



DRAFT DECISION

AusNet Services Distribution Determination 2021 to 2026

Attachment 8 Efficiency benefit sharing scheme

September 2020

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset 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 benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 – Customer service incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

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Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Victorian f-factor incentive scheme

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8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in operating expenditure (opex), and provide for a fair sharing of these between distributors and network users. Consumers benefit from improved efficiencies through lower regulated prices.

This attachment sets out our draft decision on the EBSS carryover amounts AusNet Services accrued over the 2016–20 regulatory control period and the six month extension period, and how we will apply the EBSS over the 2021–26 regulatory control period.

8.1 Draft decision

Our draft decision is to include EBSS carryover amounts totalling \$109.3 million (\$2020–21) from the application of the EBSS in the 2016–20 regulatory control period and the six month extension period.¹ This is \$17.7 million (\$2020–21) higher than AusNet Services' proposal of \$91.6 million (\$2020–21).² This difference reflects a number of adjustments we have made to correctly apply the scheme. In particular, the following differences exist between AusNet Services' proposal and our decision:

- we have updated for actual figures for 2019 reported opex, increasing total carryovers by \$2.1 million (\$2020–21)
- we did not exclude the forecast and actual opex of the cost category self-insurance in 2014 and 2015 from total opex as AusNet Services incorrectly proposed. This opex category was excluded from AusNet Services' EBSS in the 2011–15 regulatory control period but not in the 2016–20 regulatory control period, increasing total carryovers by \$9.9 million (\$2020–21)
- we removed different amounts of movements in provisions from actual opex, increasing total carryovers by \$4.1 million (\$2020–21)
- we have accounted for the capitalisation policy changes coming into effect from 2019 as a base non-recurrent efficiency adjustment, rather than adjusted reported opex in 2018 as AusNet Services proposed, increasing total carryovers by \$3.8 million (\$2020–21)
- we used updated inflation figures to convert amounts into 2020–21 dollars, decreasing total carryovers by \$2.2 million (\$2020–21).

We set out our draft decision on AusNet Services' EBSS carryover amounts in table 8.1.

¹ NER, cl. 6.4.3(a)(5).

² AusNet Services, *ASD – Workbook 5 – EBSS 2022–26*, January 2020.

Table 8.1 Draft decision on carryover amounts (\$ million, 2020–21)

	HY2021	2021–22	2022–23	2023–24	2024–25	2025–26	Total
AusNet Services' proposal	0.9	46.8	40.0	15.5	–5.8	–5.8	91.6
AER draft decision	12.5	55.2	36.3	15.4	–4.0	–6.2	109.3
Difference	11.5	8.4	–3.6	–0.1	1.8	–0.3	17.7

Source: AusNet Services, *ASD – Workbook 5 – EBSS 2022–26*, January 2020; AER analysis.

Note: Numbers may not add up due to rounding.

We will continue to apply version 2 of the EBSS to AusNet Services in the 2021–26 regulatory control period.³ Consistent with AusNet Services' proposal, we will exclude debt raising costs, its innovation fund expenditure and guaranteed service level (GSL) payments from the scheme because we have forecast them on a category specific basis and expect to continue doing so in the 2026–31 regulatory control period. We will also make other adjustments as permitted by the EBSS, such as removing demand management innovation allowance costs, and movements in provisions (as outlined in section 8.4).

We have set out in table 8.2 the opex forecasts we will use to calculate efficiency gains in the 2021–26 regulatory control period, including forecast debt raising costs.

Table 8.2 Forecast opex for the EBSS (\$ million, 2020–21)

	2018	2019	2020	HY2021	2021–22	2022–23	2023–24	2024–25	2025–26
Total forecast opex	255.2	260.2	266.3	135.1	234.8	236.3	236.6	238.5	241.1
Less GSL payments	–9.0	–9.0	–9.0	–4.5	–9.2	–9.2	–9.2	–9.2	–9.2
Less innovation allowance	–	–	–	–	–0.2	–0.2	–0.2	–0.2	–0.2
Less debt raising costs	–2.1	–2.2	–2.2	–1.2	–2.2	–2.2	–2.3	–2.3	–2.3
Forecast opex for the EBSS	244.1	249.0	254.9	128.5	223.1	224.6	224.9	226.8	229.4

Source: AER, *AusNet Services – Draft Decision – Post tax revenue model*, September 2020; AER, *AusNet Services 2021–26 – Draft Decision – EBSS model*; AER analysis.

Note: Numbers may not add up due to rounding.

We discuss the reasons for our draft decision in section 8.4.

³ NER, cl. 6.12.1(9); AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

8.2 AusNet Services' proposal

8.2.1 Carryover amounts accrued during the 2016–20 regulatory control period

AusNet Services proposed we include EBSS carryover amounts totalling \$91.6 million (\$2020–21) in its revenue in the 2021–26 regulatory control period, from the application of the EBSS in the 2016–20 regulatory control period.⁴ AusNet Services excluded the following cost categories in calculating its EBSS carryover amounts:

- debt raising costs
- demand management innovation allowance
- GSL payments
- self-insurance, capitalisation policy changes in 2018, removal of merits review expenditure and pass through opex

It also reversed its movements in provisions related to opex.

AusNet Services also proposed including EBSS carryovers in its revenues for the six month extension period.⁵

8.2.2 Application in the 2021–26 control period

AusNet Services proposed we continue to apply the latest version of the EBSS in the 2021–26 regulatory control period.⁶ It also proposed that we apply the following adjustments and exclusions:⁷

- GSL payments
- debt raising costs
- innovation allowance
- demand management innovation allowance.

8.2.3 Stakeholder submissions

The Victorian Community Organisation (VCO) raised concerns about whether the EBSS is getting opex to the efficiency frontier. The VCO stated that it is unclear whether this is due to the framework design of the EBSS, or whether we are not using the benefits of our productivity analysis to its maximum potential. It considered that opex is becoming less productive and further from the efficient frontier. The VCO also

⁴ AusNet Services, *ASD – Workbook 5 – EBSS 2022–26*, January 2020.

⁵ AusNet Services, *Distribution proposal PTRM Model (Jan–Jun 2021)*, 31 January 2020.

⁶ AusNet Services, *ASD – EDPR 2022–26 Table 8.1 Draft decision on carryover amounts (\$ million, 2020–21) Part III*, January 2020, p. 248.

⁷ AusNet Services, *ASD – EDPR 2022–26 Regulatory Proposal Part III*, January 2020, p. 248.

raised concerns about the transparency of consumer funded capital expenditure (capex) programs that lead to opex reductions and therefore EBSS carryover benefits.⁸

Energy Users Association of Australia (EUAA) questioned whether some of the large EBSS carryovers accrued by some distributors suggests overly generous opex forecasts in the current period which lessens the effectiveness of the efficiency schemes.⁹

Similar to EUAA, the AER's Consumer Challenge Panel, sub-panel 17 (CCP17) noted the significant EBSS and capital expenditure sharing scheme (CESS) carryovers accrued by some Victorian distributors in the current regulatory control period. The CCP17 stated that the outcomes are not reflective of expected results for businesses operating at the efficiency frontier and suggested that a holistic review of the incentive schemes is required.¹⁰

We acknowledge the observations made from submissions on the high EBSS carryovers accrued by some distributors, however, these outcomes must be considered in light of the combined revenues, i.e. taking into account the EBSS revenues together with the opex forecast. The high EBSS revenues will reflect lower opex in the current period and where the distributor is operating efficiently this will mean lower opex forecasts for the subsequent regulatory control period. The interrelationship between the EBSS and our revealed cost approach is discussed further in section 8.3.1.

8.3 Assessment approach

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

- the revenue increments or decrements for each year of the 2021–26 regulatory control period arising from the application of the EBSS during the 2016–20 regulatory control period¹¹
- how the EBSS will apply to AusNet Services in the 2021–26 regulatory control period.¹²

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between service providers and network users.¹³ We must also have regard to the following matters when implementing the EBSS:¹⁴

⁸ VCO, *EDPR 2021–26 Submissions to Initial Proposal*, May 2020, pp. 69–70.

⁹ EUAA, *Submission AusNet Services EDPR 21–26*, 10 June 2020, p. 2.

¹⁰ CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determinations 2021–26*, 10 June 2020, p. 2.

¹¹ NER, cl. 6.4.3(a)(5).

¹² NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

¹³ NER, cl. 6.5.8(a).

¹⁴ NER, cl. 6.5.8(c).

- the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme
- the need to provide AusNet Services with a continuous incentive to reduce opex
- the desirability of both rewarding AusNet Services for efficiency gains and penalising it for efficiency losses
- any incentives that AusNet Services may have to capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

8.3.1 Interrelationships

The EBSS is closely linked to our revealed cost approach to forecasting opex. When we assess or develop our opex forecast, the NER require us to have regard to whether the opex forecast is consistent with any incentive schemes.¹⁵

Our opex forecasting method typically relies on using the 'revealed costs' of the service provider in a chosen base year to develop a total opex forecast if the chosen base year opex is not considered to be 'materially inefficient'. Under this approach, a service provider would have 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 single year 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 regulatory control 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 single year revealed cost approach, a business would in theory receive a reward for efficiency gains through the EBSS (at a cost to consumers), but

¹⁵ NER, cl. 6.5.6(e)(8). Further, we must specify and have regard to the relationship between the constituent components of our overall decision: NEL, s 16(1)(c).

consumers would not necessarily benefit through a lower revealed cost forecast in the subsequent regulatory control period.

Therefore, we typically exclude costs that we do not forecast using a single year revealed cost forecasting approach.

For these reasons, our decision on how we will apply the EBSS to AusNet Services has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to the effect of our EBSS decision when making our opex decision, and our EBSS decision is made largely in consequence of (and takes careful account of) our past and current decisions on AusNet Services' opex.

8.4 Reasons for draft decision

8.4.1 Carryover amounts from the 2016–20 control period

Our draft decision is to include EBSS carryover amounts totalling \$109.3 million (\$2020–21) from the application of the EBSS in the 2016–20 regulatory control period.¹⁶ This is \$17.7 million (\$2020–21) higher than AusNet Services' proposal of \$91.6 million (\$2020–21). This difference reflects a number of adjustments we made to correctly apply the scheme with the key differences to AusNet Services' proposal and our decision summarised in section 8.1. We discuss each of these key differences in more detail below.

We consider that the EBSS carryover amounts we have calculated provide for a fair sharing of efficiency gains and losses between AusNet Services and its network users. It both rewards AusNet Services for the efficiency gains it has made and penalises it for its efficiency losses. Further, we consider that the benefit to networks users, through lower forecast opex, is sufficient to warrant the EBSS carryover amounts we have determined.

8.4.1.1 Inflation

Consistent with our standard approach, we used unlagged inflation to convert amounts to 2020–21 real terms. We use unlagged inflation to be consistent with our opex forecast.¹⁷

We used updated inflation forecasts compared to those AusNet Services proposed. For 2019, we used the actual headline CPI figure published by the Australian Bureau of Statistics, which was released after AusNet Services submitted its proposal.¹⁸ For 2020–21, we used the inflation forecast in the Reserve Bank of Australia's August

¹⁶ NER, cl. 6.4.3(a)(5).

¹⁷ This ensures AusNet Services is not accruing carryovers that are not being passed on to customers.

¹⁸ Australian Bureau of Statistics, *Catalogue number 6401.0, Consumer price index*, June 2020.

2020 *Statement on monetary policy*.¹⁹ This was also published after AusNet Services submitted its proposal.

8.4.1.2 Incremental efficiency gain in 2016

To calculate the incremental efficiency gain for 2016, we included self-insurance from AusNet Services' forecast and actual opex for 2014 and 2015. AusNet Services, however, incorrectly excluded this cost. This category of opex was excluded from the operation of the EBSS for the 2011–15 regulatory control period, but not for the 2016–20 regulatory control period.²⁰ We did not exclude this cost because doing so would result in the incremental gain calculated for 2016 including the incremental gain made in 2015 related to self-insurance.

To calculate the incremental gain (loss) made in the first year of a regulatory control period we start with the opex underspend (overspend) in that year. Since the forecast for that year will reflect the level of efficiency revealed in the base year in the previous regulatory control period, this underspend will reflect all efficiency gains or losses made after the base year. We then subtract any incremental gains or losses made after the base year in the previous regulatory control period. When we do this, we subtract efficiency gains made in all categories of opex subject to the EBSS in the new regulatory control period. This includes categories of opex that we excluded from the EBSS in the previous regulatory control period. This is because, we are calculating the incremental efficiency gain in 2016 for those categories of expenditure subject to the EBSS in the 2016–20 regulatory control period. For this reason we included self-insurance from AusNet Services' forecast and actual opex for 2014 and 2015 to calculate the incremental efficiency gain for 2016 (self-insurance was not excluded from the EBSS for the 2016–20 regulatory control period). By doing this, the incremental efficiency gain we have calculated for 2016 does not include the incremental efficiency gain made in 2015 related to self-insurance.

8.4.1.3 Movements in provisions

We have updated the value of movement in provisions for 2014 to 2018 to align with values reported in the economic benchmarking regulatory information notices (RINs), excluding the line item 'the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate' within the superannuation category. This is because these are defined benefits and are therefore not opex. AusNet Services confirmed these are the correct values to be used.²¹

¹⁹ Reserve Bank of Australia, *Statement on monetary policy, Appendix: Forecasts*, August 2020.

²⁰ AER, *Final Decision AusNet Services distribution determination 2016–2020 Attachment 9 – Efficiency benefit sharing scheme*, May 2016, p. 16–17.

²¹ AusNet Services, *Information Request 029*, 12 June 2020.

8.4.1.4 Updating for 2019 actuals

AusNet Services calculated its proposed EBSS carryovers using an estimate of its 2019 opex because its actuals were not available at the time. We have updated the EBSS carryover calculations to reflect actuals reported in both the annual and economic benchmarking RINs. This has an impact on total reported opex, GSL payments, demand management innovation allowance and movements in provisions for 2019.

8.4.1.5 Capitalisation policy changes

AusNet Services proposed, under the new accounting standard AASB 16, to treat leases as capex rather than opex. In AusNet Services' proposal, it removed the lease costs (totalling \$4.5 million (\$2020–21)) from its 2018 base year for the purpose of calculating its opex forecast for the 2021–26 regulatory control period. It also removed the same lease costs from 2018 reported opex for the purpose of calculating EBSS carryovers.²² The proposed treatment results in a lower opex forecast for 2021–26 but higher EBSS carryovers.

Although we understand why AusNet Services proposed to account for the capitalisation policy changes in this way, we have adopted a different approach to address the issue:

- We have made the lease capitalisation cost adjustment as a base year non-recurrent efficiency gain adjustment, rather than adjusting reported 2018 opex for the purposes of calculating EBSS carryovers. This approach gives the same estimate of opex for 2020 while accurately reflecting AusNet Services' 2018 opex. Generally, our preferred approach is to use a different base year if we have concerns that the chosen base year is not reflective of future opex. However, we believe it is an appropriate approach under these unique circumstances for the following reasons:
 - the change in accounting standard (AASB 16) is a specific issue with a transparent cost adjustment
 - we are of the view that inputs into the EBSS and CESS models should be consistent with the values in the annual RINs and shifting expenditure between opex and capex to account for changes in accounting standards may reduce the transparency of our incentive schemes
 - we know that the lease costs will not be incurred as opex in 2020. AusNet Services' proposed approach, which removes actual opex lease costs from 2018 opex, effectively assumes lease costs cease being opex from the end of 2017. By making a base year non-recurrent efficiency adjustment the calculations will more accurately reflect that these costs were

²² AusNet Services, *ASD – EDPR 2022–26 Regulatory Proposal Part III*, January 2020, p. 135, 247.

incurred as opex in 2018. By making the non-recurrent efficiency gain adjustment the costs won't be included in the estimate of opex for 2020.

- We have updated the capitalised lease cost amount to \$4.4 million (\$2020–21) compared to the \$4.5 million (\$2020–21) proposed. This reflects that following an information request, AusNet Services corrected a small discrepancy in the capitalisation adjustment amount.²³

We outlined this approach to AusNet Services and it did not raise any concerns.²⁴

8.4.1.6 Half year 2021 EBSS carryovers

As outlined in our six month extension guidance,²⁵ we have deferred the half year 2021 EBSS carryovers accrued to the beginning of 1 July 2021. Our calculation uses the half year 2021 weighted average costs of capital (WACC) and first year WACC of the 2021–26 regulatory control period to determine the present value equivalent amount, which we have included in revenues for 2021–22.

8.4.2 Application in the 2021–26 control period

Our draft decision is to continue to apply version 2 of the EBSS to AusNet Services during the 2021–26 regulatory control period. We consider applying the scheme will benefit long-term electricity customers as it will provide continuous incentives for AusNet Services to reduce opex. Provided we forecast AusNet Services' future opex using its revealed costs in the 2021–26 regulatory control period, any efficiency gains that AusNet Services achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.²⁶ We provide details on these below.

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

²³ AusNet Services, *Information Request 015*, 12 May 2020.

²⁴ AusNet Services, *Information Request 019B*, 20 July 2020.

²⁵ AER, *Correspondence to AusNet Services – Victorian EDPR and the six-month extension*, 17 August 2020.

²⁶ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

If we do not use a single year revealed cost forecasting approach, we may not pass the benefits of these revealed efficiency gains to network users. It follows that network users should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

For the 2021–26 regulatory control period we have not forecast debt raising cost, the innovation fund expenditure and GSL payments using a single year revealed cost forecasting approach. If we do the same for the 2026–31 regulatory control period we will exclude these costs from the EBSS for the 2021–26 regulatory control period.

In addition to the excluded cost categories discussed above, we will also make the following adjustments when we calculate the EBSS carryover amounts accrued during the 2021–26 regulatory control period:

- Adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass through amounts or opex for contingent projects.
- Adjust actual opex to remove demand management innovation allowance opex because it is not included in the opex forecast (but is often reported by service providers as part of their standard control services opex).²⁷
- Adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base.²⁸
- Adjust forecast opex and actual opex for inflation.²⁹
- Adjust actual opex to reverse any movements in provisions.
- Adjust opex for any services that will not be classified as standard control services in the 2026–31 regulatory control period, to the extent these costs are not forecast using a single year revealed cost approach and excluding these costs better achieves the requirements of clauses 6.5.8 of the NER.³⁰

²⁷ Clause 6.5.8(c)(5) of the NER requires us to have regard to the possible effects of the scheme on incentives for the implementation of non-network options.

²⁸ Clause 6.5.8(c)(4) of the NER requires us to have regard to any incentives the service provider may have to capitalise expenditure.

²⁹ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

³⁰ AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 14.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CCP17	Consumer Challenge Panel, sub-panel 17
CESS	capital expenditure sharing scheme
CPI	consumer price index
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
GSL payments	guaranteed service level payments
NEL	National Electricity Law
NER	National Electricity Rules
opex	operating expenditure
PTRM	post-tax revenue model
RIN	regulatory information notice
WACC	weighted average cost of capital