DRAFT DECISION
ElectraNet transmission determination
2018 to 2023

Attachment 10 – Capital expenditure sharing scheme

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

Note

This attachment forms part of the AER's draft decision on ElectraNet's transmission determination for 2018–23. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

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Attachment 11 – Service target performance incentive scheme

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Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIA	demand management innovation allowance
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
NTSC	negotiated transmission service criteria
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice

Shortened form	Extended form
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

10 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers whose capex becomes more efficient and financial penalties for those that become less efficient. Consumers benefit from improved efficiency through lower regulated prices. This attachment sets out how we will apply the CESS to ElectraNet in the 2018–23 regulatory control period.

As part of the Better Regulation program we consulted on and published version 1 of the capital expenditure incentive guideline (capex incentive guideline), which sets out the CESS.[1] 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 works 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 the cumulative underspend or overspend to work out what the service provider's share of the underspend or overspend should be.
- 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 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.

Under the CESS a service provider retains 30 per cent of an underspend or overspend, while consumers retain 70 per cent of the underspend or overspend. This means that for a one dollar saving in capex the service provider keeps 30 cents of the benefit while consumers keep 70 cents of the benefit.

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1 AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, pp. 5–9. (AER, *Capex incentive guideline*, November 2013).

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. AER, *Capex incentive guideline*, November 2013, pp. 13–20.

10.1 Draft decision

We will apply the CESS as set out in version 1 of the capital expenditure incentive guideline to ElectraNet in the 2018–23 regulatory control period.[4] The guideline provides for the exclusion from the CESS of capex the service provider incurs in delivering a priority project approved under the network capability component of the Service Target Performance Incentive Scheme (STPIS) for transmission network service providers.[5] This is consistent with the proposed approach we set out in our framework and approach paper.[6]

10.2 ElectraNet's proposal

ElectraNet supported the application of the CESS as set out in the capex incentive guideline from 1 July 2018.[7]

10.3 Assessment approach

In deciding whether to apply a CESS to a network service provider, and the nature and details of any CESS to apply to a service provider, we must:[8]

- make that decision in a manner that contributes to the capex incentive objective[9]
- take into account the CESS principles,[10] the capex objectives,[11] other incentive schemes, and, if relevant, the opex objectives, as they apply to the particular service provider, and the circumstances of the service provider.

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.

10.3.1 Interrelationships

The CESS relates to the incentives ElectraNet faces to incur efficient opex, conduct demand management and maintain or improve service levels.[12] We aim to incentivise network service providers to make efficient decisions on when and what type of

4 AER, *Capex incentive guideline*, November 2013, pp. 5–9.

5 AER, *Capex incentive guideline*, November 2013, p. 6.

6 AER, *Final Framework and Approach for ElectraNet: For the regulatory control period commencing 1 July 2018*, July 2016, pp. 19-21.

7 ElectraNet, *Revenue proposal 2019-2023 Attachment 10 - Capital Expenditure Sharing Scheme*, 28 March 2017, p. 5.

8 NER, cl. 6A.6.5A.

9 NER, cl. 6A.5A(a); the capex criteria are set out in cl. 6A.6.7(c)(1)-(3) of the NER.

10 NER, cl. 6A.6.5A(c).

11 NER, cl. 6A.6.7(a).

12 Related schemes are the efficiency benefit sharing scheme (EBSS) for opex, and the service target performance incentive scheme (STPIS) for service levels.

expenditure to incur and to balance expenditure efficiencies with service quality. We discuss these interrelationships where relevant in our capex attachment.

10.4 Reasons for draft decision

We are satisfied with ElectraNet's proposal to apply the CESS as set out in the capex incentive guideline. This includes the exclusion provided for under the CESS of capex the service provider incurs in delivering a priority project approved under the network capability component of the transmission STPIS.

The reasons for our preference for a CESS are set out in our capital expenditure incentive guideline. In developing the guideline we took into account the capex incentive objective, capex criteria, capex objectives and the NEO.