DRAFT DECISION

SA Power Networks Distribution Determination 2020 to 2025

Attachment 8 Efficiency benefit sharing scheme

October 2019

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165
Email: SAPN2020@aer.gov.au

AER reference: 62729

Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to SA Power Networks for the 2020–2025 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

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CPI	consumer price index
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
NEL	national electricity law
NER or the rules	national electricity rules
opex	operating expenditure
RAB	regulatory asset base
RIN	regulatory information notice

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 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 SA Power Networks accrued over the 2015–20 regulatory control period, and how we will apply the EBSS over the 2020–25 regulatory control period.

8.1.1 Draft decision

Our draft decision is to include EBSS carryover amounts totalling –$30.7 million ($2019–20) from the application of the EBSS in the 2015–20 regulatory control period.[1] This is $0.6 million ($2019–20) lower than SA Power Networks' proposal of —30.1 million ($2019–20). This difference reflects the following differences between SA Power Networks' proposal and our decision:

- we used different inflation figures to convert amounts into 2019–20 dollars
- we did not exclude the forecast and actual opex of specific cost categories in 2013–14 and 2014–15 from total opex as SA Power Networks proposed, other than excluding the cost of self-insurance. These opex categories were excluded from SA Power Networks' EBSS in the 2010–15 regulatory control period but not the 2015–20 regulatory control period.
- we added the opex approved for approved pass through events to forecast opex rather than excluding the actual opex associated with these events from actual opex
- we removed different amounts of movements in provisions from actual opex.

Our draft decision is based on SA Power Networks' estimated opex for 2018–19. In our final decision, we will update our calculation of the carryover amounts using actual opex in that year. We will also update our inflation forecast for 2019–20 in our final decision.

We set out our draft decision on SA Power Networks' EBSS carryover amounts in table 8.1.

[1] NER, cl. 6.4.3(a)(5).

Table 8.1 Draft decision on carryover amounts ($ million, 2019–20)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
SA Power Networks' proposal	9.0	–24.0	–5.1	–9.9	–	–30.1
AER draft decision	3.7	–26.8	–0.8	–6.8	–	–30.7
Difference	–5.2	–2.8	4.3	3.1	–	–0.6

Source: SA Power Networks, Reset RIN – Workbook 5 – EBSS, January 2019; AER, SA Power Networks draft decision – EBSS model, September 2019; AER analysis.

Note: Numbers may not add up due to rounding.

We will continue to apply version 2 of the EBSS to SA Power Networks in the 2020–25 regulatory control period.[2] Consistent with SA Power Networks' proposal, we will exclude debt raising costs from the scheme as a pre-defined 'excluded category'. 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 2020–25 regulatory control period, including forecast debt raising costs.

Table 8.2 Forecast opex for the EBSS ($ million, 2019–20)

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Total forecast opex	277.4	280.7	291.7	293.3	294.9	295.9	297.0
Less debt raising costs	–2.3	–2.3	–1.5	–1.5	–1.4	–1.4	–1.4
Forecast opex for the EBSS	**275.1**	**278.4**	**290.3**	**291.9**	**293.5**	**294.5**	**295.6**

Source: AER, *SA Power Networks draft decision - Post tax revenue model*, September 2019; AER analysis.

Note: Numbers may not add up due to rounding.

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

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

8.2 SA Power Networks' proposal

8.2.1 Carryover amounts from the 2015–20 control period

SA Power Networks proposed we include EBSS carryover amounts totalling –$30.1 million ($2019–20) in its revenue in the 2020–25 regulatory control period, from the application of the EBSS in the 2015–20 regulatory control period.[3]

SA Power Networks excluded the following cost categories in calculating its EBSS carryover amount:[4]

- debt raising costs
- self-insurance, insurance, superannuation, non-network alternatives, RIN compliance costs and pass through opex (only in 2013–14 and 2014–15)
- demand management innovation allowance opex

It also reversed its movements in provisions related to opex.

8.2.2 Application in the 2020–25 control period

SA Power Networks proposed we continue to apply version 2 of the EBSS in the 2020–25 regulatory control period.[5] It also proposed that we apply the same adjustments and exclusions for the 2020–25 regulatory control period as we applied in the 2015–20 regulatory control period, including:[6]

- adjusting forecast opex to add (subtract) any approved revenue increments (decrements) made after the distribution determination for the 2020–25 regulatory control period. This may include approved pass through amounts or opex for contingent projects
- adjusting actual opex to add capitalised opex that has been excluded from the RAB
- excluding categories of opex not forecast using a single year revealed cost approach for the 2025–30 regulatory control period where doing so would better achieve the requirements of clause 6.5.8 of the National Electricity Rules (NER), including costs associated with:
    - debt raising costs
    - the demand management innovation allowance

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3 SA Power Networks, *2020–25 Regulatory proposal—Attachment 8—Efficiency benefit sharing scheme*, 31 January 2019, p. 8.

4 SA Power Networks, *Reset RIN—Workbook 5—EBSS*, January 2019.

5 SA Power Networks, *2020–25 Regulatory proposal—Attachment 8—Efficiency benefit sharing scheme*, 31 January 2019, p. 8.

6 SA Power Networks, *2020–25 Regulatory proposal—Attachment 8—Efficiency benefit sharing scheme*, 31 January 2019, p. 10.

- adjusting forecast opex and/or actual opex in the 2020–25 regulatory control period for inflation so that the real value of the carryover amounts is consistent with the real value of the other components of SA Power Networks' regulated revenue in the 2025–30 regulatory control period
- adjusting reported actual opex to reverse any movements in provisions.

8.2.3 Stakeholder submissions

Energy Consumers Australia (ECA) raised concerns with the incentive framework we apply to distributors. It noted that the design of the EBSS notionally distributes the benefits of efficiency improvement 30:70 between distributors and consumers. It stated that, in practice, the distributor gets its share in the six years following the improvement, while consumers need to wait until the 15th year until they get the first 30 of their total 70. It stated that a scheme whereby consumers get the immediate benefit of some of the cost savings would be preferable and would in part resolve the 'paradox'.[7] We discuss these concerns in section 8.4.2.

8.3 Assessment approach

Under the NER we must determine:

- the revenue increments or decrements for each year of the 2020–25 regulatory control period arising from the application of the EBSS during the 2015–20 regulatory control period[8]
- how the EBSS will apply to SA Power Networks in the 2020–25 regulatory control period.[9]

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between service providers and network users.[10] We must also have regard to the following matters when implementing the EBSS:[11]

- 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 SA Power Networks with a continuous incentive to reduce opex
- the desirability of both rewarding SA Power Networks for efficiency gains and penalising it for efficiency losses
- any incentives that SA Power Networks may have to capitalise expenditure

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7 Energy Consumer Australia, *AER Issues Paper: SA Power Networks Electricity distribution determination 2020 to 2025, Submission*, May 2019, p. 24.

8 NER, cl. 6.4.3(a)(5).

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

10 NER, cl. 6.5.8(a).

11 NER, cl. 6.5.8(c).

- 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.[12]

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 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 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 SA Power Networks 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,

[12] 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).

and our EBSS decision is made largely in consequence of (and takes careful account of) our past and current decisions on SA Power Networks' opex.

8.4 Reasons for draft decision

8.4.1 Carryover amounts from the 2015–20 control period

Our draft decision is to include EBSS carryover amounts totalling –$30.7 million ($2019–20) from the application of the EBSS in the 2015–20 regulatory control period.[13] This is $0.6 million ($2019–20) lower than SA Power Networks' proposal of –$30.1 million ($2019–20). This difference reflects that:

- we used different inflation figures to convert amounts into 2019–20 dollars
- we did not exclude the forecast and actual opex of specific cost categories in 2013–14 and 2014–15 from total opex that SA Power Networks did, other than self-insurance. These opex categories were excluded from SA Power Networks' EBSS in the 2010–15 regulatory control period but not the 2015–20 regulatory control period.
- we added the opex approved for approved pass through events to forecast opex rather than excluding the actual opex associated with these events from actual opex
- we removed different amounts of movements in provisions from actual opex.

We consider that the EBSS carryover amounts we have calculated provide for a fair sharing of efficiency gains and losses between SA Power Networks and its network users. It both rewards SA Power Networks 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.

We discuss each of these issues in more detail below.

Our draft decision is based on SA Power Networks' estimated opex for 2018–19. In our final decision, we will update our calculation of the carryover amounts using actual opex in that year. We will also update our inflation forecast for 2019–20 in our final decision.

Inflation

Consistent with our standard approach, we used unlagged inflation to convert amounts to 2019–20 real terms. SA Power Networks, however, used lagged inflation. We questioned SA Power Networks about this and it stated that it had no objection to using unlagged inflation.[14]

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13 NER, cl. 6.4.3(a)(5).

14 SA Power Network, *Response to information request IR#034*, 27 May 2019, p. 1.

We also used different inflation forecasts for 2018–19 and 2019–20 than SA Power Networks did. For 2018–19 we used the actual CPI figures published by the Australian Bureau of Statistics, which were released after SA Power Networks submitted its proposal.[15] For 2019–20 we used the inflation forecast in the Reserve Bank of Australia's August 2019 *Statement on monetary policy*.[16] This was also published after SA Power Networks submitted its proposal.

Incremental efficiency gain in 2015–16

To calculate the incremental efficiency gain for 2015–16, we did not exclude insurance, superannuation, non-network alternatives opex and RIN compliance costs from SA Power Networks' forecast and actual opex for 2013–14 and 2014–15. We did exclude self-insurance costs. SA Power Networks, however, excluded self-insurance, insurance, superannuation, non-network alternatives opex and RIN compliance costs from its forecast opex and its actual opex for 2013–14 and 2014–15. These categories of opex were excluded from the operation of the EBSS for the 2010–15 regulatory control period, but not for the 2015–20 regulatory control period. We did not exclude these costs because doing so would result in the incremental gain we calculated for 2015–16 including the incremental gains made in 2014–15 related to these costs.

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. So 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 2015–16 for those categories of expenditure subject to the EBSS in the 2015–20 regulatory control period. For this reason we did not exclude insurance, superannuation, non-network alternatives opex and RIN compliance costs from SA Power Networks' forecast and actual opex for 2013–14 and 2014–15 to calculate the incremental efficiency gain for 2015–16 (they were not excluded from the EBSS for the 2015–20 regulatory control period). By doing this, the incremental efficiency gain we have calculated for 2015–16 does not also include the efficiency gains made in 2014–15 related to insurance, superannuation, non-network alternatives and RIN compliance costs.

Notwithstanding the above, we consider it is appropriate to treat self-insurance differently from the other opex categories that were excluded from the EBSS during the 2010–15 regulatory control period, but not the 2015–20 regulatory control period. This is because we did not forecast self-insurance opex for the 2015–20 regulatory control

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15 Australian Bureau of Statistics, *Catalogue number 6401.0, Consumer price index*, June 2019.

16 Reserve Bank of Australia, *Statement on monetary policy*, *Appendix: Forecasts*, August 2019.

period based on SA Power Networks' revealed cost in 2013–14, like the rest of opex. Instead, we forecast self-insurance costs based on an historical average. SA Power Networks' actual self-insurance costs in 2013–14 were higher than the historical average. Consequently, we reduced SA Power Networks' reported opex for 2013–14 by $3.2 million ($2014–15) when we forecast opex for the 2015–20 regulatory control period so that the total opex forecast reflected the historical average level of self-insurance costs. Given this, we note that SA Power Networks would have accrued an incremental efficiency loss of $3.2 million ($2014–15) in 2015–16 even if its actual opex for 2014–15 and 2015–16 were exactly as forecast. We recognise it would be inappropriate for SA Power Networks to accrue a penalty if it has spent exactly as forecast. This is because we must implement the EBSS so it rewards SA Power Networks for efficiency gains and penalises it for efficiency losses.[17] Consequently we have excluded self-insurance costs from actual and forecast opex for 2013–14 and 2014–15. SA Power Networks stated that it 'would expect to accept' this treatment of self-insurance costs.[18]

Pass throughs

In July 2013 we published our final decision on SA Power Networks' cost pass through application for vegetation management costs arising from an unexpected increase in vegetation growth rates.[19] We approved additional opex for SA Power Networks for 2012–13, 2013–14 and 2014–15 that we included in its allowed revenues. We added the opex amounts approved in this pass through decision to the forecast opex amounts for 2013–14 and 2014–15 that we used to calculate EBSS carryover amounts.

SA Power Networks, however, subtracted the actual opex associated with this pass through event from actual opex rather than adding the approved pass through opex to allowed opex. We asked SA Power Networks why it adopted this approach. It stated that the approach it used was consistent with the treatment of pass through opex in the 2010–15 regulatory control period, which it believed is the appropriate treatment.[20]

However, in our final decision for SA Power Networks for the 2015–20 regulatory control period, we stated that we would adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after our regulatory determination, including approved pass through amounts.[21] This is consistent with the approach specified in version 2 of the EBSS, which applied to SA Power Networks in the 2015–

17 NER, cl. 6.5.8(c)(3).

18 SA Power Networks, *Response to information request IR#064*, 5 July 2019, p. 2.

19 AER, *Final Decision: SA Power Networks cost pass through application for vegetation management costs arising from an unexpected increase in vegetation growth rates*, July 2013.

20 SA Power Networks, *Response to information request IR#034*, 27 May 2019, p. 2.

21 AER, *Final decision, SA Power Networks determination 2015−16 to 2019−20—Attachment 9—Efficiency benefit sharing scheme*, October 2015, p. 12.

20 regulatory control period.[22] SA Power Networks applied the approach to pass through opex specified in version 1 of the EBSS.[23]

When we asked SA Power Networks why it had not applied the approach specified in our final decision for the 2015–20 regulatory control period, and in accordance with version 2 of the EBSS, it stated that it had no objection to applying this approach.[24]

Movements in provisions

We removed movements in provisions from SA Power Networks' actual opex, consistent with our final decision for the current regulatory control period.[25]
SA Power Networks did not remove movements in provisions related to Guaranteed Service Level (GSL) payments in its EBSS carryover calculations.

When we asked SA Power Networks why it did not remove these movements in provisions, it stated that it was because they were minor.[26] We do not consider this is an appropriate justification to not exclude these movements in provisions.
SA Power Networks noted that no specific GSL provision account existed prior to 2017–18. For 2016–17, the GSL provision was reported as part of the provision for self-insurance. It noted that a specific GSL provision account was created during the 2017–18 regulatory year.[27] SA Power Networks also confirmed that movements in the GSL provision are reflected in the standard control services opex it reported in its annual regulatory information notices from 2016–17.[28]

Separately, we did not remove from opex the entirety of the movements in provisions SA Power Networks reported for its annual leave and long service leave provisions. We allocated a portion of these movements to capital expenditure (capex).
SA Power Networks allocated the entirety of all of its movements in provisions, for all provisions, to opex.

To the extent that labour is used to deliver capex, we would normally expect to see a portion of any provisions for employee entitlements to be allocated to capex. When we asked SA Power Networks about this, it stated that, in accordance with the costing methodologies applicable under its CAM, all provision movements are initially costed to opex. However, it confirmed that its labour rates incorporate a component to recover annual leave and long service leave expense, which results in a portion of the annual and long service leave being costed from opex to capex. Consequently a portion of its reported movements in its annual leave and long service leave provision movements are reflected in its reported capex. SA Power Networks estimated the movements in

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22 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.
23 AER, *Electricity distribution network service providers, Efficiency benefit sharing scheme*, June 2008, p. 7.
24 SA Power Networks, *Response to information request IR#046(B)*, 21 June 2019, p. 4.
25 AER, *Final decision, SA Power Networks determination 2015−16 to 2019−20—Attachment 9—Efficiency benefit sharing scheme*, October 2015, p. 12.
26 SA Power Networks, *Response to information request IR#034*, 27 May 2019, p. 3.
27 SA Power Networks, *Response to information request IR#046(B)*, 21 June 2019, p. 6.
28 SA Power Networks, *Response to information request IR#064*, 5 July 2019, p. 3.

provisions for annual leave and long service leave based on the proportion of productive hours allocated each year to standard control opex versus capex.[29] We used these estimates to remove only the movements in provisions that were allocated to opex.

8.4.2 Application in the 2020–25 control period

Our draft decision is to continue to apply version 2 of the EBSS to SA Power Networks during the 2020–25 regulatory control period. We consider applying the scheme will benefit long-term electricity customers as it will provide continuous incentives for SA Power Networks to reduce opex. Provided that we forecast SA Power Networks' future opex using its revealed costs in the 2020–25 regulatory control period, any efficiency gains that SA Power Networks achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to determining the length of the carryover period and adjusting forecast or actual opex when calculating carryover amounts.[30] We provide details on these below.

Length of carryover period

To ensure continuous incentives, the length of the carryover period for the 2020–25 regulatory control period will be the same as the length of SA Power Networks' following regulatory control period.[31] We expect SA Power Networks' next regulatory control period will be five years, starting from 1 July 2025.

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.

If we do not use a single year revealed cost forecasting approach, we may not pass the benefits of 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.

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29 SA Power Networks, *Response to information request IR#046(B)*, 21 June 2019, pp. 6–7.

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

31 NER, cl. 6.5.8(c)(2).

As noted in section 8.2.2, SA Power Networks proposed that we apply the same adjustments and exclusions for the 2020–25 regulatory control period as we applied in the 2015–20 regulatory control period.[32]

Consistent with version 2 of the EBSS, we will only exclude debt raising costs from the EBSS as a pre-defined 'excluded category'. This is because we do not forecast debt raising costs on a revealed cost basis. We instead forecast these based on a benchmark amount.

In addition to the excluded cost categories discussed above, we will also make the following adjustments when we calculate the EBSS carryover amounts for the next 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 typically reported by service providers as part of their standard control services opex)[33]
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base[34]
- adjust forecast opex and actual opex for inflation[35]
- 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 2025–30 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.[36]

Concerns raised by Energy Consumers Australia

ECA raised concerns with the incentive framework we apply to distributors. It considered 'the approach to efficiency includes an inherent paradox'. The regulator, in setting the revenue allowance, determines the efficient costs of a distributor, but the incentive regime is designed to reward greater efficiency. ECA considered that the

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32 SA Power Networks, *2020–25 Regulatory proposal—Attachment 8—Efficiency benefit sharing scheme*, 31 January 2019, p. 10.

33 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.

34 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.

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

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

better we do our job (in setting the revenue allowance to reflect efficient costs) the less the available incentive.[37]

ECA noted that the design of the EBSS notionally distributes the benefits of efficiency improvement 30:70 between distributors and consumers. It claimed that, in practice the distributor gets its share in the six years following the improvement, while consumers need to wait until the fifteenth year until they get the first 30 of their total 70. It stated that a scheme whereby consumers get the immediate benefit of some of the cost savings would be preferable and would in part resolve the 'paradox'.[38]

We disagree that the incentive framework includes 'an inherent paradox'. ECA appears to suggest that the lower revenues we set (when we do a 'better' job of setting revenues to reflect efficient costs) the lower the incentive to reduce opex because the distributor won't underspend opex by as much (or its overspend would be greater). However, our revenue forecast in no way restricts a distributor from achieving efficient costs. Further, a prudent and efficient distributor would incur only efficient costs regardless of the revenues we determine.

We note that the incentive that a distributor faces at the margin is unaffected by the opex (and capex) allowance that we set. In other words, if a distributor is able to reduce its opex by a dollar the benefit to it of doing so is the same regardless of the opex (or capex) allowance we set. Its revenues will be different if we set a different opex allowance, but the benefit to the distributor of reducing opex by a dollar will be the same. We do not think there is a paradox as described by ECA.

ECA is correct in stating that distributors receive their share of efficiency gains by retaining them for six years. In other words, if a distributor is able to reduce its ongoing level of opex by a dollar it is not until six years later, through our revealed cost opex forecasting approach and the EBSS, that its revenues reduce by a dollar. Consequently consumers start receiving their share of efficiency gains six years after they are made by the distributor (not 15 years). If we assume a 6 per cent real discount rate this results in distributors retaining 30 per cent of the value of the opex reduction in perpetuity and consumers receiving 70 per cent. If the discount rate is lower than 6 per cent consumers will receive a greater share of the total efficiency gain. We consider this is a fair sharing of efficiency gains.

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[37] ECA, *AER Issues Paper: SA Power Networks Electricity distribution determination 2020 to 2025, Submission*, May 2019, p. 24.

[38] ECA, *AER Issues Paper: SA Power Networks Electricity distribution determination 2020 to 2025, Submission*, May 2019, p. 24.