SA Power Networks

Attachment 9

Capital expenditure sharing scheme

2020-25
Regulatory Proposal

31 January 2019

This section outlines:

› the outcomes from the Capital Expenditure Sharing Scheme (CESS) in relation to the 2015-20 Regulatory Control Period; and

› the manner in which the CESS will apply to the 2020-25 Regulatory Control Period.

Company information

SA Power Networks is the registered Distribution Network Service Provider (**DNSP**) for South Australia. For information about SA Power Networks visit www.sapowernetworks.com.au

Contact

For enquiries about this Revenue Proposal please contact:
Richard Sibly
Head of Regulation
SA Power Networks
GPO Box 77
Adelaide SA 5001
sapn2020proposal@sapowernetworks.com.au

Disclaimer

This document forms part of SA Power Networks' Regulatory Proposal (**the Proposal**) to the Australian Energy Regulator (**AER**) for the 1 July 2020 to 30 June 2025 regulatory control period (2020-25 **RCP**). The Proposal and its attachments were prepared solely for the current regulatory process and are current as at the time of lodgment.

This document contains certain predictions, estimates and statements that reflect various assumptions concerning, amongst other things, economic growth and load growth forecasts. The Proposal includes documents and data that are part of SA Power Networks' normal business processes, and are therefore subject to ongoing change and development.

Whilst care was taken in the preparation of the information in this Regulatory Proposal, and it is provided in good faith, SA Power Networks, its officers and shareholders accept no responsibility or liability for any loss or damage that may be incurred by any person acting in reliance on this information or assumptions drawn from it for a different purpose or in a different context.

Copyright

Note

This attachment forms part of our Proposal for the 2020-25 RCP. It should be read in conjunction with the other parts of the Proposal.

Our Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 18:

Document	Description
	Regulatory Proposal overview
	Customer and stakeholder engagement report
! űűl·ŎKYŜyű м	! yyƴl·ƒ ǁŜøŜyƴŜ ǁŜIJƌǁŜYŜyű l·yŘ ŏ2yűǁ2ƒ YŜŎKl·yǎY
! űűl·ŎKYŜyű н	wŜƎƌƒl·ű2ǁè l·ǎǎŜű ōl·ǎŜ
! űűl·ŎKYŜyű о	wl·űŜ 2Ŧ wŜűƌǁy
! űűl·ŎKYŜyű п	wŜƎƌƒl·ű2ǁè ŘŜLJǁŜŎʎl·űʎ2y
! űűl·ŎKYŜyű р	/ l·LJʎűl·ƒ ŜÈLJŜyŘʎűƌǁŜ
! űűl·ŎKYŜyű с	hLJŜǁl·űʎyƎ ŜÈLJŜyŘʎűƌǁŜ
! űűl·ŎKYŜyű т	/ 2ǁLJ2ǁl·űŜ ʎyŏ2YŜ űl·È
! űűl·ŎKYŜyű у	9ŦŦʎŎʎŜyŏè ōŜyŜŦʎű ǎKl·ǁʎyƎ ǎŎKŜYŜ
! űűl·ŎKYŜyű ф	/ l·LJʎűl·ƒ ŜÈLJŜyŘʎűƌǁŜ ǎKl·ǁʎyƎ ǎŎKŜYŜ
Attachment 10	Service target performance incentive scheme
Attachment 11	Demand management incentives and allowance
Attachment 12	Classification of services
Attachment 13	Pass through events
Attachment 14	Alternative Control Services
Attachment 15	Negotiated services framework and criteria
Attachment 16	Connection policy
Attachment 17	Tariff Structure Statement
Attachment 18	List of Proposal documentation

Contents

List of tables

9 Capital expenditure sharing scheme

9.1 Overview

The Capital Expenditure Sharing Scheme (**CESS**) provides an incentive for distribution network service providers (**DNSP**s) to only undertake efficient capital expenditure (**capex**) and provides a mechanism to share efficiency gains between DNSPs and customers. Customers benefit from efficiency gains through a lower regulatory asset base (**RAB**) in future regulatory control periods (**RCP**s).

SA Power Networks' carryover for the 2015-20 RCP has been calculated at $69.7 million, in accordance with version 1 of the CESS applied in our distribution determination for the 2015-20 RCP (**2015 Determination**)[1]. We have achieved an underspend as compared to our capex allowances in the 2015-20 RCP primarily due to:

- lower augmentation and customer driven capex as a result of lower than forecast demand; and
- prudent delays in replacing network assets as a result of developing and implementing more efficient approaches to network asset management.

SA Power Networks proposes to continue to apply version 1 of the CESS for the 2020-25 RCP.

9.2 Rule requirements

9.2.1 Calculation of carryover amounts for the 2015-20 RCP

The National Electricity Rules (**NER**) set out two relevant requirements in relation to the CESS, namely:

- the building blocks used to calculate the annual revenue requirement for each regulatory year of the 2020-25 RCP must include (amongst other things) any revenue increments or decrements for the relevant regulatory year arising from the application of the CESS2; and
- the building block determination must also specify how any applicable CESS is to apply to a DNSP in the 2020-25 RCP3.

The Australian Energy Regulator (**AER**) applied version 1 of the CESS to SA Power Networks for the 2015-20 RCP as specified in the 2015 Determination. SA Power Networks must calculate the carryover efficiency gain or loss for the 2015-20 RCP in accordance with version 1 of the CESS and the 2015 Determination[4]. This involves[5]:

- calculating efficiency gains and losses in net present value terms for each regulatory year of the 2015-20 RCP and then the total efficiency gain or loss calculated for the 2015-20 RCP;
- applying a sharing factor to the total efficiency gain or loss for the 2015-20 RCP to calculate SA Power Networks' share of the gain or loss for the 2015-20 RCP;
- calculate financing benefits or costs that accrue through the 2015-20 RCP; and

---

[1] AER, Final decision: SA Power Networks determination 2015-16 to 2019-20, Attachment 10 – Capital expenditure sharing scheme, October 2015.

[2] NER 6.4.3(a)(5).

[3] NER 6.3.2(a)(3).

[4] AER, Final decision: SA Power Networks determination 2015-16 to 2019-20, Attachment 10 – Capital expenditure sharing scheme, October 2015.

[5] AER, Better Regulation: Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013, clause 2.3.

- calculate the CESS payment by subtracting the financing benefit or cost that has accrued from SA Power Networks' share of the total efficiency gain or loss for the 2015-20 RCP.

When calculating the annual CESS payments, further adjustments may be made for deferrals of capex, or where the AER excludes capex overspends from the RAB after an ex post review[6].

Adjustments to the CESS payment may only be made for deferrals of capex by SA Power Networks where capex has been deferred in the 2015-20 RCP and[7]:

- the amount of the deferred capex in the 2015-20 RCP is material;
- the total of the estimated underspend of capex in the 2015-20 RCP is material; and
- total approved forecast capex in the 2020-25 RCP is materially higher than it would likely have been if a material amount of capex was not deferred in the 2015-20 RCP.

9.2.2 CESS to apply for the 2020-25 RCP

The CESS to apply to the 2020-25 RCP must be developed and implemented in accordance with clause 6.5.8A of the NER. In developing and implementing the CESS for the 2020-25 RCP, the AER must have regard to the following[8]:

- DNSPs should be rewarded or penalised for improvements or declines in efficiency in capex;
- rewards and penalties should be commensurate with the efficiencies or inefficiencies in capex; and
- interactions with other incentive schemes, the capex objectives and if relevant the operating expenditure (opex) objectives, as they apply to the particular DNSP, and the circumstances of the DNSP.

In its final Framework and Approach (**F&A**) paper for the 2020-25 RCP, the AER stated that it intends to apply the CESS to SA Power Networks in the 2020-25 RCP, as it considers this will contribute to the capex incentive objective[9] by providing SA Power Networks with an ex ante incentive to spend only efficient capex in each regulatory year of the 2020-25 RCP[10].

9.3 Carryover amounts for the 2015-20 RCP

The increments and decrements (**carryover amounts**) to be included in the building blocks for the 2020-25 RCP are those arising from the application of the CESS in the 2015-20 RCP.

As noted above, the CESS which applies to SA Power Networks for the 2015-20 RCP is version 1 of the CESS as specified in the 2015 Determination.

9.3.1 Calculation of carryover amounts for the 2015-20 RCP

Incremental efficient gains/losses for each regulatory year of the 2015-20 RCP have been calculated in accordance with version 1 of the CESS and the 2015 Determination.

[6] *AER, Better Regulation: Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013, clause 2.3.1.*

[7] *Ibid, clause 2.5.*

[8] *NER 6.5.8A(c), (d) and (e).*

[9] The capex incentive objective (as set out in clause 6.4A of the NER) is to ensure that, where the value of a RAB is subject to assessment in accordance with the NER, then the only capex that is included in an adjustment that increase the value of that RAB is capex that reasonably reflects the capex criteria.

[10] *AER, Final framework and approach, SA Power Networks 2020-25, July 2018, page 73.*

In that regard, we note that SA Power Networks will underspend its overall capex allowances in the 2015-20 RCP. The primary reasons for this underspend are:

- actual customer demand has been lower than forecast, which allowed prudent deferral of a number of augmentation (substation and sub-transmission) projects and also resulted in fewer than forecast customer connections;
- delaying some work programs, in particular asset replacement work, while new, more asset management efficient approaches[11] were being developed and implemented by SA Power Networks. These approaches were initially implemented as pilot trials before being rolled out across the SA Power Networks regulated network business. As a result, replacement capex (repex) has ramped up over the 2015-20 RCP to the current level in line with allowances and is forecast to remain approximately at this level for the remainder of the 2015-20 RCP and going forward into the 2020-25 RCP;
- lower than forecast costs to deliver the major Kangaroo Island undersea cable project; and
- significant storm events in the 2016/17 regulatory year necessitated a diversion of resources to repairing and reinstating the network, and away from implementing our capital program in the 2015-20 RCP, resulting in an increase in opex and decrease in capex during this regulatory year. Further, during the 2015-20 RCP we also diverted significant capex and resources in response to our increased focus on the safety of our distribution network, including with respect to the risk of bushfires starting from powerlines, given recent interstate and overseas events.

This underspend should not give rise to an adjustment to the CESS payment for the following reasons:

- As stated by the AER in the Explanatory Statement to the Capital Expenditure Incentive Guideline[12] and the F&A for the 2020-25 RCP[13], the CESS is designed to ensure that DNSPs still face incentives to re-prioritise their capex budgets in response to changing circumstances during a RCP. The AER's approach to forecasting capex is to forecast the total amount of efficient capex a DNSP needs over the RCP. While the forecast capex for a RCP is informed by the AER's forecast of the prudent and efficient capex the DNSP will need to complete discrete projects or programs, this is only to inform the total forecast of capex for the RCP. The AER considers that most of the time a DNSP is best placed to decide the projects and programs it needs to carry out once it knows its forecast capex. This means, from time to time, a DNSP may choose to defer some discrete projects that were initially considered to be prudent and efficient when forming the forecast capex for the RCP. Conversely, the DNSP may also choose to bring forward other discrete projects that had not previously been assessed.
- The CESS is designed to ensure that a DNSP will only face an adjustment where the deferral of capex in a RCP has led to materially higher capex forecasts in the next RCP. Where this is not the case, it is unlikely the DNSP would receive a windfall gain from deferring capex between RCPs. Correspondingly, customers are likely to face lower prices in the next RCP because of a DNSPs' decision to defer the capex. SA Power Networks new approach to valuing work has enabled us to remove more network risk during the 2015-20 RCP than we otherwise would have, had we spent in line with allowances using our previous 'risk-based replacement' approach. Our 'value-based replacement' approach also results in us forecasting less repex for the 2020-25 RCP than we otherwise would have.

[11] These new asset management approaches were only possible following the collection of more detailed asset information and asset condition data (the collection of more detailed information has been underway since around 2013) and the development of new IT tools and systems to analyse this information and data and make this information and data more 'visible' across the SA Power Networks business.

[12] *AER, Better Regulation: Explanatory Statement, Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013, page 32.*

[13] *AER, Final framework and approach, SA Power Networks 2020-25, page 74.*

- While there has been some deferral of capex in the 2015-20 RCP and there will be an underspend of capex during the 2015-20 RCP as compared to the overall capex allowance for the 2015-20 RCP, the amount of the deferred capex and total capex underspend are not material taking into account the reasons for the deferral and/or underspend and the particular circumstances that impacted upon SA Power Networks' capex program for the 2015-20 RCP. Also, consistent with the incentive framework, the deferred capex largely reflected capex that SA Power Networks was best placed to assess whether to defer in order to ensure that more efficient and prudent approaches were developed and implemented for discrete projects.
- Finally, and most importantly, SA Power Networks proposed total forecast capex for the 2020-25 RCP is not materially higher than it likely would have been if no capex had been deferred in the 2015-20 RCP.

Further details concerning the capex which was deferred and the circumstances surrounding that deferral can be provided on request by the AER.

As SA Power Networks will not overspend its overall capex allowances in the 2015-20 RCP, no adjustment is required as a result of any ex post review for efficient capex carried out by the AER.

Customers will benefit from our lower capex through a lower RAB, that will reduce revenue allowances and prices in future RCPs. We forecast a CESS payment of $69.7 million for the 2015-20 RCP as shown in Table 9-1 below:

Table 9-1: Actual/estimated CESS payment for 2015-20 RCP

million $June 2020	2020/21	2021/22	2022/23	2023/24	2024/25	Total
CESS Payment	13.9	13.9	13.9	13.9	13.9	69.7

Our detailed calculation of the CESS payment set out in Table 9-1 is contained in the Reset RIN Workbook 6.

The timing of this regulatory proposal for the 2020-25 RCP (**Proposal**) means that the CESS payments for the 2018/19 and 2019/20 regulatory years are estimates. Actual capex incurred by SA Power Networks for the 2018/19 regulatory year will be known in time for our revised regulatory proposal for the 2020-25 RCP (**Revised Proposal**). We will update the CESS payment for that regulatory year in our Revised Proposal to reflect the updated actual capex information for the 2018/19 regulatory year.

As the 2019/20 regulatory year will be an estimate at the time of our Revised Proposal and the AER's final distribution determination for the 2020-25 RCP, further adjustments may need to be made to the CESS payment for the 2019/20 regulatory year where actual capex for that year is different to the estimate. Consistent with the CESS, these adjustments will be made in our distribution determination process for the 2025-30 RCP[14].

9.4 CESS to apply for the 2020-25 RCP

In its F&A for the 2020-25 RCP, the AER states that it proposes to apply the CESS to SA Power Networks in the 2020-25 RCP, as it considers this will contribute to the capex incentive objective by providing SA Power Networks with an ex ante incentive to spend only efficient capex[15]. SA Power Networks will be rewarded for making efficiency gains, whilst electricity customers will benefit through lower prices from a lower RAB in future RCPs. Conversely, we will be penalised for an efficiency loss (by spending more than our capex allowances) through the CESS.

By applying the CESS, the Efficiency Benefit Sharing Scheme (**EBSS**), the Service Target Performance Incentive Scheme (**STPIS**) and the new Demand Management Incentive Scheme (**DMIS**) to SA Power

[14] *AER, Better Regulation: Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013, cl 2.4.*
[15] *AER, Final framework and approach, SA Power Networks 2020-25, page 73.*

Networks, the incentives for capex, opex, service performance and for identifying and undertaking efficient demand management options will be balanced to promote efficient decision making in relation to expenditure and service quality.

Accordingly, SA Power Networks proposes that the AER apply version 1 of the CESS for the 2020-25 RCP.

Shortened Forms

2015 Determination .... *Distribution determination for the 2015-20 RCP*
AER .... *Australian Energy Regulator*
capex .... *Capital Expenditure*
CESS .... *Capital expenditure sharing scheme*
DMIS .... *Demand Management Incentive Scheme*
DNSP .... *Distribution Network Service Provider*
EBSS .... *Efficiency Benefit Sharing Scheme*
F&A .... *Framework and Approach*
NER .... *National Electricity Rules*
opex .... *Operating Expenditure*
Proposal .... *Regulatory proposal for the 2020-25 RCP*
RAB .... *Regulatory Asset Base*
RCP .... *Regulatory Control Period*
repex .... *Replacement Capex*
Revised Proposal .... *Revised regulatory proposal for the 2020-25 RCP*
STPIS .... *Service Target Performance Incentive Scheme*