

Draft Decision

Energex Electricity

Distribution Determination

2025 to 2030

(1 July 2025 to 30 June 2030)

Attachment 9

Capital expenditure sharing scheme

September 2024

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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. Customers 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 notice⁴ will apply in the building block model.

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 Energex 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 to apply a CESS revenue decrement amount of \$72.8 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 \$24.6 million higher than Energex’s forecast decrement of \$48.2 million.

The CESS decrement arises as a result of an overspend in total capex to which the CESS applies against the forecast for the 2020–25 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. This figure includes Energex’s proposed ICT exclusion of \$131.5 million.

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)	-13.33	-13.33	-13.33	-13.33	-13.33	-66.64
CESS carryover true-up for 2020–21	-1.24	-1.24	-1.24	-1.24	-1.24	-6.20
AER draft decision CESS	-14.57	-14.57	-14.57	-14.57	-14.57	-72.83

Note: Numbers may not sum due to rounding.

Source: AER analysis. Energex, *RIN.04 SCS CESS 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

9.2 Energex's proposal

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

Energex proposed a CESS decrement of \$48.2 million (\$2024–25) for the 2025–30 regulatory control period. This is due to Energex overspending spread across all years of the current regulatory period but notably higher in the last two years of the period. Energex cites the Covid-19 pandemic, digitalisation and cost of specialist resources as the primary drivers for its overspend during the 2025–30 regulatory control period. As part of its CESS proposal,

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 - Ergon Energy, Energex 2025–30 – July 2023*, July 2023, p. 16.

Energex proposed to exclude its ICT overspend of \$131.5 million from the current regulatory period from the CESS calculation and also from its actual capex.⁸ Energex states it has included the exclusion in order to simplify its modelling.⁹

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

Energex submitted a true-up calculation method, which proposed a true-up increment of \$16.1 million (\$2024–25) to be added to its CESS revenue increments in the 2025–30 period.¹⁰

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

Energex proposed to apply the CESS in the 2025–30 regulatory period.¹¹

9.3 Assessment approach

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

- the revenue impact on Energex arising from applying the CESS in the 2020–25 regulatory control period;¹² and
- whether or not to apply the CESS to Energex in the 2025–30 regulatory control period and how any applicable scheme will apply;¹³

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.¹⁴

In deciding whether to apply a CESS to Energex for the 2025–30 regulatory control period, and the nature of the details of the scheme, we must:¹⁵

- make that decision in a manner that contributes to the capex incentive objective¹⁶

⁸ Energex, *2025–30 Regulatory Proposal*, 31 January 2024, p. 147.

⁹ Energex, *2025–30 Regulatory Proposal*, 31 January 2024, p. 147.

¹⁰ Energex, *7.02 – Model – SCS CESS True-Up Model – January 2024*, 31 January 2024.

¹¹ Energex, *2025–30 Regulatory Proposal*, 31 January 2024, p. 145.

¹² NER, cl. 6.4.3(a)(5).

¹³ NER, cl. 6.12.1(9).

¹⁴ Increments or decrements arising from the application of applicable incentive mechanisms, including any capital expenditure sharing scheme, form one of the building blocks that must be used to determine the annual revenue requirement for distribution network service providers for each regulatory year of a regulatory control period: NER, cl. 6.4.3(a)(5).

¹⁵ NER cl. 6.5.8A(e).

¹⁶ NER, cl. 6.5.8A(e)(3); the capex incentive objective is set out in cl. 6.4A(a).

- take into account the CESS principles,¹⁷ the capex objectives and, where relevant, the operating expenditure (opex) objectives,¹⁸ the interaction with other incentive schemes,¹⁹ and the circumstances of the service provider.²⁰

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 Energex’s overall forecast revenue requirement for the 2025–30 regulatory control period.

The CESS relates to other incentives Energex 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 decrement of \$72.8 million (\$2024–25) in the 2025–30 period, comprising of a \$66.6 million decrement for the 2020–25 capex performance and a \$6.2 million decrement for the final year true-up for 2019-20. This is \$24.6 million higher than Energex’s proposed CESS revenue decrement of \$48.2 million. We set out our reasons in the sections below.

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

Our draft decision includes a CESS decrement of \$72.8 million for Energex’s capex performance in the 2020–25 period. The differences between Energex’s proposal and our draft decision reflects adjustments to the actual/estimated capex to reflect the RFM, which includes the proposed ICT exclusion to the RAB. Findings from our assessment of the inputs included updates to asset disposals and capitalised leases, and modelling inputs such as CPI and the WACC to reflect more up-to-date information. Energex’s flood cost pass through has also been incorporated into the 2020–25 total capex allowance section.

9.4.1.1 Ex-post period exclusions

Under our CESS Guideline, there are certain defined circumstances in which we may make exclusions, which are for adjustments for the deferral of capex and ex-post exclusions from

¹⁷ NER, cl. 6.5.8A(e)(4)(i); the CESS principles are set out in cl.6.5.8A(c).

¹⁸ NER, cll. 6.5.8A(e)(4)(i) and 6.5.8A(d)(2); the capex objectives are set out in cl. 6.5.7(a); the opex objectives are set out in cl. 6.5.6(a).

¹⁹ NER, cl. 6.5.8A(d)(1).

²⁰ NER, cl. 6.5.8A(e)(4)(ii).

the RAB. Therefore, by default the CESS applies to all categories of capex and we are only able to adjust if certain criteria are met for the mentioned circumstances. This includes “when a NSP has overspent, the amount of capex above the allowance that does not reasonably reflect the capital expenditure criteria can be excluded from the RAB”.²¹ Ex-post exclusions are important to consider to potentially avoid the NSP from bearing more than 100 per cent of the cost of the excluded capex.²² The exclusions from our ex post review are included in the model by deducting those amounts from the actual capex, reducing the amount of capex to which the CESS applies

Our assessment of the proposed exclusions for 2019–24 against the NER requirements

Energex’s CESS proposal included exclusions for its ICT overspend of \$131.5 million during the first three years of the 2020–25 regulatory control period. As Energex’s ex-post actual expenditure was below the AER forecast, an ex-post review was not required. However, Energex’s has proposed to exclude its ICT overspend from the RAB. The total capex we assess for the CESS is reflected in the RFM. In removing the ICT overspend from the RAB, the total capex in the RFM is reduced, therefore reducing the capex to which the CESS applies. The overspend will be self-funded and not subject to penalties under the CESS mechanism. This results in lower costs for consumers. The removal of the overspend leads to a change in the CESS decrement from -\$103.2 million to -\$66.6 million.

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

Our draft decision includes a true-up adjustment of -\$6.2 million (\$2024–25) to account for the updated actual capex for 2019–20. This is \$22.2 million less than Energex’s forecast true-up adjustment of \$16.0 million.

²¹ AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 17.

²² AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 9.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
NER or the rules	national electricity rules
NSP	network service provider
RAB	regulatory asset base
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital