AUSTRALIAN ENERGY REGULATOR

# Incentives review: CESS workshop

# Workshop agenda

**2.00 – 2.30 AER perspective**

- welcome and introduction
- overview of position paper
- questions

**2.30 – 3.00 Networks perspective**

- ENA
- questions

**3.00 – 3.30 Consumer perspective**

- CCP
- David Havyatt
- questions

**3.30 – 4.00 Discussion**

# This presentation

- Provides an overview of the position paper
  - We released the position paper because submissions focussed on the CESS
  - The position paper presents data on outcomes to date
- Explores CESS issues further
  - Should the CESS be retained?
  - What sharing ratio should apply?
  - Is there a case for a variable sharing ratio and how could it be implemented?
- AER will draw on stakeholder feedback from this workshop and submissions in developing its draft decision

# Objective of CESS

## CESS aims to incentivise efficiency

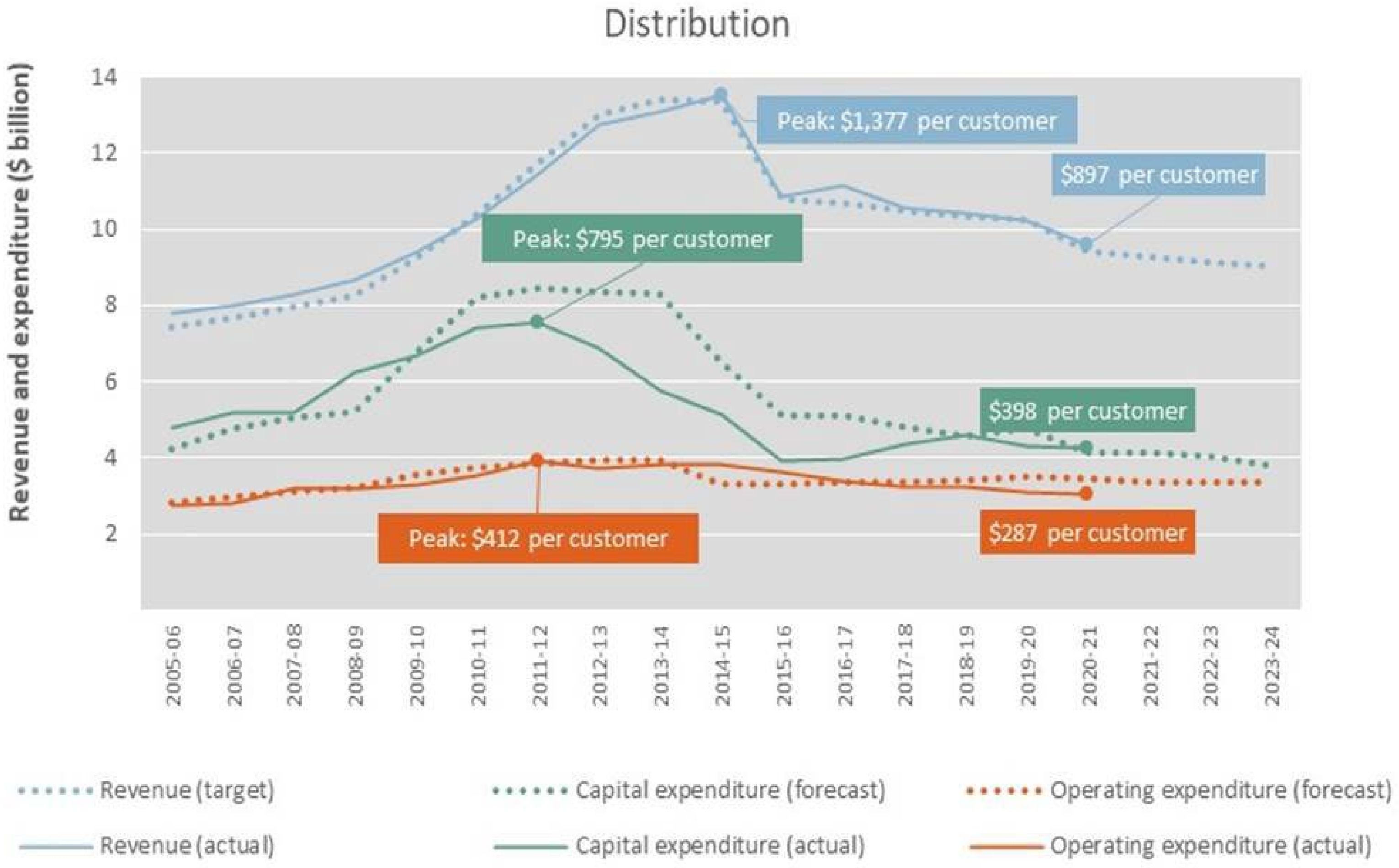
- It should incentivise management effort
- Consumers benefit if the AER learns from revealed costs
- Harder to implement revealed cost model for capex than opex – more capex lumpiness eg DER, transmission

## For consumers there is a trade -off

- Higher CESS sharing ratio means more incentive payments – we can think of this as an information rent
- Optimal trade off between efficiency gains and CESS payments is unknown (insufficient data)
- The current 30% sharing ratio is based on the EBSS sharing ratio

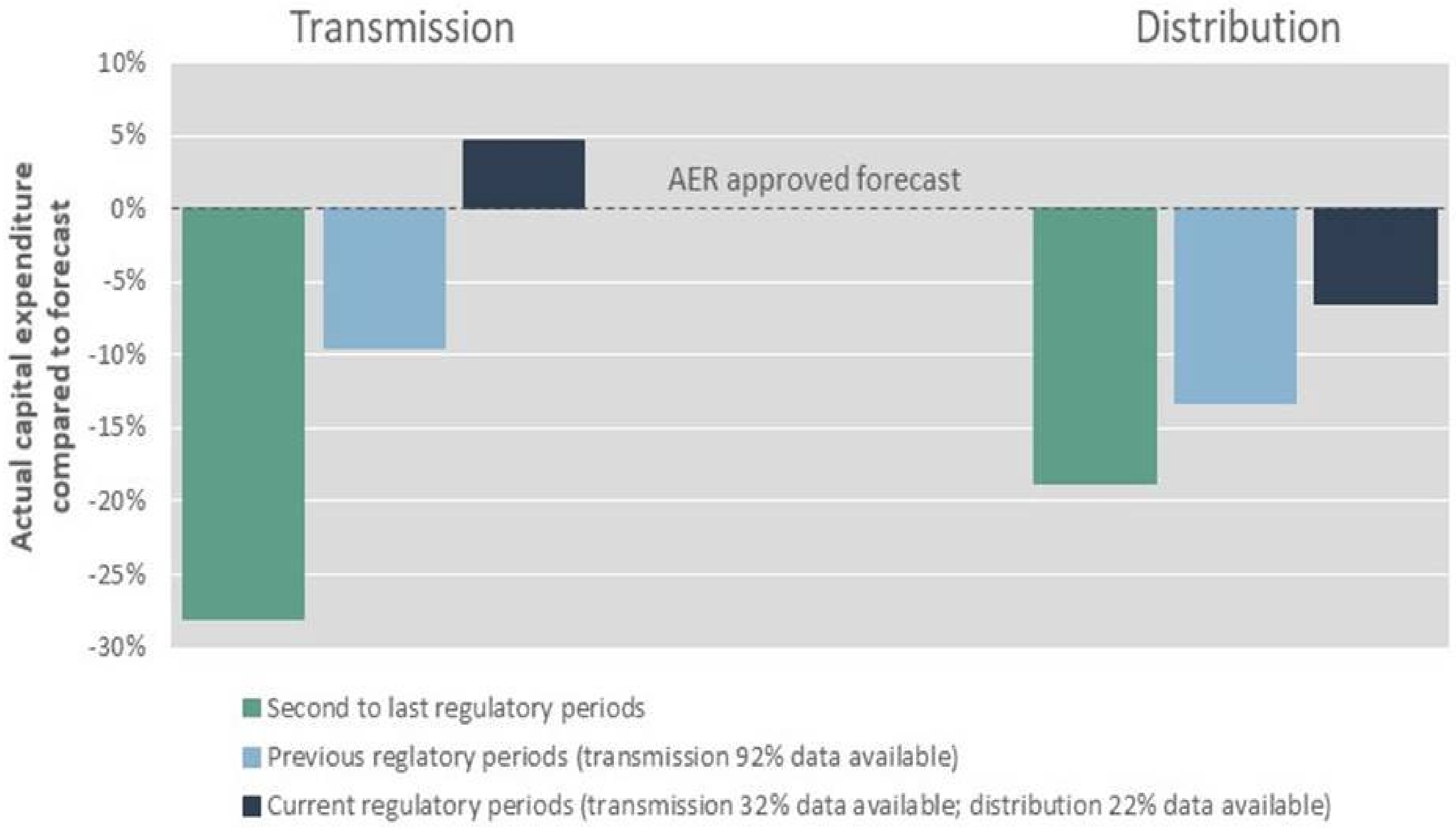
## So is there a case for change?

# The networks are becoming more efficient



# … and AER forecasting accuracy is improving

**Capex expenditure compared to AER forecast**



# … but outcomes vary across networks

- Typically networks spend less capex than forecast
- In most cases network proposals reflect the gains made
  - With capex forecasts based on revealed lower expenditure from the previous regulatory period
- However some networks underspend and then ask for significant step ups at the next reset
  - Example of Citipower, Powercor and United Energy
- Question arises whether underspends are the result of genuine efficiency gains, and whether they outweigh the incentives the CESS provides
- There may now be a case for a targeted CESS response in such circumstances

# Capex outcomes by distribution networks

| DNSP | Underspend in previous regulatory control period | Final decision compared to actuals in previous regulatory control period | Initial proposal compared to actuals in previous regulatory control period |
|---|---|---|---|
| AusNet Services | -15% | -18% | -14% |
| CitiPower | -32% | 3% | 49% |
| Jemena | -23% | 9% | 7% |
| Powercor | -14% | 0% | 24% |
| United Energy | -22% | 17% | 58% |
| SA Power Networks | -16% | -5% | 2% |
| Evoenergy | 2% | -8% | -3% |
| Ausgrid | -16% | -5% | 6% |
| Endeavour Energy | -6% | 9% | 8% |
| Essential Energy | -16% | -6% | -5% |
| Energex | -12% | -21% | -20% |
| Ergon Energy | -3% | -24% | -8% |

# Issue 1

# Retain the CESS?

## Stakeholder views

- Networks - retain CESS
- CCP - reduce sharing ratio and improve transparency
- David Havyatt - remove the CESS
  - benchmarking and frontier analysis a preferable approach

## AER position

- Retain CESS
  - Revealed cost remains primary tool for forecasting expenditure
  - Data suggests CESS driving efficiency and AER is learning from outcomes
- Improve transparency

# Issue 2

# What CESS sharing ratio?

## Stakeholder views

- Networks – retain 30%
- CCP – 20%
- Consumer groups – perceptions that consumers paying too much for forecasting error

## AER position

- Retain 30% sharing ratio as a default rate
  - Given efficiency gains over time and improving forecast accuracy
- Introduce a 20% sharing ratio for proposals of concern
  - Where proposals do not reflect revealed costs, are not supported by consumers and/or otherwise not well supported

# Issue 3

# How to implement a variable sharing ratio

## Options

1. Principles based approach
   - For example, apply the better resets handbook principles
   - Criteria could include consistency of forecast with capex outcomes, rigor of assessments (eg cost/Benefit), and consumer engagement

2. Bright line test
   - For example, apply 30% sharing ratio for outperformance of up to 10%, then sharing ratio of 20%
   - For example, apply 20% rate in forecast period if previous period spend was 10% lower than forecast and forecast is 10% higher than last period capex

3. Hybrid (principles based approach and bright line test)
   - For example, a bright line test combined with the opportunity for a network to make the case why a lower sharing ratio should not be applied

# Next steps

| | |
|---|---|
| Submissions | 9 September 2022 |
| Draft Decision | Late October 2022/early November 2022 |
| Final Decision | April 2023 |
| Guideline changes | Separate consultation process if changes required |