Draft Decision

Ausgrid 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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8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for service providers 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 section sets out our draft decision and reasons on the EBSS carryover amounts Ausgrid has accrued over the 2019–24 regulatory control period, and how we will apply the EBSS over the 2024–29 regulatory control period.

8.1 Draft decision

Our draft decision is to include EBSS carryover amounts totalling $398.1 million ($2023–24) from the application of the EBSS in the 2019–24 regulatory period.[1] This is $0.2 million less than Ausgrid's proposal of $398.3 million.[2] This difference reflects adjustments we have made to:

- include a non-recurrent efficiency gain related to the accounting treatment of leases in the 2019–24 regulatory control period
- update actual and forecast inflation.

We set out our draft decision in table 8.1.

Table 8.1 Draft decision on Ausgrid's carryover amounts ($million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Ausgrid's proposal	149.2	195.5	58.5	–4.9	–	398.3
AER's draft decision	147.4	193.3	57.6	–5.4	5.3	398.1
Difference	**–1.8**	**–2.1**	**–1.0**	**–0.5**	**5.3**	**–0.2**

Note: Numbers may not add up due to rounding.
Source: Ausgrid, *RIN. 12 – 2024–2029 – Reset RIN – workbook 3 – EBSS*, 31 January 2023; AER analysis.

We will continue to apply version 2 of the EBSS to Ausgrid in the 2024–29 regulatory control period.[3] Consistent with Ausgrid's proposal, we will exclude debt raising costs from the scheme because we have forecast them on a category specific basis and will continue doing

1 NER, cl. 6.4.3(a)(5).

2 Ausgrid, *RIN.12 – 2024–2029 – Reset RIN – workbook 3 – EBSS,* 31 January 2023.

3 NER, cl. 6.12.1(9); AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

so in the 2029–34 regulatory control period.[4] We will also make other adjustments as permitted by the EBSS, such as removing movements in provisions related to opex, and adding approved opex for pass throughs and contingent projects to forecast opex (as outlined in section 8.4).

8.2 Ausgrid's proposal

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

Ausgrid included EBSS carryover amounts totalling $398.3 million ($2023–24) in its revenues for the 2024–29 regulatory control period from the application of the EBSS in the 2019–24 regulatory control period. Ausgrid excluded the following cost categories in calculating its EBSS carryover amounts:[5]

- debt raising costs
- demand management innovation allowance mechanism (DMIAM) opex
- movements in provisions related to opex.

8.2.2 Application in the 2024–29 control period

Ausgrid proposed we continue to apply version 2 of the EBSS in the 2024–29 period. Ausgrid supported the adjustments we apply in version 2 of the EBSS, and additionally proposed the following exclusions:[6]

- debt raising costs
- DMIAM opex
- innovation expenditure
- community resilience expenditure.

8.2.3 Stakeholder submissions

In terms of stakeholder submissions, Origin Energy was concerned with the opex underspend achieved by Ausgrid in the 2019–24 regulatory control period, and whether this underspend reflected sustainable efficiency improvements. Origin argued that networks on the efficiency frontier would presumably have limited scope to achieve efficiencies in excess of our efficiency targets. The ability of distribution network service providers, particularly those on (or close to) the efficiency frontier, to consistently achieve EBSS payments tends to suggest that the incentive regime may not be operating as intended. It considered that this

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4 Ausgrid, *2024–29 Regulatory Proposal,* 31 January 2023, p. 145.

5 Ausgrid, *RIN.12 – 2024–2029 – Reset RIN – workbook 3 – EBSS,* 31 January 2023.

6 Ausgrid, *2024–29 Regulatory Proposal,* 31 January 2023, p. 145.

was either a result of insufficient rigor in our opex forecast assessment, or that the efficiency targets for network service providers were not challenging enough. [7]

We acknowledge that Ausgrid has been able to achieve efficiency gains in previous periods, while being assessed as having base year opex that is not materially inefficient. This outcome is consistent with the operation of the incentive framework. Our opex efficiency assessments incorporate a degree of conservatism, given we utilise benchmarking tools which are necessarily imperfect and imprecise. The EBSS provides an ongoing incentive to achieve opex efficiencies. It is then important that these efficiencies are shared with consumers, through lower forecast opex. We will continue to regularly examine the effectiveness and appropriateness of our opex forecast assessment process and efficiency incentives and implement changes where there is a need to do so.

We also received a submission from Ausgrid's Reset Customer Panel (RCP), which initially suggested that it was appropriate to exclude both the proposed innovation and resilience step changes from the EBSS. However, in its updated report on Ausgrid's resilience business case, the RCP noted that it subsequently consulted the AER's expenditure staff on this issue. This led the RCP to revise its earlier position, and to recommend that the resilience expenditure be subject to the EBSS.[8] As discussed in Attachment 6 of this draft decision, we have not included these step changes in our alternative estimate of total opex for the draft decision.

8.3 Assessment approach

Under the National Electricity Rules (NER), we must determine:

- the revenue increments or decrements for each year of the 2024–29 regulatory control period arising from the application of the EBSS during the 2019–24 regulatory control period[9]
- how the EBSS will apply to Ausgrid in the 2024–29 regulatory control period.[10]

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between Ausgrid and its network users.[11] We must also have regard to the following matters when implementing the EBSS:[12]

- the need to provide Ausgrid with a continuous incentive to reduce opex

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7 Origin Energy, *Submission – 2024–29 Electricity Determination – NSW and ACT*, May 2023, pp. 3–5.

8 RCP, *RCP independent report on Ausgrid's resilience investment business case 2024–29*, 14 July 2023, pp. 47–48.

9 NER, cl. 6.4.3(a)(5).

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

11 NER, cl. 6.5.8(a).

12 NER, cl. 6.5.8(c).

- the desirability of both rewarding Ausgrid for efficiency gains and penalising it for efficiency losses
- any incentives that Ausgrid may have to inappropriately 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 the opex forecast, the NER requires us to have regard to whether the opex forecast is consistent with any incentive schemes.[13]

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 therefore 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 6 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 business 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 business. If we subject costs to the EBSS that are not forecast using a revealed cost approach, a business would in theory receive a reward for efficiency gains 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.

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[13] 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: NEL, s. 16(1)(c).

For these reasons, our decision on how we will apply the EBSS to Ausgrid 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 Ausgrid's opex.

8.4 Reasons for draft decision

This section provides the reasons for our draft decision on the carryover amounts that arise from applying the EBSS during the 2019–24 regulatory control period, and how we will apply the EBSS in the 2024–29 regulatory control period.

8.4.1 Carryover amounts from the 2019–24 control period

Our draft decision is to include EBSS carryover amounts totalling $398.1 million ($2023–24) from the application on the EBSS in the 2019–24 regulatory control period. Consistent with Ausgrid's approach, we have also used the version 1 formula of the EBSS to calculate the incremental gain for 2019–20. In total, our draft decision carryovers are $0.2 million lower than Ausgrid's proposal of $398.3 million. This difference is because we:

- included lease costs in total opex for the 2019–24 regulatory control period and a non-recurrent efficiency gain of –$5.3 million, to align the accounting treatment of leases with the regulatory period, which increased carryovers by $5.1 million
- updated actual and forecast inflation for 2022–23 and 2023–24, respectively, which decreased carryovers by –$5.2 million.

We discuss each of these in detail below.

We consider that the EBSS carryover amounts we have calculated provide for a fair sharing of efficiency gains and losses between Ausgrid and its network users. It provides rewards to Ausgrid for any efficiency gains it has made, and penalises Ausgrid for any efficiency losses. Further, we consider that the benefit to consumers, through lower forecast opex, is significant and sufficient to warrant the EBSS carryover amounts we have determined.

8.4.1.1 Adjustments for the change in accounting treatment of leases

As mentioned in Attachment 6, there was an accounting change for the treatment of leases implemented by the Australian Accounting Standards Board (AASB) that impacted Ausgrid's expenditure reporting in the 2019–24 regulatory control period. This change resulted in leases, which were included in approved opex for the 2019–24 regulatory control period, now being considered as capex under AASB16.

In its proposal, Ausgrid did not propose adjustments to base opex or the EBSS for lease costs. Ausgrid noted our view that the accounting change for operational leases from opex to capex should be treated as opex in the current period, and only changed to capex in the

2024–29 regulatory control period.[14] In response to our request for further information, Ausgrid advised that operating lease expenditures had been reported as capex in its regulatory information notices for the 2019–24 regulatory control period.[15] Ausgrid stated that it had not adopted our approach as it needed time to assess the implications, including understanding what the status of a major lease would have been had it occurred under the accounting rules at the time of its 2019–24 determination.

Ausgrid later clarified that for one major lease, which started and ended in the 2019–24 regulatory control period, removing it from base year opex via a base adjustment resulted in a windfall loss.[16] Ausgrid argued that for this lease a non-recurrent efficiency adjustment was the appropriate mechanism to remove the cost of this lease from base year opex and ensured no windfall gains/losses. Ausgrid proposed a non-recurrent efficiency adjustment of –$5.3 million ($2023–24) to be made to its base year opex in both its opex and EBSS models to account for the efficient sharing of this major lease.[17]

We acknowledge that under the amended AASB16, which came into effect 1 July 2019, lease costs now must be reported as capex in Ausgrid's statutory accounts.[18] However, we consider our August 2022 advice represents the appropriate approach for regulatory purposes. Under this approach, there would be no opportunity for network service providers to incur windfall gains or losses that have resulted purely from movement of expenditure between opex and capex due to mid-period accounting changes. As such, we have adjusted Ausgrid's reported opex, in our alternative estimate for total forecast opex and our draft decision EBSS model, to include all lease costs Ausgrid incurred over the 2019–24 regulatory control period to accurately reflect Ausgrid's actual incurred opex.[19] Conversely, we included a base adjustment of –$0.1 million to remove its ongoing lease costs from its base year opex for forecasting purposes, which reflects the change in accounting treatment of lease costs as capex in the 2024–29 period. This approach to reverse a mid-period accounting change is also consistent with our recent decision on Transgrid's 2023–28 revenue proposal.[20]

Additionally, we agree with Ausgrid's argument with respect to the major lease noted in its proposal. As the lease was not included in the 2019–24 period's base year opex allowance, and started and ended in the current period, a non-recurrent efficiency adjustment was the

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14 Ausgrid, *Att. 6.1 – Proposed operating expenditure*, *31 January 2023*, p. 22.

15 Ausgrid, *Response to information request IR#038 – Opex – property leases*, 21 June 2023, p. 2.

16 Ausgrid, *Response to information request IR#038 – Opex – property leases*, 21 June 2023, p. 5.

17 Ausgrid, *Response to information request IR#046 – Opex – property leases – mid-year period*, 7 July 2023, p. 4; This equates to the –$4.9 million ($2022–23) referenced in Ausgrid's response in IR#046.

18 Australian Accounting Standard Board, *Australian Accounting Standard AASB 16, Leases*, 31 December 2021.

19 We also made an opposing adjustment to capex and removed lease costs from the RAB roll forward model to ensure no double counting of lease costs.

20 AER, *Transgrid – 2023–28 – Draft decision – Attachment 8 – Efficiency benefit sharing scheme*, 30 September 2022, pp. 5–6.

appropriate approach. In our alternative estimate for total forecast opex and our draft decision EBSS model, we included a –$5.3 million non-recurrent efficiency adjustment to account for the removal of this major lease from its base year opex. This is consistent with Ausgrid's proposal.

8.4.1.2 Inflation

Consistent with our standard approach and opex forecast, we used unlagged inflation to convert opex amounts to 2023–24 dollars. This approach is also consistent with the approach Ausgrid adopted in its proposal.[21]

We used updated consumer price index values compared to those Ausgrid used in its proposal. For 2022–23, we used the actual headline June quarter 2023 consumer price index figure published by the Australian Bureau of Statistics, which was released after Ausgrid submitted its proposal.[22] For 2023–24, we used the inflation forecast for the year to June 2024 in the Reserve Bank of Australia's August 2023 *Statement on monetary policy*,[23] which was also published after Ausgrid submitted its proposal.

8.4.1.3 Version 1 EBSS formula

We have used the equation from version 1 of the EBSS to calculate the incremental loss Ausgrid made in the 2019–20, consistent with Ausgrid's proposal. We considered this appropriate as Ausgrid did not use revealed costs for its base year (2017–18) when it forecast opex for the 2019–24 regulatory control period. Instead, Ausgrid used a lower amount than its actual base year expenditure to forecast its total opex expenditure for the 2019–24 regulatory control period. At that time, we accepted this approach as we were satisfied that this produced a total forecast that reasonably reflected the opex criteria.

However, in this circumstance, using the version 2 equation would penalise Ausgrid even if its actual expenditure was equal to forecast opex. We consider this result to be inconsistent with the intent of the EBSS. In particular, we must have regard to the desirability of both rewarding a distributor for efficiency gains and penalising it for efficiency losses.[24] Spending exactly as forecast is neither an efficiency gain or loss. Thus, it follows that a distributor should accrue no carryovers when it spends as forecast. This is achieved by using the version 1 equation to calculate the incremental gain for 2019–20 if we assume Ausgrid spent as forecast.

We therefore consider that using the equation in version 1 of the EBSS yields a result more consistent with the intent of the EBSS (e.g. should Ausgrid spend exactly as forecast, this would result in a zero carryover).

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21 Ausgrid, *RIN.12 – 2024–2029 – Reset RIN – workbook 3 – EBSS,* 31 January 2023.

22 Australian Bureau of Statistics, *Catalogue number 6401.0, Consumer price index*, June 2023.

23 Reserve Bank of Australia , *Statement on monetary policy, Appendix: Forecasts*, August 2023.

24 NER, cl. 6.5.8(c)(3).

8.4.2 Application in the 2024–29 control period

Our draft decision is to continue to apply version 2 of the EBSS to Ausgrid during the 2024–29 regulatory control period. We consider applying the scheme will benefit the long-term interests of electricity consumers by providing a continuous incentive for Ausgrid to reduce its opex. Provided we forecast Ausgrid's future opex using its revealed costs in the 2024–29 regulatory control period, any efficiency gains (losses) that Ausgrid achieves will lead to lower (higher) future opex forecasts, and thus lower (higher) network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.[25] We provide details on these below.

8.4.2.1 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 in the following control period. 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 consumers receive a benefit through lower forecast opex in the next regulatory control period. This is the way consumers 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 benefits of these revealed efficiency gains to consumers. It follows that consumers should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

We do not forecast debt raising costs using a single year revealed cost forecasting approach. Instead, we provide a benchmark forecast. Accordingly, we have excluded these costs from the EBSS for the 2024–29 regulatory control period since any achieved efficiency gains (or losses) would not be passed on to network users.

We will also exclude projects under the DMIAM, because including them in the EBSS would distort the incentives provided under these schemes and allowances.

Similarly, we note Ausgrid's proposal that the opex component of its network innovation program and community resilience expenditure be excluded from the EBSS for the 2024–29 regulatory control period.[26] The proposed innovation program opex was not forecast on a revealed cost basis, and is unlikely to be forecast on that basis in future given the nature of these costs. We therefore agree that any network innovation program opex should be excluded from application of the EBSS for the 2024–29 regulatory control period. Our initial assessment of Ausgrid's proposed community resilience opex suggests these costs may be more recurrent in nature, and therefore able to be forecast on a revealed cost basis in future.

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25 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

26 Ausgrid, *2024–29 Regulatory Proposal,* 31 January 2023, p. 145.

However, as discussed in Attachment 6, we have not included opex for community resilience or the network innovation program in our forecast total opex for this draft decision.

In addition to the excluded cost categories discussed above, we will also make the following adjustments when we calculate the EBSS carryover amounts accrued during the 2024–29 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
- adjust reported opex to add capitalised opex that has been excluded from the regulatory asset base[27]
- adjust forecast opex and reported opex for inflation[28]
- adjust reported 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 period, to the extent these costs are not forecast using a single year revealed cost approach and excluding these costs better achieves the requirements of clauses 6.5.8 of the NER.[29]

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27 Clause 6.5.8(c)(4) of the NER requires us to have regard to any incentives the service provider may have to capitalise expenditure.

28 AER, *Efficiency Benefit Sharing Scheme*, November 2013, p. 7.

29 AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers*, November 2013, pp. 14–16.

Shortened forms

Term	Definition
AASB	Australian Accounting Standards Board
AER	Australian Energy Regulator
capex	capital expenditure
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
NER	national electricity rules
opex	operating expenditure
RCP	Ausgrid's Reset Customer Panel