

FINAL DECISION

Directlink transmission determination

2015−16 to 2019−20

Attachment 10 − Capital expenditure sharing scheme

April 2015

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1. Note
2. This attachment forms part of the AER's final decision on Directlink's revenue proposal 2015–20. It should be read with other parts of the final decision.
3. The final decision includes the following documents:
4. Overview
5. Attachment 1 – maximum allowed revenue
6. Attachment 2 – regulatory asset base
7. Attachment 3 – rate of return
8. Attachment 4 – value of imputation credits
9. Attachment 5 – regulatory depreciation
10. Attachment 6 – capital expenditure
11. Attachment 7 – operating expenditure
12. Attachment 8 – corporate income tax
13. Attachment 9 – efficiency benefit sharing scheme
14. Attachment 10 – capital expenditure sharing scheme
15. Attachment 11 – service target performance incentive scheme
16. Attachment 12 – pricing methodology and negotiated services
17. Attachment 13 – pass through events
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1. Shortened forms

| 1. Shortened form | 1. Extended form |
| --- | --- |
| 1. AARR | 1. aggregate annual revenue requirement |
| 1. AEMC | 1. Australian Energy Market Commission |
| 1. AEMO | 1. Australian Energy Market Operator |
| 1. AER | 1. Australian Energy Regulator |
| 1. ASRR | 1. annual service revenue requirement |
| 1. augex | 1. augmentation expenditure |
| 1. capex | 1. capital expenditure |
| 1. CCP | 1. Consumer Challenge Panel |
| 1. CESS | 1. capital expenditure sharing scheme |
| 1. CPI | 1. consumer price index |
| 1. DRP | 1. debt risk premium |
| 1. EBSS | 1. efficiency benefit sharing scheme |
| 1. ERP | 1. equity risk premium |
| 1. MAR | 1. maximum allowed revenue |
| 1. MRP | 1. market risk premium |
| 1. NEL | 1. national electricity law |
| 1. NEM | 1. national electricity market |
| 1. NEO | 1. national electricity objective |
| 1. NER | 1. national electricity rules |
| 1. NSP | 1. network service provider |
| 1. NTSC | 1. negotiated transmission service criteria |
| 1. opex | 1. operating expenditure |
| 1. PPI | 1. partial performance indicators |
| 1. PTRM | 1. post-tax revenue model |
| 1. RAB | 1. regulatory asset base |
| 1. RBA | 1. Reserve Bank of Australia |
| 1. repex | 1. replacement expenditure |
| 1. RFM | 1. roll forward model |
| 1. RIN | 1. regulatory information notice |
| 1. RPP | 1. revenue and pricing principles |
| 1. SLCAPM | 1. Sharpe-Lintner capital asset pricing model |
| 1. STPIS | 1. service target performance incentive scheme |
| 1. TNSP | 1. transmission network service provider |
| 1. TUoS | 1. transmission use of system |
| 1. WACC | 1. weighted average cost of capital |

# Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers whose capex becomes more efficient and financial penalties for those that become less efficient. Consumers benefit from improved efficiency through lower regulated prices. This attachment sets out how we will apply the CESS to Directlink in the 2015­–20 regulatory control period.

1. As part of the Better Regulation program we consulted on and published version 1 of the capital expenditure incentive guideline (capex incentive guideline), which sets out the CESS.[[1]](#footnote-1) The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between service providers and consumers.
2. The CESS works as follows:

* We calculate the cumulative underspend or overspend for the current regulatory control period in net present value terms.
* We apply the sharing ratio of 30 per cent to the cumulative underspend or overspend to work out what the service provider's share of the underspend or overspend should be.
* We calculate the CESS payments taking into account the financing benefit or cost to the service provider of the underspends or overspends.[[2]](#footnote-2) We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB.[[3]](#footnote-3)
* The CESS payments will be added or subtracted to the service provider's regulated revenue as a separate building block in the next regulatory control period.

1. Under the CESS a service provider retains 30 per cent of an underspend or overspend, while consumers retain 70 per cent of the underspend on overspend. This means that for a one dollar saving in capex the service provider keeps 30 cents of the benefit while consumers keep 70 cents of the benefit.

## Final decision

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline to Directlink in the 2015–20 regulatory control period.[[4]](#footnote-4) This is consistent with the proposed approach we set out in our framework and approach paper.[[5]](#footnote-5) We will apply the exclusion from the CESS of capex the service provider incurs in delivering a priority project approved under the network capability component of the Service Target Performance Incentive Scheme (STPIS) for transmission network service providers.[[6]](#footnote-6)

## Directlink's revised proposal

Directlink initially proposed that we apply the CESS as set out in the capex incentives guideline.[[7]](#footnote-7) Directlink did not raise any issues regarding the CESS in its revised proposal.

## AER's assessment approach

1. In deciding whether to apply a CESS to a network service provider, and the nature and details of any CESS to apply to a service provider, we must:[[8]](#footnote-8)

* make that decision in a manner that contributes to the capex incentive objective[[9]](#footnote-9)
* take into account the CESS principles,[[10]](#footnote-10) the capex objectives,[[11]](#footnote-11) other incentive schemes, and, where relevant the opex objectives, as they apply to the particular service provider, and the circumstances of the service provider.

1. Broadly, the capex incentive objective is to ensure that only capex that meets the capex criteria enters the RAB used to set prices. Therefore, consumers only fund capex that is efficient and prudent.

### Interrelationships

1. The CESS relates to other incentives Directlink faces to incur efficient opex, conduct demand management and maintain or improve service levels.[[12]](#footnote-12) We aim to incentivise network service providers to make efficient decisions on when and what type of expenditure to incur and to balance expenditure efficiencies with service quality. We discuss these interrelationships where relevant as part of our reasons below and in our capex attachment.

## Reasons for final decision

We maintain our draft decision to apply the CESS to Directlink as set out in the capex incentive guideline. We will apply the exclusion from the CESS set out in the guideline of capex the service provider incurs in delivering a priority project approved under the network capability component of the Service Target Performance Incentive Scheme (STPIS) for transmission network service providers.[[13]](#footnote-13)

1. AER, Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013, pp. 5–9. (AER, Capex incentive guideline, November 2013). [↑](#footnote-ref-1)
2. We calculate benefits as the benefits to the service provider of financing the underspend since the amount of the underspend can be put to some other income generating use during the period. Losses are similarly calculated as the financing cost to the service provider of the overspend. [↑](#footnote-ref-2)
3. The capex incentive guideline outlines how we may exclude capex from the RAB. AER, Capex incentive guideline, November 2013, pp. 13–20. [↑](#footnote-ref-3)
4. AER, Capex incentive guideline, November 2013, pp. 5–9. [↑](#footnote-ref-4)
5. AER, Framework and approach paper, Directlink, Regulatory control period commencing 1 July 2015, January 2014, p. 20. [↑](#footnote-ref-5)
6. AER, Capex incentive guideline, November 2013, p. 6. [↑](#footnote-ref-6)
7. Directlink, Directlink Joint Venture, Directlink Revenue Proposal, Effective July 2015 to June 2020, May 2014, p. 93. [↑](#footnote-ref-7)
8. NER, cl. 6A.6.5A. [↑](#footnote-ref-8)
9. NER, cl. 6A.5A(a); the capex criteria are set out in cl. 6A.6.7(c)(1)-(3) of the NER. [↑](#footnote-ref-9)
10. NER, cl. 6A.6.5A(c). [↑](#footnote-ref-10)
11. NER, cl. 6A.6.7(a). [↑](#footnote-ref-11)
12. Related schemes are the efficiency benefit sharing scheme (EBSS) for opex, and the service target performance incentive scheme (STPIS) for service levels. [↑](#footnote-ref-12)
13. AER, Capex incentive guideline, November 2013, p. 6. [↑](#footnote-ref-13)