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Dear Arek

Feedback on the AER's Capital Expenditure Incentive Guideline Review Consultation Paper

Jemena welcomes the opportunity to provide feedback on the Australian Energy Regulator's (**AER**)'s Capital Expenditure Incentive Guideline Review (**Guideline**) consultation paper. The Guideline is designed to incentivise efficient capex by network businesses through the Capital Expenditure Sharing Scheme (**CESS**) and ex-post reviews. While the CESS provides ex-ante incentives, the ex-post review mechanism ensures that efficient capex is included in the regulatory asset base (**RAB**).

The National Electricity Rules (**NER**) requires the AER to consider improvements or declines in the capex efficiency of a Distribution Network Service Provider (**DNSP**) when determining the CESS outcome. The current Guideline does not permit the AER to adjust the CESS where, through an ex-post review, the AER finds the capex overspend efficient. CESS would penalise the DNSPs for any overspend despite AER's ex-post review finding that overspend was efficient. This creates tension between the CESS outcome and intent of the NER and the revenue and pricing objectives underlying the National Electricity Law (**NEL**).

As part of this review, the AER is also seeking stakeholder feedback on need and scope of exclusions for CESS applicable to DNSPs. The AER notes –

> *We are seeking stakeholder views on whether the Guideline should be amended to extend the ability to modify the CESS or exclude the CESS entirely for specific types of capex to DNSPs.*

In coming to our view on exclusions for DNSPs we have considered the need for retaining simplicity and low cost of regulation as desired objectives. We propose the following exclusions from the operation of the CESS scheme for AER's consideration:

Exclusion of Connection Capex from CESS

Connection capex is typically demand-driven and DNSPs have no control over the outturn demand within a regulatory period. The NER requires DNSPs to make an offer to connect customers who make a request, leaving DNSPs no discretion in incurring these costs. A prime example of this is data centre investments, which were not anticipated by Australian Energy Market Operator (**AEMO**), forecasting agencies or DNSPs, but require substantial increases in capex to connect these customers to the electricity distribution network. Under the current CESS framework, DNSPs will be penalised

for prudently incurring these necessary costs if they result in an overall overspend. We elaborate on this issue at length in our application to the AER as part of our 2021-26 electricity distribution price review reopener.[1]Excluding connection capex from the CESS would avoid this issue, ensure DNSPs are not unfairly penalised for their efficient investments and uphold the intent of the revenue and pricing principles.[2]

Connection capex is subject to efficiency measures. In Victoria, under the Electricity Distribution Code of Practice, customers are afforded the opportunity to require DNSPs to go to market to secure alternative market prices. This test ensures customers are provided with connection offers that secure efficient prices. Given this, applying the CESS efficiency assessment to connection capex is not necessary to achieve the efficiency objective.

The AER has already allowed the exclusion of connection capex from CESS for Jemena Gas Networks (NSW) Ltd (**JGN**) in the 2020-25 period and has extended the application to the Victorian gas distribution networks' 2023-28 Access Arrangements, which should provide a useful regulatory precedent. The AER also allows for specific category-level cost exclusions from its opex Efficiency Benefit Sharing Scheme (**EBSS**) which typically accounts for costs beyond DNSPs' control.

Exclusion of Innovation-Related Capex from CESS

We believe that prenominated innovation-related capex should be excluded from the CESS. Innovation spending can lead to long-term gains that benefit consumers, but the current CESS framework discourages investment in such projects if they result in an overspend. For electricity DNSPs, this could include innovation capex to encourage Customer Energy Resources (**CER**) integration. For gas DNSPs, this could include capex that supports the flow of renewable gases which contribute to achieving the newly incorporated emission reduction objective as part of National Gas Objective (**NGO**).

As the transition to net zero emissions progresses, innovation becomes increasingly critical. Given the rapid pace of change in the sector, the optimal combination of technological, economic, and regulatory solutions remains uncertain. Therefore, it is essential that both electricity and gas DNSPs receive regulatory certainty, enabling them to innovate and trial new network management approaches without facing penalties.

In summary, we urge the AER to reconsider the application of CESS by excluding connection and prenominated innovation related capex. Doing so would encourage investment in critical infrastructure and innovation without penalising DNSPs for efficient spending that contributes to the long-term interests of consumers.

Yours sincerely

[signed]

Sandeep Kumar
Group Manager Regulatory Analysis, Pricing and Strategy

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1 Jemena Electricity Networks (Vic) Ltd, *Application to reopen the 2021-26 Electricity Distribution Price Review Determination Reopening JEN's distribution determination for capital expenditure*, 15 October, 2024.

2 NEL 7A – Revenue and pricing principles (2) A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in— (a) providing direct control network services; and (b) complying with a regulatory obligation or requirement or making a regulatory payment.