

Draft Decision

Directlink Electricity Transmission Determination 2025 to 2030 (1 July 2025 to 30 June 2030)

Attachment 9 Capital expenditure sharing scheme

September 2024

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Version	Date	Pages
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Contents

9	Capital expenditure sharing scheme	1
9.1	Draft decision.....	2
9.2	Directlink's proposal.....	3
9.3	Assessment approach	3
9.4	Reasons for draft decision	4
	Shortened forms.....	6

9 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers whose capital expenditure (capex) becomes more efficient and financial penalties for those that become less efficient. Consumers benefit from improved efficiency through lower regulated prices.

The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between service providers and consumers.

The CESS mechanism was recently updated in April 2023. The changes to the CESS will apply to the 2025–30 regulatory period and will apply as follows:

- We calculate the cumulative underspend or overspend for the current regulatory control period in net present value terms.
- We apply the sharing ratio of 30 per cent to all efficiency losses, and a tiered rate for efficiency gains, to work out what the service provider's share of the underspend or overspend should be.¹
- We calculate the CESS payments taking into account the financing benefit or cost to the service provider of the underspend or overspend.² We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the regulatory asset base (RAB).³

The CESS payments will be added or subtracted to the service provider's regulated revenue as a separate building block in the next regulatory control period.

For the current regulatory period, the CESS version referred to in the regulatory information notice will apply to the model.⁴

We consider in addition to greater incentives to improve capex efficiency, the CESS provides a consistent incentive to incur capex efficiently during a regulatory control period and encourages more efficient substitution between capex and operating expenditure (opex).

This attachment sets out our draft decision for the determination of the revenue impact from the CESS in the 2020–25 regulatory control period and the application of the CESS for Directlink in the 2025–30 regulatory control period.

¹ The tiered rate calculation for efficiency gains will apply a 30 per cent sharing ratio for any underspend amount up to and including 10 per cent of the approved forecast capex allowance, while any amount greater will incur a 20 per cent sharing ratio.

² We calculate benefits as the benefits to the service provider of financing the underspend since the amount of the underspend can be put to some other income generating use during the period. Losses are similarly calculated as the financing cost to the service provider of the overspend.

³ The capex incentive guideline outlines how we may exclude capex from the RAB and adjust the CESS payment for deferrals. AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, April 2023, pp. 8, 13–19.

⁴ AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013.

9.1 Draft decision

9.1.1 Revenue impact in the 2025–30 period

Our draft decision is to apply a CESS revenue increment amount of \$0.35 million (\$2024–25) across the 2025–30 regulatory control period. This is from the application of the CESS in 2020–25 regulatory control period and the corresponding CESS carryover true-up for 2019–20. This is \$0.39 million more than Directlink’s forecasted decrement of \$0.04 million.

The CESS increment arises as a result of an overspend in total capex applicable to the CESS against the forecast for the 2020–25 period, combined with adjustments for the final year of the previous 2015–20 period. Our draft decision on the revenue impact of the application of the CESS in the 2020–25 period and the corresponding CESS carryover true-up 2019–20 is summarised in Table 9.1.

Table 9.1 CESS revenue increments in 2025–30 (\$ million, 2024–25)

CESS item	2025–26	2026–27	2027–28	2029–29	2029–30	Total
CESS revenue increment as per NER 6.4.3(a)(5)	-0.08	-0.08	-0.08	-0.08	-0.08	-0.42
CESS carryover true-up for 2019–20	0.15	0.15	0.15	0.15	0.15	0.77
AER draft decision CESS	0.07	0.07	0.07	0.07	0.07	0.35

Note: Numbers may not sum due to rounding.

Source: AER analysis. Directlink – RIN04 – SCS CESS Model – January 2024, 31 January 2024. Directlink, 7.02 – Model – SCS CESS True-Up Model – January 2024, 31 January 2024.

9.1.2 Application of CESS in the 2025–30 regulatory control period

We will apply the CESS as set out in the 2023 capital expenditure incentives guideline.⁵ The reasons for adopting this CESS are set out in our final decision for the review of incentive schemes for networks, and the final decision for capital expenditure incentive guideline.⁶ This is consistent with the proposed approach we set out in our framework and approach paper.⁷

⁵ AER, *AER - Final decision - Capital expenditure incentive guideline*, April 2023, pp. 3–9.

⁶ AER, *AER - Final decision - Review of incentive schemes for networks*, April 2023, pp. 14-22; and AER, *AER - Final decision - Capital expenditure incentive guideline*, April 2023.

⁷ AER, *AER - Final framework and approach – Directlink 2025–30 – July 2023*, July 2023, p. 6.

9.2 Directlink's proposal

9.2.1 CESS revenue increments from the 2020–25 regulatory control period

Directlink proposed a CESS decrement of \$0.04 million (\$2024–25) for the 2025–30 regulatory control period. This figure included exclusions of the actual and estimated capex for its insulated gate bipolar transistors (IGBT) replacement project and did not include adjustments for the CESS carryover true-up. Directlink cites the impact of Covid-19 and supply change shortages on its IGBT project as the primary drivers for its overspend during the 2025–30 regulatory control period.⁸

9.2.2 Final year actual capex true-up for 2019–20

Directlink did not submit a true-up calculation to account for the updated actual capex in 2019–20 in its original proposal. After we engaged with Directlink, it submitted a true-up calculation increment of \$2.74 million (\$2024–25).⁹

9.2.3 Application of CESS in the 2025–30 regulatory control period

Directlink proposed to apply the CESS in the 2025–30 regulatory period.¹⁰ Directlink proposed to exclude its IGBT obsolescence project forecast of \$15.5 million from the current regulatory period from the CESS calculation.¹¹

9.3 Assessment approach

Under the National Electricity Rules (NER) we must decide:

- the revenue impact on Directlink arising from applying the CESS in the 2020–25 regulatory control period; and
- whether or not to apply the CESS to Directlink in the 2025–30 regulatory control period and how any applicable scheme will apply;¹²

We must determine the appropriate revenue increments or decrements (if any) for each year of the 2025–30 regulatory control period arising from the application of the CESS during the 2020–25 regulatory control period.¹³

In deciding whether to apply a CESS to Directlink for the 2025–30 regulatory control period, and the nature of the details of the scheme, we must:¹⁴

- make that decision in a manner that contributes to the capex incentive objective¹⁵

⁸ Directlink, *Attachment 04 – Capital Expenditure*, 31 January 2024, p. 5.

⁹ Directlink, *CESS final year True-up model version 2*, 5 August 2024.

¹⁰ Directlink, *2025–30 Directlink Revenue Proposal*, 31 January 2024, p. 89.

¹¹ Directlink, *2025–30 Directlink Revenue Proposal*, 31 January 2024, p. 67.

¹² NER, cl. 6A.14.1(5A).

¹³ NER, cl. 6A.5.4(a)(5).

¹⁴ NER cl. 6.5.8A(e).

- take into account the CESS principles,¹⁶ the capex objectives and, where relevant, the operating expenditure (opex) objectives,¹⁷ the interaction with other incentive schemes,¹⁸ and the circumstances of the service provider.¹⁹

Broadly, the capex incentive objective is to ensure that only capex that meets the capex criteria enters the RAB used to set prices. Therefore, consumers only fund capex that is efficient and prudent.

9.3.1 Interrelationships

The approval of the CESS revenue increment determines the associated CESS building block as part of Directlink’s overall forecast revenue requirement for the 2025–30 regulatory control period.

The CESS relates to other incentives Directlink faces to incur efficient opex, conduct demand management, and maintain or improve service levels. Related schemes include the efficiency benefit sharing scheme (EBSS) for opex, the service target performance incentive scheme (STPIS) for service levels, and the demand management incentive allowance mechanism (DMIAM). We aim to incentivise network service providers to make efficient decisions on when and what type of expenditure to incur and to balance expenditure efficiencies with service quality.

9.4 Reasons for draft decision

Our draft decision is to include an overall CESS revenue increment of \$0.35 million (\$2024–25) in the 2025–30 period, comprising a \$0.42 million decrement for the 2020–25 capex performance and a \$0.77 million increment for the final year true-up. This is \$0.39 million higher than Directlink’s proposed CESS revenue decrement of \$0.04 million. We set out our reasons in the sections below.

9.4.1 CESS revenue increment from the 2020–25 regulatory control period

Our draft decision includes a CESS increment of \$0.35 million for Directlink’s capex performance in the 2020–25 period. The differences between Directlink’s proposal and our draft decision reflects adjustments for the proposed exclusions, updates to asset disposals and capitalised leases, and adjustments to modelling inputs such as CPI and the WACC to reflect more up-to-date information. We will update these inputs, where relevant, in our final decision.

We are satisfied a deferral adjustment is not required because there was no material underspend in capex. We discuss our consideration of Directlink’s exclusion proposal below.

¹⁵ NER, cl. 6.5.8A(e)(3); the capex incentive objective is set out in cl. 6.4A(a).

¹⁶ NER, cl. 6A.6.5A(e)(4)(i); the CESS principles are set out in cl.6A.5A(a).

¹⁷ NER, cll. 6A.6.5A(e)(4)(i) and 6A.6.5A(d)(2); the capex objectives are set out in cl. 6A.6.7(a); the opex objectives are set out in cl. 6A.6.6(a).

¹⁸ NER, cll. 6A.6.5A(e)(4)(1) and 6A.6.5A(d)(1).

¹⁹ NER, cl. 6A.6.5A(e)(4)(ii).

9.4.1.1 Proposed exclusions from the CESS in the 2020–25 period

Directlink proposed its IGBT obsolescence project forecast should be excluded from the application of the CESS in the 2020–25 period. Directlink claims there is a potential detriment to consumers if Directlink is penalised, as this will discourage innovative solutions and require costs of major expenditure to be locked down at the time of the project proposal, rather than when implementation of the project is being undertaken.²⁰

Our draft decision is to not accept this exclusion. The capital incentive guideline does not provide for capex to be excluded ex post on the basis proposed by Directlink. We also do not consider that, in this circumstance, the CESS discourages innovation. In receiving an increment, Directlink will have the flexibility to manage the timing and costs of its total capex.

We would expect Directlink to seek out capex efficiencies through innovation, as Directlink will benefit through reduced costs and more efficient business practices. The CESS provides an incentive for this. It is also not clear how excluding IGBT specifically would encourage innovation. Rather, this would increase the level of risk customers would bear and shift the burden of overspends onto consumers.

9.4.2 Final year actual capex true-up for 2019–20

Our draft decision includes a true-up adjustment of \$0.77 million (\$2024–25) to account for the updated actual capex for 2019–20. This is \$1.97 million less than Directlink’s forecast true-up adjustment of \$2.74 million.

²⁰ Directlink, *2025–30 Directlink Revenue Proposal*, 31 January 2024, p. 66.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
Capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management incentive allowance mechanism
EBSS	efficiency benefit sharing scheme
IGBT	insulated gate bipolar transistors
NER	national electricity rules
NSP	network service provider
Opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital