Jemena

9 September 2022

Sebastian Roberts
Network Expenditure
Australian Energy Regulator
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Canberra, ACT, 2601

Lodged via email to incentivereview@aer.gov.au

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Dear Sebastian,

Response to AER's Position Paper on Capital Expenditure Sharing Scheme (CESS)

Jemena Electricity Networks (Vic) Ltd (**JEN**) welcomes the opportunity to respond to the Australian Energy Regulator's (**AER**) position paper on *Review of incentive schemes: options for CESS* (**position paper**). We also acknowledge and appreciate the consultative approach followed by the AER and considering our recommendation prior to publishing its position paper.[1] In this submission, we focus on the variable options proposed by the AER to identify when a lower sharing factor can be applied as part of CESS.

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JEN endorses and has contributed to the Energy Network Association's (**ENA**) response to the AER. Amongst the options presented by the AER we consider that the bright line test#2, which applies a 20 per cent sharing ratio to any underspend in excess of a threshold level, best meets the ex-ante incentive framework and encourages better forecasting. However, as the ENA's consultant (NERA) notes, setting the threshold at a level that maintains strong efficiency incentives is extremely important.

Under the bright line test#2, the proposal is to:

- apply a CESS sharing ratio of 30 per cent for the first 10 per cent of underspend by a Distribution Network Service Provider (**DNSP**)
- apply a lower sharing ratio of 20 per cent to underspend in excess of 10 per cent.

We support a tiered underspend approach which is consistent with the approach we recommended to the AER. However, we consider that more consideration and engagement is required to determine the right underspend threshold level to maintain strong incentives. A flat 10 per cent threshold does not adequately account for the size and scale of different DNSPs, particularly given the lumpy nature of many capex projects. For example, a large-scale zone substation replacement could cost between $30 and $35 million, which for a smaller DNSP could account for over 5 per cent of the DNSP's total capex during a particular regulatory period. For a larger DNSP with a much larger capex forecast, an equivalent large-scale zone substation replacement of similar cost could account for less than 1 per cent of the DNSP's total capex.

This example highlights that one project can have a much greater impact on the capex underspending level for smaller DNSPs than larger DNSPs. In other words, not all underspends are equal. Importantly, for smaller DNSPs, one large-scale capex project could move a DNSP's level of underspending from below the 10 per cent threshold proposed by the AER to above the threshold if this project is no longer required due to changing network circumstances. We also consider that 10% threshold is too low and would disadvantage efficient firms.

[1] Joint letter to AER from Jemena, CitPower, Powercor, United Energy and South Australia Power Networks, 24 June 2022.

Therefore, we recommend that the AER should account for different network sizes when determining the threshold level. One potential approach that the AER could consider to account for network size is –

- to classify businesses into small, medium and large DNSP's based on their regulated asset base (**RABs**) value or the AER's approved capex allowance, and
- then apply an appropriate threshold such as 25%, 20% and 15% (for illustration) to the the small, medium and large DNSPs respectively.

We look forward to working collaboratively with the AER on this matter. If you have any questions regarding this submission, please do not hesitate to contact

Kind regards,

Ana Dijanosic
General Manager, Regulation
Jemena