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Dear Sebastian,

Ausgrid welcomes the opportunity to comment on the Australian Energy Regulator's (**AER**) options paper for the Capital Expenditure Sharing Scheme (**CESS**). We appreciate the AER taking this extra step in the review process before making a draft decision on an important feature of the incentive framework.

The Energy Networks Australia (**ENA**) submission, supported by Ausgrid, provides more detail from an industry perspective. This submission outlines the key issues from Ausgrid's perspective. Our overarching observation is that it is important for networks to know how an incentive scheme will apply to it ahead of its regulatory determination, to promote the incentive to seek in long-term efficiencies.

Case not made for any change to CESS

We support the AER's preliminary views that CESS should be retained in its current form (with a 30% sharing ratio), and that there are opportunities to improve the information requirements relating to the difference between actual and forecast capex.[1]

However, we do not think the case has been made to introduce a 20% sharing rate in certain circumstances. The data shows that since implementation of the CESS forecast capex has decreased and underspends have also decreased.[2] This demonstrates that the tools being used to forecast and set capex allowances are improving and reducing the likelihood that underspends could be due to forecasting error or over-forecasting.

In our March submission, we noted that it would be appropriate to allow the AER's new capex assessment tools to take effect before making to changes to the CESS.[3] We maintain the view that the best way to ensure the capex allowance is set at an efficient level—such that outperformance can be attributed to actual efficiency—is for the AER to use the suite of measures at its disposal to incentivise better proposals. This could be supported through strengthened information provision requirements.

Tiered incentive rate has least negative consequences

While we support the current CESS, we note the issues paper the issues paper raises 3 options for applying a variable CESS rate:[4]

[1] AER, Review of incentive schemes for networks: discussion paper, p 54.
[2] AER, Position paper: options for the capital expenditure sharing scheme, p 2.
[3] Ausgrid, Incentive scheme review submission, March 2022, p 3.
[4] AER, Position paper: options for the capital expenditure sharing scheme, p 15.

- Principles based approach;
- Bright line test where 20% sharing applies based on a mechanistic threshold for underspend in one period and proposed capex in the next;
- Bright line test where 20% sharing applies based on a mechanistic threshold for underspend in a period (tiered incentive rate).

We make the following observations about these options, in turn.

A principles-based approach is the least desirable of the 3 alternate options due to the reduction in regulatory certainty and transparency. We would also caution against assuming that networks on the early signal pathway are more likely to satisfy the capex expectations that would be used under a principles-based approach.[5] For example, where a network may not be on the early signal pathway for factors other than the quality of its application, it may be inappropriate to assume that network is less likely to meet the capex expectations.

A bright line test linked to a threshold underspend in one period and capex proposal in the next may:

- disincentivise efficiencies above the threshold;
- not take account of the possibility that a capex proposal more than 10% higher than the previous period actuals may be fully supported by circumstances at the time, for example technological change driving significant network upgrades or customer support for significant resilience activities.

Alternatively, a bright line test linked only to a mechanistic threshold underspend in a period may also disincentivise efficiencies above the threshold.

If the AER is minded to implement a mechanism change to the sharing percentage, the second bright line test option is preferred because it has less chance of creating unintended consequences. We also note that if a bright line test is implemented, as noted by the AER any threshold will necessarily be arbitrary[6]. This is because there is no evidence or data to demonstrate what proportion of an underspend could be attributed to forecast error. If a bright line test is implemented, it is critical that the selected threshold does not lead to unintended consequences to the detriment of customers. We strongly encourage the AER to be mindful of the disincentive to find significant cost savings that will be created when setting the threshold.

If you have any questions regarding this submission, please contact Fiona McAnally [redacted]

Regards,

[redacted]

Rob Amphlett Lewis
Chief Customer Officer

[5] AER, Position paper: options for the capital expenditure sharing scheme, p 15.
[6] AER, Position paper: options for the capital expenditure sharing scheme, p 15.