# DRAFT DECISION
# Murraylink transmission determination
# 2018 to 2023

# Attachment 9 – Efficiency benefit sharing scheme

September 2017

AUSTRALIAN ENERGY REGULATOR

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# Note

This attachment forms part of the AER's draft decision on Murraylink'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

# 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. 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. 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, Murraylink operated under the electricity transmission network service providers' EBSS, released in September 2007.[1] This was the first time the EBSS applied to Murraylink.

## 9.1 Draft decision

Our draft decision is to approve EBSS carryover amounts totalling $0.4 million ($2017–18) from the application of the EBSS in the 2013–18 regulatory control period. This is $0.3 million ($2017–18) lower than the carryover amounts Murraylink proposed, which totalled $0.7 million ($2017–18).[2]

Table 9.1 sets out our draft decision on the EBSS carryover amounts Murraylink accrued during the 2013–18 regulatory control period.

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

| | 2018–19 | 2019–20 | 2020–21 | 2021–22 | 2022–23 | Total |
|---|---|---|---|---|---|---|
| Murraylink's proposal | –0.16 | –0.17 | 0.52 | – | 0.52 | **0.71** |
| **AER draft decision** | **–0.02** | **–0.22** | **0.48** | **–** | **0.16** | **0.41** |

Source: Murraylink, *Revenue proposal*, *PTRM*, 31 January 2017; AER analysis.

1 AER, *Murraylink Transmission determination 2013–14 to 2017–18*, April 2013, p. 10.

2 Murraylink, *Revenue proposal*, 31 January 2017, p. 24.

Our draft decision is to apply version two of the EBSS to Murraylink in the 2018–23 regulatory control period.[3] Consistent with Murraylink's proposal, we will exclude debt raising costs from the scheme. However, we will not exclude connection charges. We discuss the reasons for our draft decision in section 9.4.2.

Table 9.2 sets out 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.

**Table 9.2 Forecast total 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 | 4.09 | 4.12 | 4.34 | 4.39 | 4.37 | 4.42 | 4.37 | 4.54 |
| Less debt raising costs | –0.07 | –0.07 | –0.07 | –0.01 | –0.01 | –0.01 | –0.01 | –0.01 |
| **Forecast total opex for the EBSS** | **4.02** | **4.05** | **4.27** | **4.38** | **4.36** | **4.41** | **4.36** | **4.53** |

Source: Murraylink, *Revenue proposal*, *PTRM*, 31 January 2017; AER analysis.

Note: Numbers may not add up to total due to rounding.

## 9.2 Murraylink's proposal

### 9.2.1 Carryover amounts from the 2013–18 control period

Murraylink proposed we add carryover amounts totalling $0.7 million ($2017–18) to its revenue in the 2018–23 regulatory control period.[4]

### 9.2.2 Application in the 2018–23 control period

Murraylink proposed we apply version two of the EBSS in the 2018–23 regulatory control period. It proposed a five year carryover period and that debt raising costs and connection charges be excluded from the scheme.[5]

## 9.3 Assessment approach

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

- 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 period[6]
- how the EBSS will apply to Murraylink in the 2018–23 regulatory control period.[7]

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

4 Murraylink, *Revenue proposal*, 31 January 2017, p. 24.

5 Murraylink, *Revenue proposal*, 31 January 2017, p. 119.

6 NER, cl. 6A.5.4(a)(5).

The EBSS must provide for a fair sharing between service providers and network users of opex efficiency gains and efficiency losses.[8] We must also have regard to the following matters when implementing the EBSS:[9]

- the need to provide the network service provider with continuous incentives to reduce opex
- 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.[10]

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

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7 NER, cl. 6A.14.1(1)(iv), cl. 6A.14.3(d)(2).
8 NER, cl. 6A.6.5(a).
9 NER, cl. 6A.6.5(b).
10 NER, cl. 6A.6.6(e)(8).

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.

## 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 $0.4 million ($2017–18) from the application of the EBSS in the 2013–18 regulatory control period. This is less than the $0.7 million ($2017–18) Murraylink proposed. The reasons for the difference are:

- Murraylink reported actual opex in real rather than nominal dollars
- Murraylink did not use the same estimate of opex in 2017–18 to calculate its efficiency gains as it used to forecast opex
- some of the formulas in the EBSS model we provided Murraylink referenced incorrect cells
- we updated the CPI index values in the model.

In our final decision, we will update our calculation of the carryover amounts using *actual* opex for 2016–17. Our draft decision is based on an estimate because actual data for 2016–17 is not yet available. We will also update inflation.

### 9.4.2 Application in the 2018–23 control period

We will apply version two of the EBSS to Murraylink during the 2018–23 regulatory control period. This is consistent with Murraylink's proposal. The Consumer Challenge Panel (CCP 9) submitted that incentive schemes are important given the lack of commercial drivers in most aspects of Murraylink's operation.[11]

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 Murraylink's following regulatory control period, to ensure

[11] Consumer Challenge Panel (sub panel 9), *Submission on Murraylink's revenue proposal*, 12 May 2017, p. 5.

continuous incentives.[12] This is likely to be consistent with Murraylink's proposed five year carryover period.

### *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.

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.

Consistent with Murraylink's proposal, we will exclude debt raising costs from the EBSS. This is because we typically do not forecast these costs based on revealed expenditure in a single year.

Murraylink also proposed we exclude connection charges from the EBSS. These are charges levied on Murraylink by its adjacent transmission networks, namely AusNet Services and ElectraNet. The CCP supported Murraylink's proposal to exclude these charges.[13]

Our draft position is not to exclude connection charges from the EBSS. Unlike debt raising costs, we forecast Murraylink's connection charges using revealed costs in a single year. However, if Murraylink's connection costs are materially different from its revealed costs in 2016, it will be eligible to apply for a cost pass through.[14] The EBSS states that we will adjust forecast opex to add any approved revenue increments (or subtract any approved revenue decrements) made after the initial regulatory determination, including approved pass throughs.[15] In the event we approve a pass through, the effect of this approach would be the same as excluding connection charges from the EBSS. If, on the other hand, connection costs are not materially different from revealed costs, we consider they should be shared with consumers in the same way as any other costs and subject to the EBSS. This is consistent with how we stated we would treat uncontrollable costs when we published the EBSS.[16]

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12 NER, cl. 6A.6.5(b)(1).

13 CCP9, *Submission on Murraylink's revenue proposal*, 12 May 2017, p. 5.

14 Murraylink proposed a connection charge pass through event which we accepted in attachment 13 of this draft decision. The pass through event is defined as an event where the connection charge levied by AusNet Services and ElectraNet is different from that incurred in the 2016 base year.

15 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 9.

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