this decision explains our revealed cost approach and interrelationships with the EBSS.

9.4 Reasons for final decision

9.4.1 Carryover amounts from the 2014–17 regulatory control period

We consider AusNet Services should receive a total EBSS carryover amount of $1.0 million ($2016–17) from the application of the EBSS during the 2014–17 regulatory control period. This is consistent with AusNet Services' revised proposal.

In our draft decision, we calculated an EBSS carryover amount of $5.1 million ($2016–17) from the application of the EBSS during the 2014–17 regulatory control period. We also stated we would update our calculation in the final decision when AusNet Services' actual 2015–16 opex was available.[14]

In our final decision, we have replaced estimated opex for 2015–16 with actual data and updated inflation with the most recent actuals published by the Australian Bureau of Statistics. The carryover amount of $1.0 million ($2016–17) reflects these updates.

[14] AER, *Draft Decision AusNet Services transmission determination - Attachment 9 - EBSS*, July 2016, p. 9-9.

9.4.2 Application of the EBSS in the 2017–22 regulatory control period

We will apply version two of the EBSS to AusNet Services in the 2017–22 regulatory control period,[15] consistent with our draft decision. We revised version one of EBSS as part of our better regulation program.[16]

AusNet Services accepted the majority of our draft decision in relation to the application of the EBSS in the 2017–22 regulatory control period. It accepted the EBSS exclusions, with the exception of self-insurance.

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

- easement land tax
- debt raising costs.

We will subject self-insurance to the EBSS because we forecast self-insurance using a revealed cost approach (see attachment 7 of this decision for an explanation of our revealed cost approach). We would typically exclude such costs where we do not rely on a revealed cost forecasting approach to forecast those costs.

AusNet Services proposed excluding self-insurance costs because it forecast it as a category specific cost rather than using a revealed cost forecasting approach.

We consider self-insurance should be subject to the EBSS for two main reasons:

First, AusNet Services benefits from applying the EBSS to self-insurance costs. AusNet Services submits self-insurance events are uncontrollable,[17] and 'self-insurance losses are by nature volatile and can vary markedly from year to year'.[18] If AusNet Services incurs a significant self-insurance loss exceeding the revealed cost forecast, the EBSS allocates the cost between AusNet Services and its customers in the proportion of 30:70, thereby reducing AusNet Services' risk of a substantial loss.

If a category specific forecast is adopted, AusNet Services cannot mitigate its forecasting risk in this way, and will therefore have to bear the full costs of any self-insurance loss that exceeds its forecast. In a similar sense, a business will be incentivised to apply a category-specific forecast if it expects to underspend against the forecast amount, with the result that the EBSS does not apply and the business therefore ends up retaining the entirety of any underspend for that category, rather than having to share the underspend with consumers through the EBSS.

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

16 See https://www.aer.gov.au > networks & pipelines > better regulation.

17 AusNet Services, *Revised revenue proposal*, 21 September 2016, p. 121.

18 AusNet Services, *Revised revenue proposal*, 21 September 2016, p. 120.

Second, applying the EBSS to external insurance and not to self-insurance could distort the choice between insuring or self-insuring risk. The inconsistent sharing of efficiency gains between costs forecast on a 'revealed cost' basis and those using a category specific forecast can distort the incentive to spend efficiently if there is any substitutability between cost categories.

In these cases the service provider would have an incentive to increase expenditure for the category forecast on a category specific basis and reduce expenditure on categories included in the revealed cost forecast. This is because it would generate an EBSS reward without actually making an efficiency gain and reducing its total opex. A service provider may be better off doing this even if it results in an inefficient outcome.

For this reason, we consider AusNet Services would not have an incentive to adopt the efficient mix of insurance and self-insurance if we forecast self-insurance on a category specific basis and exclude it from the EBSS.