DRAFT DECISION
Powerlink Queensland Transmission Determination

2022 to 2027

Attachment 9
Capital expenditure sharing scheme

September 2021

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Note

This attachment forms part of the AER's draft decision on Powerlink Queensland's transmission network revenue determination for the 2022–27 regulatory control period. 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 – 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

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9 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards to network service providers whose capital expenditure (capex) becomes more efficient and financial penalties for those that become less efficient. Consumers benefit from improved efficiency through lower regulated prices. We first applied the CESS to Powerlink in the 2017–22 regulatory control period.

This attachment sets out our decision for both the determination of the revenue impacts as a result of the CESS applying in the 2017–22 regulatory control period, and the application of the CESS for Powerlink in the 2022–27 regulatory control period.

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. Under the CESS a service provider retains 30 per cent of an under-spend or over-spend, while consumers retain 70 per cent of the under-spend or over-spend. 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.

The CESS works as follows:

1. We calculate the cumulative efficiency gains or losses for the current regulatory control period in net present value terms.
2. We apply a ratio of 30 per cent to the cumulative under-spend or over-spend to work out the service provider's share of the under-spend or over-spend.
3. We calculate the CESS payment taking into account the financing benefit, or cost, to the service provider of the under-spend or over-spend.[1] We can also make a further adjustment to account for deferral of capex and ex post exclusions of capex from the regulatory asset base (RAB).[2]
4. The CESS payment is added or subtracted to the service provider's regulated revenue as a separate building block in the next regulatory control period.

[1] We calculate benefits as the benefits to the service provider of financing the under-spend since the amount of the under-spend 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 over-spend.

[2] The capex incentive guideline outlines how we may exclude capex from the RAB. AER, *Capex incentive guideline*, November 2013, pp. 13–20.

9.1 Draft decision

9.1.1 Revenue impacts in the 2022–27 period from applying the CESS in the 2017–22 period

Our draft decision is to apply a CESS revenue decrement amount of $3.3 million ($2021–22) from the application of the CESS in the 2017–22 regulatory control period.[3] CESS revenue decrements arise as a result of an over-spend in capex against the forecast for the relevant period (in this case, the 2017–22 period).

Our draft decision on the revenue impact of the application of the CESS in the 2017–22 period is summarised in Table 9.1.

Table 9.1 AER's draft decision on Powerlink's CESS revenue ($ million, 2021–22)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Powerlink's proposal	-0.74	-0.74	-0.74	-0.74	-0.74	-3.7
AER draft decision	-0.67	-0.67	-0.67	-0.67	-0.67	-3.3

Source: Powerlink, *2023–27 Revenue proposal, Capital expenditure sharing scheme model,* January 2021 and AER analysis.

Note: Numbers may not add up due to rounding.

Given the timing of this draft decision, we calculated the CESS revenue decrements in Table 9.1 using estimates of Powerlink's capex for 2020–21 and 2021–22 regulatory years. The CESS revenue decrement we calculated ($3.3 million) is different to the revenue decrement that Powerlink proposed ($3.7 million) because we applied updated modelling inputs.

9.1.2 Application of the CESS in the 2022–27 period

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline to Powerlink in the 2022–27 regulatory control period.[4] The guideline provides for 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.[5] This is consistent with the proposed approach we set out in our framework and approach paper.[6]

[3] NER, cl. 6A.14.1(5A).

[4] AER, *Capital Expenditure Incentive Guideline*, November 2013, pp. 5–9.

[5] Ibid, p. 6.

[6] AER, *Final framework and approach for Powerlink 2022–27 – Regulatory control period commencing 1 July 2022*, July 2020.

9.2 Powerlink's proposal

9.2.1 Revenue impacts in the 2022–27 period from applying the CESS in the 2017–22 period

Powerlink proposed a $3.7 million ($2021–22) CESS revenue decrement to its regulated revenue in the 2022–27 regulatory control period.[7]

9.2.2 Application of the CESS in the 2022–27 period

Powerlink proposed that the CESS for the 2022–27 regulatory control period forecast period is the same as that applied to the current regulatory control period.[8]

9.3 Assessment approach

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

- the revenue impacts on Powerlink arising from applying the CESS in the 2017–22 regulatory control period
- whether or not to apply the CESS to Powerlink in the 2022–27 regulatory control period and how any applicable scheme will apply.[9]

We must determine the appropriate revenue increments or decrements (if any) for each year of the 2022–27 period arising from the application of the CESS during the 2017–22 period.[10]

We must also determine how any applicable CESS is to apply to Powerlink in the 2022–27 period.[11] In deciding whether to apply a CESS to Powerlink for the 2022–27 period, and the nature and details of the scheme, we must:[12]

- make that decision in a manner that contributes to the capex incentive objective[13]
- take into account the CESS principles,[14] the capex objectives and, where relevant, the operating expenditure (opex) objectives,[15] the interaction with other incentive schemes,[16] and the circumstances of the service provider.[17]

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7 Powerlink, *Revenue Proposal 2023–27 - Capital Expenditure Sharing Scheme Model,* January 2021.

8 Powerlink, *2023–27 Revenue proposal*, January 2021, p. 141.

9 NER, cl. 6A.14.1(5A).

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

11 NER, cl. 6A.14.5(5A).

12 NER, cl. 6A.6.5A(e).

13 NER, cl. 6A.6.5A (e) (3); the capex incentive objective is set out in cl. 6A.5A (a).

14 NER, cl. 6A.6.5A (e) (4) (i); the CESS principles are set out in cl.6A.6.5A(c).

15 NER, cll. 6A.6.5A(e)(4)(i) and 6A.6.5A(d)(2); the capex objectives are set out in cl. 6A.6.7(a); the opex objectives are set out in cl. 6A.6.6(a).

16 NER, cll. 6A.6.5A(e)(4)(i) and 6A.6.5A(d)(1).

17 NER, cl. 6A.6.5A(e)(4)(ii).

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.

9.3.1 Interrelationships

The approval of CESS payments/penalties determines the associated CESS building block as part of Powerlink's overall forecast revenue requirement for the 2022–27 regulatory control period.

The CESS relates to other incentives Powerlink faces to incur efficient opex, conduct demand management, and maintain or improve service levels. Related schemes include the efficiency benefit sharing scheme (EBSS) for opex, and the STPIS for service levels. 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.

9.4 Reasons for draft decision

We consider Powerlink should receive a CESS revenue decrement of $3.3 million ($2021–22) from the application of version 1 of the CESS during the 2017–22 regulatory control period. This means that Powerlink's allowed revenue in the 2022–27 regulatory control period is $3.3 million less than it would otherwise have been due to the application of the CESS to Powerlink in the 2017–22 period.

The timing of our draft decision means that the 2020–21 and 2021–22 regulatory year incurred capex figures used to calculate the CESS revenue decrements are estimates. Our capital expenditure incentive guideline provides for the calculation of CESS revenue amounts to use both actual and estimated capex for all years of the current period to determine the CESS revenues in the forecast period.[18]

Given that the 2021–22 regulatory year capex will be an estimate, at the time of our final decision we may need to make further adjustments to the revenue amount where actual underspending or overspending in the 2021–22 regulatory year is different to the estimate. These adjustments will be made when we undertake our revenue determination for the subsequent regulatory control period.[19]

Our calculation of the CESS is in accordance with section 2.3 of version 1 of the capital expenditure incentive guideline.[20]

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18 AER, *Capital Expenditure Incentive Guideline*, November 2013, pp. 7–8.

19 AER*, Explanatory Statement - Capital Expenditure Incentive Guideline*, November 2013, p. 21.

20 AER, *Capital Expenditure Incentive Guideline*, November 2013, p. 6.

In the 2017–22 period, Powerlink was subject to version 1 of the CESS. Under this scheme the CESS revenue decrements are to be based on the difference between:

- approved forecast capex set out in our determination for Powerlink for the 2017–22 period
- actual capex for the 2017–22 period, after the removal of any excluded cost categories such as network capability incentive parameter action plan (NCIPAP) capex, asset disposals and deferred capex in the current regulatory control period.[21]

Powerlink proposed to defer $18.24 million (nominal) for its office building refit project for the 2017–22 period.[22] Powerlink has deferred this project to the 2022–27 period.[23] Powerlink submitted that although the provision of office accommodation that facilitates contemporary work practices remains important for its business, it determined that it was more important to defer this project and focus on enhancing its network analysis, project planning and other work practices to meet the emerging technical challenges of its energy market in the short-term.[24] We consider that Powerlink's justification for its deferral of its proposed office building refit project is reasonable. We also consider the amount of the deferred capex to be sufficiently material for the purposes of an adjustment to the CESS payments where a network service provider has deferred capex in the current regulatory control period.[25]

The formulas for calculating the revenue decrements are set out in our determination CESS model.[26]

The CESS revenue decrement we calculated ($3.3 million) is different to the revenue decrement that Powerlink proposed ($3.7 million) because we have used:

- more recent inflation figures; and
- an updated weighted average cost of capital input information.

9.4.1 Application of the CESS in the 2022–27 period

The reasons for our preference for a CESS are set out in our capital expenditure incentive guideline.[27] In developing the guideline we took into account the capex incentive objective, capex criteria, capex objectives and the National Electricity Objective (NEO).

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21 An estimate of 2020-21 and 2021–22 capex has been used for the draft decision.

22 Powerlink, *2023–27 Revenue proposal, Capital expenditure sharing scheme model,* January 2021.

23 Powerlink, *2023–27 Revenue proposal,* January 2021, p. 44.

24 Ibid, p. 44.

25 AER, *Capital Expenditure Incentive Guideline*, November 2013, p. 9.

26 AER, *Draft decision, Powerlink transmission determination 2022–27, CESS model*, January 2021.

27 AER, *Capital Expenditure Incentive Guideline*, November 2013.

We will apply version 1 of the CESS to Powerlink in the 2022–27 regulatory control period.[28] As we have set out in the framework and approach paper, we consider the CESS is needed to provide Powerlink with a continuous incentive to pursue efficiency gains. This approach is consistent with Powerlink's revenue proposal.[29]

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[28] Ibid, November 2013.

[29] Powerlink, *2023–27 Revenue proposal*, January 2021, p. 141.

A. Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
EBSS	Efficiency benefit sharing scheme
NCIPAP	Network capability incentive parameter action plan
NEO	National Electricity Objective
NER	National Electricity Rules
Opex	Operating expenditure
RAB	Regulatory asset base
STPIS	Service target performance incentive scheme