

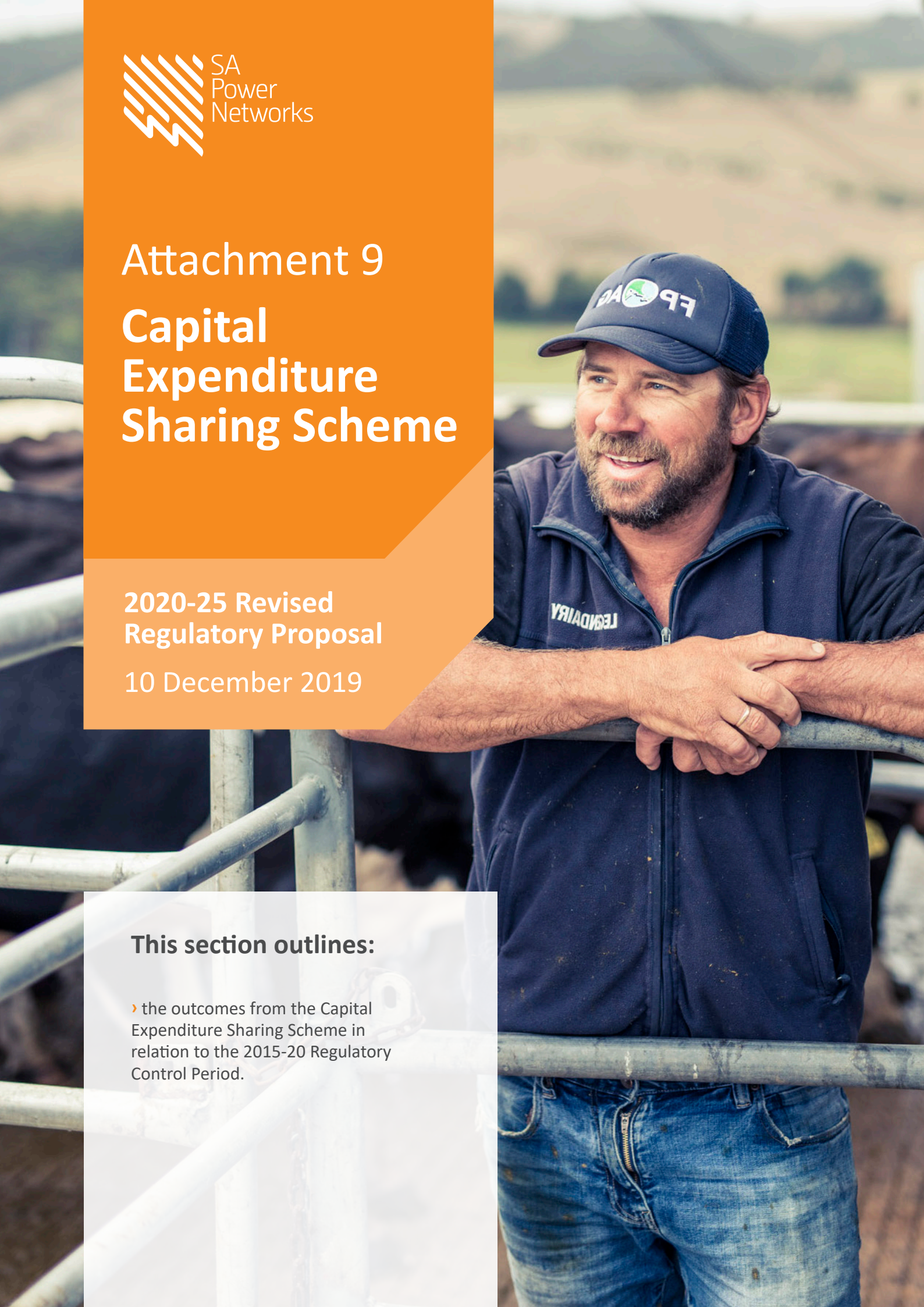
# Attachment 9

## Capital Expenditure Sharing Scheme

2020-25 Revised  
Regulatory Proposal  
10 December 2019

### **This section outlines:**

- › the outcomes from the Capital Expenditure Sharing Scheme in relation to the 2015-20 Regulatory Control Period.



## Company information

SA Power Networks is the registered Distribution Network Service Provider for South Australia. For information about SA Power Networks visit [sapowernetworks.com.au](http://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](mailto:sapn2020proposal@sapowernetworks.com.au)

## Disclaimer

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

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.

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## Note

This attachment forms part of our Proposal for the 2020-25 Regulatory Control Period. 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:

<b>Document</b>	<b>Description</b>
	Regulatory Proposal overview
Attachment 1	Annual revenue requirement and control mechanism
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
<b><i>Attachment 9</i></b>	<b><i>Capital Expenditure Sharing Scheme</i></b>
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 Part A
Attachment 17	Tariff Structure Statement Part B - Explanatory Statement
Attachment 18	List of Proposal documentation

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## 9 Capital expenditure sharing scheme

### 9.1 Overview

Table 9-1 sets out and compares the final Capital Expenditure Sharing Scheme (**CESS**) carryovers in SA Power Networks' Regulatory Proposal (**Original Proposal**) for the 2020-25 regulatory control period (**RCP**), the Australian Energy Regulator's (**AER's**) position in its draft decision on our Original Proposal (**Draft Decision**) and our response to the Draft Decision (**Revised Proposal**).

**Table 9-1: Summary of CESS carryovers in SA Power Networks' Original Proposal, AER's Draft Decision and SA Power Networks' Revised Proposal**

Original Proposal	AER Draft Decision	Revised Proposal
69.7 (\$ million)	69.0 (\$ million)	76.3 (\$ million)

The CESS provides an incentive for distribution network service providers (**DNSPs**) 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 RCPs.

In its Draft Decision, the AER included a CESS revenue increment of \$69.0 million (\$ June 2020) for SA Power Networks from the application of the CESS in the 2015-20 RCP.<sup>1</sup> The AER indicated that it would update its calculations for the actual capex for the 2018/19 regulatory year in its final decision and, if available, updated inflation data.

In our Revised Proposal, we have updated the AER's CESS carryover calculation for the 2015-20 RCP to include actual expenditure for the 2018/19 regulatory year and to include our latest 2019/20 capex forecast. We have also applied the latest inflation forecasts. The outcomes are summarised in Table 9-2 below:

**Table 9-2: SA Power Networks CESS payment in 2020-25 RCP (June 2020, \$ million)**

CESS Carryover	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Original Proposal	13.9	13.9	13.9	13.9	13.9	69.7
Draft Decision	13.8	13.8	13.8	13.8	13.8	69.0
Revised Proposal	15.3	15.3	15.3	15.3	15.3	76.3

Total may not add up due to rounding

The AER will continue to apply the CESS to SA Power Networks in the 2020-25 RCP.<sup>2</sup>

### 9.2 Original Proposal

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. SA Power Networks applied version 1 of the CESS as specified in the distribution determination for the 2015-20 RCP.<sup>3</sup>

SA Power Networks expected to underspend its overall capex allowance in the 2015-20 RCP, which would have resulted in a CESS carryover gain of \$69.7 million for the RCP, as shown in Table 9-3 below:

<sup>1</sup> AER, *Draft Decision for SA Power Networks Distribution Determination 2020 to 2025*, Attachment 9: Capital expenditure sharing scheme (**Attachment 9**), page 6.

<sup>2</sup> Ibid.

<sup>3</sup> AER, *Final decision for SA Power Networks Distribution Determination 2015-16 to 2019-20*, Attachment 10: Capital expenditure sharing scheme, October 2015.

**Table 9-3: Original Proposal forecast CESS carryover amount for the 2015-20 RCP**

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

The underspend in the 2015-20 RCP primarily results from:<sup>4</sup>

- actual customer demand being lower than forecast, allowing prudent deferral of augmentation projects and fewer than forecast customer connections;
- delays in asset replacement work, while new, more efficient asset management approaches were developed and implemented;
- lower than forecast costs to deliver the major Kangaroo Island undersea cable project; and
- significant storm events in the 2016/17 regulatory year diverting resources to repairing and reinstating the network, and away from implementing our capital program.

SA Power Networks contended that the underspend should not give rise to an adjustment to the CESS payment as:<sup>5</sup>

- we prudently reprioritised our capex program due to changing circumstances in the 2015-20 RCP;
- customers will face lower prices from the next RCP as a result of the underspend;
- the amount of the deferred capex and total capex underspend is not material considering the circumstances that impacted upon our capex program in the 2015-20 RCP; and
- our 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.

SA Power Networks also referenced the AER's Framework & Approach paper for the 2020-25 RCP in which the AER stated that it intended to apply the CESS to SA Power Networks in the 2020-25 RCP to provide an ex ante incentive to spend only efficient capex. SA Power Networks therefore proposed that the AER apply version 1 of the CESS for the 2020-25 RCP.<sup>6</sup>

### 9.3 Draft Decision

In its Draft Decision, the AER included a carryover revenue increment of \$69.0 million for application of the CESS for the 2015-20 RCP, as shown in Table 9-4 below:

**Table 9-4: Draft Decision CESS carry-over amount for the 2015-20 RCP**

June 2020, \$ million	2020/21	2021/22	2022/23	2023/24	2024/25	Total
CESS Carryover	13.8	13.8	13.8	13.8	13.8	69.0

The AER's Draft Decision was \$0.7 million lower than SA Power Networks' forecast in our Original Proposal, due to the AER adopting:<sup>7</sup>

- more recent inflation figures;
- updated weighted average cost of capital (WACC) inputs; and
- changes to actual capex for consistency with the capex roll forward model.

The AER's Draft Decision is based on SA Power Networks' estimated capex for the 2018/19 regulatory year. In its final decision for the 2020-25 RCP, the AER will update its calculation of the carryover amount using actual capex for that year and, if available, updated inflation data.<sup>8</sup>

The AER may make an adjustment to SA Power Networks' CESS payment for capex deferred in the 2015-20 RCP where:

<sup>4</sup> SA Power Networks, 2020-25 Regulatory Proposal, Attachment 9 – Capital expenditure sharing scheme, January 2019, page 8.

<sup>5</sup> Ibid, pages 8-9.

<sup>6</sup> Ibid, page 9.

<sup>7</sup> AER, Attachment 9, page 6.

<sup>8</sup> AER, Attachment 9, page 6.

- the amount of the deferred capex in the 2015-20 RCP is material; and
- the amount of the 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.<sup>9</sup>

The AER did not adjust SA Power Networks' CESS revenue increment to account for material deferrals in the 2015-20 RCP as it did not consider that deferrals had materially increased its Draft Decision substitute of capex.<sup>10</sup> The AER has acknowledged that its position may change in response to SA Power Networks' Revised Proposal.<sup>11</sup>

The AER will continue to apply the CESS in the 2020-25 RCP to provide SA Power Networks with a continuous incentive to pursue efficiency gains.<sup>12</sup>

## 9.4 Revised Proposal

SA Power Networks has updated the AER's Draft Decision calculation of the CESS carryover amount for the 2015-20 RCP for actual capex for the 2018/19 regulatory year, and for the Reserve Bank of Australia's (RBA's) inflation forecast for 2019/20. We have also reduced our 2019/20 capex forecast to be consistent with our latest forecasting assumptions. This results in a carryover gain of \$76.3 million for the application of the CESS for the 2015-20 RCP, as shown in Table 9-5 below:

**Table 9-5: Revised Proposal CESS carry-over amount for the 2015-20 RCP**

June 2020, \$ million	2020/21	2021/22	2022/23	2023/24	2024/25	Total
CESS Carryover	15.3	15.3	15.3	15.3	15.3	76.3

SA Power Networks' actual capex for the 2018/19 base year was around \$11 million (\$ June 2020) lower than forecast, primarily driven by:

- lower than forecast net customer connections; and
- removal of more than \$4 million of capex provision movements, predominantly for increases in annual and long service leave expense.

SA Power Networks contends that, consistent with the AER's Draft Decision, our Revised Proposal 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. Our revised forecast replacement capex (**repex**) for the 2020-25 RCP is higher than the allowance in the AER's Draft Decision, but is in line with our forecast expenditure for the current 2015-20 RCP. It is also significantly lower than would have been forecast without the development of new asset management efficient approaches being implemented through our Asset and Works Program. Further, we have significantly reduced our forecast capex in the 2020-25 RCP for property projects deferred from the 2015-20 RCP.

Further details on our Revised Proposal capex forecasts for the 2020-25 RCP can be found in Attachment 5 – Capital expenditure.

SA Power Networks' CESS calculation of its carryover for the 2015-20 RCP is contained in Supporting Document 9.1 – CESS Model.

<sup>9</sup> AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 9.

<sup>10</sup> AER, Attachment 9, page 8.

<sup>11</sup> AER, Attachment 9, page 9.

<sup>12</sup> AER, Attachment 9, page 10.



## Shortened Forms

<b>AER</b>	<i>Australian Energy Regulator</i>
<b>Attachment 9</b>	<i>AER, Draft Decision for SA Power Networks Distribution Determination 2020 to 2025, Attachment 9: Capital expenditure sharing scheme</i>
<b>capex</b>	<i>capital expenditure</i>
<b>CESS</b>	<i>Capital Expenditure Sharing Scheme</i>
<b>DNSP</b>	<i>Distribution Network Service Provider</i>
<b>Draft Decision</b>	<i>AER, Draft Decision—SA Power Networks Distribution Determination 2020 to 2025</i>
<b>Original Proposal</b>	<i>Regulatory Proposal for the 2020-25 RCP</i>
<b>RAB</b>	<i>Regulated Asset Base</i>
<b>RBA</b>	<i>Reserve Bank of Australia</i>
<b>RCP</b>	<i>Regulatory Control Period</i>
<b>repex</b>	<i>replacement expenditure (capex)</i>
<b>Revised Proposal</b>	<i>Revised Regulatory Proposal for the 2020-25 RCP</i>
<b>WACC</b>	<i>Weighted Average Cost of Capital</i>