Willogoleche Wind Turbines

Attachment 9

Capital Expenditure Sharing Scheme

Revenue Proposal 2023-24 to 2027-28

31 JANUARY 2022

ElectraNet

Company Information

ElectraNet Pty Ltd (ElectraNet) is the principal electricity transmission network service provider (TNSP) in South Australia.

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Note

This attachment forms part of our Revenue Proposal for the 2023-24 to 2027-28 regulatory period. It should be read in conjunction with the other parts of the Revenue Proposal.

Our Revenue Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 14:

- Revenue Proposal 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 (this document)
- Attachment 10 – Service target performance incentive scheme
- Attachment 11 – Pricing methodology
- Attachment 12 – Pass through events
- Attachment 13 – Demand Management Innovation Allowance
- Attachment 14 – List of supporting documents

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9. Capital Expenditure Sharing Scheme

9.1 Key points

- We have applied the Capital Expenditure Sharing Scheme (CESS) to determine the incentive payments arising from the current 2017-18 to 2022-23 regulatory period applicable to our capital expenditure.
- We support the continued application of the CESS in the forthcoming regulatory period.
- However, we welcome the AER's position in its Framework and Approach paper that it will review the application of the CESS in relation to contingent projects. Depending on the outcome of the AER's review of its incentive schemes in 2022, we may seek to apply an updated version of the CESS in the 2023-24 to 2027-28 regulatory period.

9.2 Introduction

This attachment presents information relating to the application of the CESS for the 2023-24 to 2027-28 regulatory period. The remainder of this attachment is structured as follows:

- Section 9.3 provides background information on the rationale for the CESS, and how the scheme operates.
- Section 9.4 sets out the incentive payments arising under the CESS for the current regulatory period.
- Section 9.5 comments on the application of the scheme for the forthcoming regulatory period.

9.3 Background

The AER's framework and approach paper[1] explains that:

- The CESS gives us financial rewards if we deliver capital expenditure savings compared to the AER's allowance, and penalties if we exceed the allowance. Consumers benefit from capital expenditure efficiencies through lower network charges in the future.
- The CESS approximates the efficiency gains and efficiency losses by calculating the difference between forecast and actual capital expenditure in each year. It shares these gains or losses between us and our customers.
- Broadly, the objective of the CESS is to ensure that only capital expenditure that meets the capital expenditure criteria under the Rules enters the Regulated Asset Base. Therefore, consumers only fund capital expenditure that is efficient and prudent.
- When the CESS, Efficiency Benefit Sharing Scheme and Service Target Performance Incentive Scheme apply to us, the incentives for improvements in operating expenditure, capital expenditure and service outcomes are more balanced. This encourages us to make efficient decisions on when and what type of expenditure to incur, and to efficiently trade off expenditure reductions with service quality and reliability.

1 AER, Framework and approach for ElectraNet for regulatory control period commencing 1 July 2023, June 2021, p18-20, available at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/electranet-determination-2023-28/aer-position

The AER explains[2]:

> *The CESS works as follows:*
>
> - *we calculate the cumulative underspend or overspend for the current regulatory control period in net present value terms*
> - *we apply the sharing ratio of 30 per cent to the cumulative underspend or overspend to work out the TNSP's share of the underspend or overspend*
> - *CESS payments are calculated taking into account the financing benefit or cost to the TNSP of the underspend or overspend. Further adjustments can also be made to account for deferral of capex and ex post exclusions of capex from the RAB*
> - *The CESS payments will be added or subtracted to the TNSP's regulated revenue as a separate building block in the next regulatory control period.*

Under the CESS, a TNSP retains 30 per cent of the benefits of any underspend, while consumers retain the other 70 per cent. This means that for every dollar saving in capex, the TNSP keeps 30 cents while consumers gain 70 cents. A similar approach applies for any overspend.

9.4 Outcomes from the CESS in the current period

As explained above, the application of the CESS gives rise to annual financial rewards or penalties, according to whether we have delivered savings compared to our capital expenditure allowance.

Attachment 5 explains the efforts we have made during the current regulatory period to ensure that our capital expenditure is prudent and efficient. Our actual capital expenditure has fallen under the allowance in some years, which leads to bonus payments while it has exceeded the AER's allowance in other years, which leads to penalty payments under the CESS.

We have calculated the efficiency carryover amount in accordance with the AER's final decision and determination regarding the application of the CESS for the current regulatory period. This calculation involves the following steps:

1. Calculate the capital expenditure subject to the CESS, after any adjustments from cost pass-throughs or contingent projects.[3]
2. Calculate the cumulative overspend or underspend for the current regulatory control period in net present value terms.
3. Apply the sharing ratio of 30% to the cumulative overspend or underspend amount to determine our share.
4. Calculate the CESS payments taking account of the financing benefit.

The AER's guidelines also provide for an adjustment to be made in calculating CESS payments where capital expenditure has been deferred from the current regulatory period if:

- the amount of deferred capital expenditure is material;
- the underspend in the current period is material; and
- the total capital expenditure in the forthcoming period is materially increased.

2 Ibid, p18.

3 AER, Better Regulation - Capital Expenditure Incentive Guideline, November 2013 section 2.3.1, p9.

As discussed in Attachment 5 we are forecasting a deferral in expenditure on Project EnergyConnect into the coming regulatory period. The amount, approximately $60 million, is likely to be considered material if viewed in isolation.

We discussed this issue during our engagement with the CAP Working Group. Its view was that an adjustment for the deferral of Project EnergyConnect should be made under the CESS to ensure that ElectraNet does not receive a windfall gain from the movement in the project. On this basis, we have made an adjustment to the CESS to account for this deferral, as set out below.

However, we have also reprioritised capital expenditure into the current period that had previously been deferred to rebalance our capital program from a delivery perspective, consistent with the objectives of the CESS. This already minimises the net impact on customers in the coming period by offsetting the movement in Project EnergyConnect.

As a result, an adjustment for the deferred expenditure on Project EnergyConnect under the CESS is not strictly required, nor is it consistent with the requirements of the scheme, as none of the above conditions are now met:

- the amount of deferred capex into the next regulatory period is not material;
- the level of underspend in the current period is not material; and
- total capex in the forthcoming period has not materially increased.

The reprioritisation of the capital program largely removes any benefit that might otherwise have accrued under the CESS, consistent with the feedback from the CAP Working Group and interests of customers. However, applying an adjustment for the deferral in addition to this now results in a material carry forward penalty (of approximately $11.1m) under the CESS as shown below.

We submit the appropriateness of this adjustment under the CESS should be reconsidered and welcome further engagement on this during the assessment of our Revenue Proposal to ensure the objectives and requirements of the CESS are met.

Table 9.1 shows our capital expenditure during the current regulatory period compared to the AER allowance. These data are applied in a CESS model, which accompanies this Revenue Proposal, to derive the penalty amounts that are included in our revenue requirement for the 2023-24 to 2027-28 regulatory period. These annual penalty amounts are shown in Table 9.2.

Table 9.1: Historical cost performance for CESS carryover calculation ($m nom)

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Total Capex Allowance (including approved contingent projects)	123.92	226.01	222.34	454.61	384.19	**1411.07**
Forecast capital expenditure for CESS purposes (including approved contingent projects)	160.33	182.42	218.34	434.92	392.45	**1388.46**
Adjustment for deferral of PEC expenditure to FY24-28						**-60.24**

Table 9.2: CESS carryover amounts for the forthcoming regulatory period ($m 2022-23)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
CESS Carryover	-2.2	-2.2	-2.2	-2.2	-2.2	-11.1

9.5 Scheme applying from 1 July 2023

The AER's framework and approach paper states that version 1 of the CESS will continue to apply to us in the 2023-24 to 2027-28 regulatory period. However, the AER also noted that it is planning to review its incentive schemes, including the CESS, during 2022 to ensure that they remain relevant and fit-for-purpose.

In our Framework and Approach submission we raised concerns regarding the operation of the CESS in relation to contingent projects that are forecast to span regulatory periods.[4] As explained in that submission, the Rules require that the total approved capital expenditure allowance of a contingent project should be preserved. Therefore, if the approved allowance for the project is exceeded in the first regulatory period, a corresponding reduction is applied to the balance of the approved allowance in the following regulatory period. In addition, the CESS will impose a penalty in relation to any overspend relative to the allowance in the first period, to be applied in following period.

The operation of the contingent project provisions and the CESS results in a double penalty for any overspend, imposing a disproportionate impact on the network business. The converse also applies, whereby a double benefit would apply for any underspend experienced in the first regulatory period, imposing a disproportionate impact on network customers.

While this is not an issue in the current regulatory period, as no contingent project allowance has been approved that spans periods, for the above reasons, we have proposed that the CESS should not apply to any contingent project approved in the forthcoming regulatory period that spans multiple regulatory periods. This proposed change will avoid this unintended consequence for customers and for us. We welcome the AER's position in its Framework and Approach Paper that it will consider this issue as part of its incentive scheme review, which is expected to be completed during 2022.

We also note that, under the current version of the CESS, the capital expenditure allowance is calculated as our approved allowance, plus any adjustments the AER allows from pass-throughs, reopening of capital expenditure or contingent projects.[5] As noted above, the treatment of contingent projects in the CESS in the forthcoming regulatory period may change depending on the outcome of the AER's review of its incentive schemes.

Subject to these changes, for the purpose of establishing the capital expenditure forecasts applicable to the CESS calculation for the 2023-24 to 2027-28 regulatory period, we therefore propose the values in Table 9.3.

Table 9.3: CESS capital expenditure forecasts ($m 2022-23)

	2023-24	2024-25	2025-26	2026-27	2027-28	TOTAL
Capital Expenditure Forecast	152.3	155.6	140.2	132.7	115.1	695.9
Adjustments	0	0	0	0	0	0
Movement in Provisions	0	0	0	0	0	0
CESS Target	**152.3**	**155.6**	**140.2**	**132.7**	**115.1**	**695.9**

4 Letter to Sebastian Roberts, dated 5 November 2020.

5 AER, Better Regulation - Capital Expenditure Incentive Guideline, November 2013 section 2.3.1, p9.

ElectraNet