Draft Decision

Power and Water Corporation Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 8
Efficiency benefit sharing scheme

September 2023

AUSTRALIAN ENERGY REGULATOR

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The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in operating expenditure (opex) and provide for a fair sharing of the benefits of these efficiencies between network service providers and users. Consumers benefit from improved efficiencies through lower regulated prices.

This attachment sets out how we will apply the EBSS to Power and Water Corporation (PWC) over the 2024–29 regulatory control period.

8.1 Draft decision

Our draft decision is to apply the EBSS to PWC in the 2024–29 regulatory control period.[1] This is consistent with PWC's proposal.[2] We will exclude debt-raising costs from the scheme. We will make adjustments as permitted by the EBSS, such as removing demand management innovation allowance costs, and movement in provisions (as outlined in section 8.4).

We stated in the Framework and approach decision for PWC that we intended to apply the EBSS in the 2024–29 regulatory control period if we were satisfied the scheme will fairly share efficiency gains and losses between the distributors and consumers.[3] We also stated that this will occur only if the opex forecast for the following period is based on the distributor's revealed cost. As set out in Attachment 6, we have relied on PWC's revealed opex for 2021–22 as the basis for forecasting opex for the 2024–29 period. This is because we consider that its revealed costs in 2021–22 are not materially inefficient.[4] Given this, it is reasonably likely that we will rely on PWC's revealed costs over the 2024–29 regulatory control period to forecast opex for the following regulatory control period. For these reasons, we consider applying the EBSS to PWC in the 2024–29 regulatory control period is reasonable and consistent with the National Electricity Rules - Northern Territory (NT NER).

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1 We must make a decision on how the EBSS is to apply to PWC; this is one of the 'constituent decisions' we must make as part of a distribution determination: NT NER, cl.6.12.1(9).

2 PWC, *12.01 - Incentives Scheme attachment*, 31 January 2023, p. 7.

3 AER, *Framework and approach, Power and Water Corporation, Regulatory control period commencing 1 July 2024*, July 2022, p. 41.

4 AER, *Draft Decision, Power and Water Corporation 2024–29, Attachment 6 Operating expenditure, September 2023,* pp. 17–18.

8.2 Power and Water Corporation's proposal

8.2.1 Carryover amounts accrued during the 2019–24 regulatory control period

The EBSS did not apply to PWC in the 2019–24 regulatory control period. Consequently, PWC did not accrue any carryover amounts.

8.2.2 Application in the 2024–29 control period

PWC proposed we apply the EBSS in the 2024–29 regulatory control period.[5] It also proposed that debt raising costs be excluded from the EBSS, consistent with our standard approach. PWC proposed no other exclusions from the EBSS, as debt raising cost were the only costs not forecast using the base-step-trend approach.[6]

In proposing that the EBSS apply in the 2024–29 regulatory control period, (after not applying in the pervious regulatory control period) PWC noted that as part of its proposed opex it had not adjusted revealed costs to determine base opex, i.e. it had used audited actual costs in the proposed base year of 2021–22. It considered this meant applying the EBSS is appropriate and should ensure that it can fairly share efficiency gains and losses between it and its customers.[7]

8.2.3 Stakeholder submissions

One of the three submissions received commented on the EBSS. Jacana Energy supported the application of the EBSS for PWC in the next regulatory period, noting that the EBSS would provide continuous incentive for PWC to seek efficiencies and that the benefits are shared with consumers.[8]

8.3 Assessment approach

Under the NT NER we must determine how the EBSS will apply to PWC in the 2024–29 regulatory control period.[9]

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between service providers and network users.[10] We must also have regard to the following matters when implementing the EBSS:[11]

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5 PWC, *12.01 - Incentives Scheme attachment,* 31 January 2023, p. 7.

6 PWC, *12.01 - Incentives Scheme attachment,* 31 January 2023, p. 7.

7 PWC, *12.01 - Incentives Scheme attachment,* 31 January 2023, p. 7.

8 Jacana Energy, *Submission - 2024–29 Electricity Determination - Power and Water Corporation*, May 2023, p. 9.

9 NT NER, cl. 6.12.1(9).

10 NT NER, cl. 6.5.8(a).

11 NT NER, cl. 6.5.8(c).

- the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme
- the need to provide PWC with a continuous incentive to reduce opex
- the desirability of both rewarding PWC for efficiency gains and penalising it for efficiency losses
- any incentives that PWC may have to capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

8.3.1 Interrelationships

The EBSS is closely linked to our revealed cost approach to forecasting opex. When we assess or develop our opex forecast, the NT NER require us to have regard to whether the opex forecast is consistent with any incentive schemes.[12]

Our opex forecasting method typically relies on using the 'revealed costs' of the service provider in a chosen base year to develop a total opex forecast if the chosen base year opex is not considered to be 'materially inefficient'. Under this approach, a service provider would have an incentive to spend more opex in the expected base year. Also, a service provider has less incentive to reduce opex towards the end of the regulatory control period, where the benefit of any efficiency gains is retained for less time.

The application of the EBSS serves two important functions:

1. It removes the incentive for a service provider to inflate opex in the expected base year in order to gain a higher opex forecast for the next regulatory control period
2. It provides a continuous incentive for a service provider to pursue efficiency improvements across the regulatory control period.

The EBSS does this by allowing a service provider to retain efficiency gains (or losses) for a total of six years, regardless of the year in which the service provider makes them. Where we do not propose to rely on the single year revealed costs of a service provider in forecasting opex, this has consequences for the service provider's incentives and our decision on how we apply the EBSS.

When a distributor makes an incremental efficiency gain, it receives a reward through the EBSS, and consumers benefit through a lower revealed cost forecast for the subsequent regulatory control period. This is how efficiency improvements are shared between consumers and the distributor. If we subject costs to the EBSS that are not forecast using a revealed cost approach, a distributor would in theory receive a reward for efficiency gains

[12] NT NER, cl. 6.5.6(e)(8). Further, we must specify and have regard to the relationship between the constituent components of our overall decision: National Electricity Law, s. 16(1)(c).

through the EBSS (at a cost to consumers), but consumers would not benefit through a lower revealed cost forecast in the subsequent regulatory control period.

Therefore, we typically exclude costs that we do not forecast using a single year revealed cost forecasting approach.

For these reasons, our decision on how we will apply the EBSS to PWC has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to the effect of our EBSS decision when making our opex decision, and our EBSS decision is made largely in consequence of (and takes careful account of) our past and current decisions on PWC's opex.

8.4 Reasons for draft decision

8.4.1 Application in the 2024–29 control period

Under the NT NER we must determine how the EBSS will apply to PWC in the 2024–29 regulatory control period.[13]

Our draft decision is to apply version 2 the EBSS to PWC during the 2024–29 regulatory control period. We consider applying the scheme would result in benefits for electricity customers and it will provide continuous incentives for PWC to reduce opex. This is because, as stated earlier, we have relied on PWC's revealed costs to forecast opex over the 2024–29 regulatory control period. Further, we consider we are likely to forecast PWC's future opex using its revealed costs in the 2024–29 regulatory control period, meaning any efficiency gains that PWC achieves will lead to lower opex forecasts and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.[14] We provide details on these below.

8.4.1.1 Adjustments to forecast or actual opex when calculating carryover amounts

The EBSS allows us to exclude categories of costs that we do not forecast using a single year revealed cost forecasting approach. We do this to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through the EBSS and network users receive a benefit through lower forecast opex in the next period. This is the way network users and the service provider share in the benefits of an efficiency improvement. If we do not use a single year revealed cost forecasting approach, we may not pass the revealed efficiency gains through to network users. Network users should not pay for EBSS benefits where they do not receive the benefits of a lower opex forecast.

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13 NT NER, cl. 6.3.2(a)(3) and cl. 6.12.1(9).

14 AER, *Efficiency benefit sharing scheme for electricity network service providers,* November 2013, pp. 7–8.

Consistent with the EBSS, we will exclude debt raising costs from the EBSS as a pre-defined 'excluded category'. This is because we have not forecast debt raising on a revealed cost basis as part of base year operating expenditure. We instead forecast these using benchmarking.

In addition to excluded debt raising costs, we will also make the following adjustments when we calculate the efficiency gains and losses that will be carried over into the next regulatory control period:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass through amounts or opex for contingent projects[15]
- adjust actual opex to remove demand management innovation allowance opex because it is not included in the opex forecast (but is typically reported by service providers as part of their standard control services opex)[16]
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base[17]
- adjust actual and forecast opex for inflation[18]
- adjust actual opex to reverse any movements in provisions
- adjust opex for any services that will not be classified as standard control services in the 2029–34 regulatory control period, to the extent that this better achieves the requirements of clause 6.5.8 of the NT NER.[19]

15 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

16 Clause 6.5.8(c)(5) of the NT NER requires us to have regard to the possible effects of the scheme on incentives for the implementation of non-network options.

17 NT NER, cl. 6.5.8(c)(4) requires us to have regard to any incentives the service provider may have to capitalise expenditure.

18 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

19 AER, *Explanatory Statement, Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 14.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
EBSS	efficiency benefit sharing scheme
NT NER	National Electricity Rules - Northern Territory
opex	operating expenditure
PWC	Power and Water Corporation