



**FINAL DECISION
SA Power Networks
determination 2015–16 to
2019–20**

**Attachment 9 – Efficiency
benefit sharing scheme**

October 2015

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Note

This attachment forms part of the AER's final decision on SA Power Networks' 2015–20 distribution determination. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

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 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanism

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators

Shortened form	Extended form
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
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
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 opex.

To encourage a service provider to become more efficient it is allowed to keep any difference between its approved 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 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 incurring opex in the expected base year in order to receive a higher opex allowance in the following regulatory control period.

During the 2010–15 regulatory control period SA Power Networks operated under the Electricity distribution network service providers EBSS, released in June 2008.¹

9.1 Final decision

Our final decision is to approve an EBSS carryover amount of –\$1.2 million (\$2014–15) from the application of the EBSS in the 2010–15 regulatory control period.² It is different to our preliminary decision and SA Power Networks' revised proposal because we:

- adjusted its allowed opex to account for new regulatory information notice (RIN) reporting costs
- revised the CPI adjustments in the EBSS model to be consistent with our opex model.

Our final decision for the EBSS carryover amounts from the 2010–15 regulatory control period is outlined in Table 9.1.

Table 9.1 AER's final decision on SA Power Networks' EBSS carryover amounts (\$ million, 2014–15)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
SA Power Networks' revised proposed carryover	–0.7	–5.0	–2.7	3.8	0.0	–4.7
Final decision	0.1	–4.4	–1.9	5.0	0.0	–1.2

Source: AER analysis; SA Power Networks, *Revised regulatory proposal*, p. 309.

¹ AER, *Electricity distribution network service providers Efficiency benefit sharing scheme*, June 2008.

² AER, *Electricity distribution network service providers' EBSS*, June 2008.

We have maintained our preliminary decision to apply version two of the EBSS to SA Power Networks in the 2015–20 regulatory control period.³

When we apply version two of the EBSS we will exclude the cost categories listed in section 9.5.2 from forecast and actual opex for the calculation of EBSS carryover amounts. Table 9.2 sets out our final decision on SA Power Networks' target opex for the EBSS (total opex less excluded categories⁴), against which we will calculate efficiency gains in the 2015–20 regulatory control period.

Table 9.2 AER's final decision on SA Power Networks' forecast opex for the EBSS (\$ million, 2014–15)

	2015–16	2016–17	2017–18	2018–19	2019–20
Forecast opex for the EBSS	241.5	250.2	250.1	253.3	256.3

Source: AER analysis; SA Power Networks, *Revised regulatory proposal, PTRM*.

Note: Total forecast opex less forecast opex on debt raising costs and DMIA.

9.2 Preliminary decision

In our preliminary decision we calculated an EBSS carryover of –\$4.7 million (\$2014–15).⁵ This was different to the carryover proposed by SA Power Networks of \$13.9 million because we:

- excluded movements in provisions
- did not exclude costs for either major event day guaranteed service level (GSL) payments or regulatory compliance costs
- did not apply the deferred negative carryover from the 2005–10 RCP accrued under the Efficiency Carryover Mechanism.

Our preliminary decision was to apply version two of the EBSS to SA Power Networks in the 2015–20 regulatory control period.⁶

9.3 SA Power Networks' revised proposal

SA Power Networks accepted our overall decision on the EBSS carryover amounts from the 2010–15 regulatory control period.⁷ However, it maintained its position that uncontrollable costs associated with major event day GSL payments and regulatory compliance costs should be excluded from the EBSS calculation. It also considered that movements in provisions should be included in the calculation.

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

⁴ Debt raising costs and DMIA.

⁵ AER, *Preliminary decision, SA Power Networks determination, Attachment 9*, April 2015, pp. 9–6.

⁶ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

⁷ SA Power Networks, *Revised regulatory proposal*, October 2015, p. 310.

SA Power Networks accepted our preliminary decision on how the EBSS is to apply in the 2015–20 regulatory control period.⁸ However, SA Power Networks stated that in the 2015–20 regulatory control period, it could potentially incur operating costs to meet new regulatory requirements imposed by Power of Choice and other NER changes. It stated if it incurs costs arising from regulatory changes that have not been taken into account in our final determination or will be unable to be recovered through the pass through event mechanism because of the high materiality threshold; these costs should be excluded from the EBSS.⁹

9.4 AER’s assessment approach

Under the NER we must decide:

1. the revenue increments or decrements (if any) for each regulatory year of the 2015–20 period arising from the application of the EBSS during the 2010–15 regulatory control period¹⁰
2. how any applicable EBSS is to apply to SA Power Networks in the 2015–20 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 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 service providers with continuous incentives, so far as is consistent with economic efficiency, to reduce opex
- the desirability of both rewarding service providers for efficiency gains and penalising them for efficiency losses
- any incentives that service providers may have to capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

9.4.1 Interrelationships

The EBSS is intrinsically linked to a revealed cost forecasting approach for opex. Under this forecasting approach, the EBSS has two specific functions:

⁸ SA Power Networks, *Revised regulatory proposal*, October 2015, p. 310.

⁹ SA Power Networks, *Revised regulatory proposal*, October 2015, p. 311.

¹⁰ NER, cl. 6.4.3(a)(5).

¹¹ NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

¹² NER, cl. 6.5.8(a).

¹³ NER, cl. 6.5.8(c).

- To mitigate the incentive for a service provider to increase opex in the expected 'base year' to increase its approved opex forecast for the following regulatory control period.
- To provide a continuous incentive for a service provider to make efficiency gains - service providers receive the same reward for an underspend and the same penalty for an overspend in each year of the regulatory control period.

Where we do not propose to rely on the revealed costs of a service provider in forecasting opex there are consequences for a service provider's incentives to make productivity improvements. This effects our decision on how we apply the EBSS. We have taken into account the interrelationship between the EBSS and our approach to opex forecasting in reaching our decision.

Incentives to reduce opex may also affect a service provider's incentives to undertake capex. We take into account these interactions in developing and implementing the EBSS as well as developing the CESS. For instance:

- In developing and implementing the EBSS, we must have regard to any incentives that service providers may have to capitalise operating expenditure as well as the possible effects of the scheme on incentives for the implementation of non-network alternatives.¹⁴
- In developing the CESS, we must take into account the interaction of the scheme with other incentives that service providers may have in relation to undertaking efficient opex or capex as well as the capex objectives and, if relevant, the opex objectives.¹⁵

9.5 Reasons for final decision

9.5.1 Carryover amounts from the 2010–15 regulatory control period

SA Power Networks accepted our preliminary decision about the overall carryover amount we will apply in the 2015–20 regulatory control period.¹⁶ However, we have since changed our position to account for increased costs it incurred to comply with new RIN reporting requirements and to update the inflation estimate we applied. Collectively, these adjustments reduced its negative EBSS carryover amount from –\$4.7 million to –\$1.2 million (\$2014–15).

RIN compliance costs

In 2013–14 SA Power Networks was required to comply with our new economic benchmarking and category analysis RINs for the first time. This led to an increase in

¹⁴ NER, cl. 6.4.3(a)(4),(5).

¹⁵ NER, cl. 6.5.8A(d).

¹⁶ SA Power Networks, *Revised regulatory proposal*, October 2015, p. 310.

costs. In its initial proposal SA Power Networks proposed we exclude \$1.25 million for RIN compliance costs in 2014. SA Power Networks stated these categories were consistent with the provisions in its 2010 determination.¹⁷ In that determination we said we would exclude other specific uncontrollable costs incurred and reported by (the then) ETSA Utilities during the 2010–15 regulatory control period, which we consider should be excluded after assessment against the relevant principles expressed in clause 6.6.1(j) of the NER and in the EBSS.¹⁸ SA Power Networks considered an exclusion for RIN compliance costs would be consistent with this clause.

We did not allow this exclusion in our preliminary decision.¹⁹ In arriving at our position we had regard to the relevant principles expressed in clause 6.6.1(j) of the NER and in the EBSS²⁰ which allowed us to consider any factors we considered relevant. We considered the interrelationships described in section 9.4.1 above were relevant. The EBSS is intrinsically linked to our opex revealed cost forecasting approach. We stated that SA Power Networks had included the costs incurred for regulatory compliance costs (\$1.25 million) in the base year it used to calculate its opex forecast for the next period, resulting in a higher opex forecast. Consequently, those costs should also be included in the base year used to calculate the EBSS.²¹

We have reconsidered our position not to allow this exclusion and we now consider we are required to adjust SA Power Network's opex allowance under the terms set out in the electricity distribution EBSS.²² CitiPower and Powercor raised this matter in their regulatory proposals submitted as part of the Victorian determination process. They stated that the EBSS that applied to the Victorian (and South Australian) businesses requires that adjustments be made to the EBSS where there are compliance costs as a result of new or changed regulatory requirements.²³

The opex forecast must include any necessary adjustments for changes in responsibilities that result from compliance with a new or amended law or licence, or other statutory or regulatory requirement.²⁴

CitiPower and Powercor adjusted their EBSS carryover amounts as a result of the increased RIN requirements they faced in 2014.

Consistent with the approach we have adopted for CitiPower and Powercor, we have also adjusted SA Power Networks' EBSS carryover amounts as a result of these

¹⁷ SA Power Networks, *Regulatory proposal*, October 2014, pp. 282–283.

¹⁸ AER, *ETSA Utilities distribution determination 2010–15*, 4 May 2010, p. 209.

¹⁹ AER, *Preliminary decision, SA Power Networks determination 2015-20, Attachment 9*, April 2015, pp. 9–11.

²⁰ In addition to the matters listed in clause 6.6.1(j)(1)–(7), clause 6.6.1(j)(8) of the pass through provisions allows us to consider any factors we consider relevant.

²¹ AER, *Preliminary decision, SA Power Networks determination 2015-20, Attachment 9*, April 2015, pp. 9–11 to 9–12.

²² AER, AER, *Electricity distribution network service providers Efficiency benefit sharing scheme*, June 2008, p. 7.

²³ CitiPower, *Regulatory proposal*, April 2015, p. 249; Powercor, *Regulatory proposal*, April 2015, p. 257.

²⁴ AER, *Electricity distribution network service providers Efficiency benefit sharing scheme*, June 2008, p. 7.

increased costs. SA Power Networks did not refer to this clause in the EBSS when it initially proposed this exclusion.

Major event day GSL payments and movements in provisions

We maintain our preliminary decision not to exclude costs associated with major event day GSL payments. We maintain there is no specific allowed exclusion for these costs under the EBSS. We note that major event day GSL payments are not a new or amended regulatory requirement; therefore we are not required to adjust the EBSS as we have for regulatory reporting requirements.

We maintain our preliminary decision to adjust reported actual opex to reverse any movements in provisions. As we stated in our preliminary decision, we consider movements in provisions should be excluded from EBSS calculations.²⁵ This is because we consider the increases in provisions do not represent an actual cost incurred in delivering network services when calculating efficiency gains or losses.

CPI adjustment

Our calculations of the EBSS carryover amounts and SA Power Networks' proposal are also different because we revised our CPI adjustment in our EBSS model to be consistent with our opex model. We consider the CPI adjustment in the EBSS model should be the same as the CPI adjustment in the opex model because of the interaction between the EBSS carryover amounts and our opex forecast. If they are not consistent, a service provider could receive a reward or penalty for different inflation assumptions.

9.5.2 How the EBSS will apply in the 2015–20 regulatory control period

We have maintained our preliminary decision to apply version two of the EBSS to SA Power Networks in the 2015–20 regulatory control period.

Version two of the EBSS specifies our approach to determining the length of the carryover period, calculating the incremental efficiency gains 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 2015–20 regulatory control period will be five years. This aligns the EBSS carryover period with the length of SA Power Networks' regulatory control periods.

²⁵ AER, *Preliminary decision, SA Power Networks determination, Attachment 9*, April 2015, pp. 9-10.

Incremental efficiency gains

We will calculate incremental efficiency gains differently depending on whether they are in:

- the first regulatory year
- the second regulatory year to the penultimate regulatory year
- the final regulatory year.

We will do this according to the formulas set out in version two of the EBSS.²⁶

When calculating actual opex under the EBSS we will adjust reported actual opex for the 2015–20 regulatory control period to reverse any movements in provisions. We consider actual opex net of movement in provisions best reflects the actual opex incurred by the service provider during the regulatory control period.

Adjustments to forecast or actual opex when calculating carryover amounts

The EBSS allows for exclusions of categories of costs from the EBSS where we do not use 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.

We will exclude debt raising costs and the demand management innovation allowance (DMIA) from the EBSS because the forecasts for these categories are not based on a single year of revealed expenditure.

In addition to the excluded cost category we will also:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination. This may include approved pass through amounts
- adjust actual opex to add capitalised opex that has been excluded from the RAB
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2020 where doing so better achieves the requirements of clause 6.5.8 of the NER.

²⁶ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, pp. 5–7.

Excluding costs arising from regulatory changes

SA Power Networks stated that in the 2015–20 regulatory control period, it could potentially incur operating costs to meet new regulatory requirements imposed by Power of Choice and other Rule changes. It stated if it incurs costs arising from regulatory changes that have not been taken into account in our final determination or it cannot receive a pass through amount due to the materiality threshold, these costs should be excluded from the EBSS.²⁷

We will not exclude these costs from the EBSS. The materiality threshold in the pass through provisions is designed to capture only material changes in a service provider's regulatory obligations not accounted for in its expenditure forecasts. If a change is not material enough for a pass through amount, then we consider it is also not material enough for an EBSS exclusion.

A benefit of our approach is that we treat all changes in regulatory compliance costs symmetrically. Under SA Power Networks' proposed approach it would not be penalised where regulatory compliance costs increased during the regulatory control period but it would benefit where regulatory compliance costs decreased.

²⁷ SA Power Networks, *Revised regulatory proposal*, October 2015, p. 311.