



DRAFT DECISION

Directlink Transmission Determination 2020 to 2025

Attachment 8 Efficiency benefit sharing scheme

October 2019

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Note

This attachment forms part of the AER's draft decision on Directlink's 2020–25 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Pricing methodology

Attachment 12 – Pass through events

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
EBSS	efficiency benefit sharing scheme
NEL	national electricity law
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
STPIS	service target performance incentive scheme
TNSP	transmission network service provider

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 these between distributors and network users. Consumers benefit from improved efficiencies through lower regulated prices.

This attachment sets out our draft decision and reasons on the EBSS carryover amounts Directlink has accrued over the 2015–20 regulatory control period, and how we will apply the EBSS over the 2020–25 regulatory control period.

8.1 Draft decision

Our draft decision is to include carryover amounts totalling –\$2.0 million (\$2019–20) from the application of the EBSS in the 2015–20 regulatory control period. This is \$0.5 million (\$2019–20) less than the Directlink's proposal of –\$1.5 million (\$2019–20).¹

We set out our draft decision on Directlink's EBSS carryover amounts in table 8-1.

Table 8-1 Draft decision on carryover amounts (\$million, 2019–20)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Directlink's proposal	–0.7	–0.8	–0.3	–	0.3	–1.5
AER draft decision	–0.6	–1.2	–0.4	–	0.1	–2.0

Source: Directlink, *Revenue proposal 2020–25, PTRM*, 31 January 2019; AER analysis.

Note: Numbers may not add up due to rounding.

Our draft decision is based on Directlink's estimated opex for 2018–19. In our final decision, we will update our calculation of the carryover amounts using actual opex in that year. We will also update our inflation forecast for 2019–20 in our final decision.

Our draft decision is to continue to apply version two of the EBSS to Directlink in the 2020–25 regulatory control period. Consistent with Directlink's proposal, we will exclude debt raising costs from the scheme as a pre-defined 'excluded category'.² If we forecast insurance costs as a category specific forecast in the 2025–30 regulatory control period, consistent with our draft decision for the 2020–25 regulatory control period, we will also exclude them from the scheme.

We have set out in table 8-2 the opex forecasts we will use to calculate efficiency gains in the 2020–25 regulatory control period, subject to further adjustments permitted by

¹ Directlink, *Revenue Proposal 2020–25*, 31 January 2019, pp. 33–34.

² Directlink, *Revenue Proposal 2020–25*, 31 January 2019, pp. 97–98.

the EBSS and assuming that insurance costs will not be forecast using a single year revealed cost approach for the 2025–30 regulatory control period.

Table 8-2 Forecast total opex for the EBSS (\$million, 2019–20)

	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Forecast total opex	3.8	3.8	3.8	4.6	4.7	4.7	4.7	4.8
Less debt raising costs	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Less insurance costs	-0.3	-0.3	-0.3	-0.5	-0.5	-0.6	-0.6	-0.6
Forecast total opex for the EBSS	3.5	3.4	3.4	4.0	4.1	4.1	4.1	4.1

Source: AER analysis.

Note: Numbers may not add up to total due to rounding.

8.2 Directlink's proposal

8.2.1 Carryover amounts from the 2015–20 regulatory control period

Directlink proposed we include EBSS carryover amounts totalling –\$1.5 million (\$2019–20) in its revenue in the 2020–25 regulatory control period, from the application of the EBSS in the 2015–20 regulatory control period.³

8.2.2 Application in the 2020–25 regulatory control period

Directlink proposed that we continue to apply the EBSS in the 2020–25 regulatory control period. It proposed a five year carryover period and that debt raising costs be excluded from the scheme.⁴

8.3 Assessment approach

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

- the revenue increments or decrements for each year of the 2020–25 regulatory control period arising from the application of the EBSS during the 2015–20 regulatory control period⁵
- how the EBSS will apply to Directlink in the 2020–25 regulatory control period.⁶

³ Directlink, *Revenue Proposal 2020–25*, 31 January 2019, pp. 33–34.

⁴ Directlink, *Revenue Proposal 2020–25*, 31 January 2019, pp. 97–98.

⁵ NER, cl. 6A.5.4(a)(5).

⁶ NER, cll. 6A.14.1(1)(iv) and cl. 6A.14.3(d)(2).

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between Directlink and network users.⁷ We must also have regard to the following matters when implementing the EBSS:⁸

- the need to provide Directlink with continuous incentives to reduce opex
- the desirability of both rewarding Directlink for efficiency gains and penalising it for efficiency losses
- any incentives that Directlink 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 opex revealed cost approach to forecasting opex. When we assess or develop our opex forecast, the NER require us to have regard to whether the opex forecast is consistent with any incentive schemes.⁹

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 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 six 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

⁷ NER, cl. 6A.6.5(a).

⁸ NER, cl. 6A.6.5(b).

⁹ NER, cl. 6A.6.6(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).

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.

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

8.4 Reasons for draft decision

8.4.1 Carryover amounts from the 2015–20 regulatory control period

Our draft decision is to include EBSS carryover amounts totalling –\$2.0 million (\$2019–20) from the application of the EBSS in the 2015–20 regulatory control period. This is \$0.5 million (\$2019–20) less than Directlink's proposal of –\$1.5 million (\$2019–20). This difference reflects that:

- we excluded insurance costs from the EBSS carryover calculations to be consistent with our operating expenditure forecast for the 2020–25 regulatory control period
- we updated the CPI index values in the model.

As we stated in our draft decision for Directlink's 2015–20 transmission determination, when we calculate Directlink's carryover amounts from the 2015–20 regulatory control period we will exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2020 where doing so better achieves the requirements of clause 6A.6.5 of the NER.¹⁰ We have forecast insurance costs specifically in our opex forecast for the 2020–25 regulatory control period, which means this category of costs is not forecast with a single year revealed cost approach.¹¹

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

¹⁰ AER, *Draft decision, Directlink transmission determination 2015–20, Attachment 9 Efficiency benefit sharing scheme*, November 2014, p. 9.

¹¹ AER, *Draft decision, Directlink transmission determination 2020–25, Attachment 6 Operating expenditure*, October 2019, pp. 17–19.

Our draft decision is based on Directlink's estimated opex for 2018–19. In our final decision, we will update our calculation of the carryover amounts using *actual* opex for 2018–19. We will also update our inflation forecast for 2019–20 in our final decision.

8.4.2 Application in the 2020–25 regulatory control period

Our draft decision is to continue to apply version two of the EBSS to Directlink during the 2020–25 regulatory control period. We consider applying the scheme will benefit long-term electricity customers as it will provide continuous incentives for Directlink to reduce opex. Provided that we forecast Directlink's future opex using its revealed costs in the 2020–25 regulatory control period, any efficiency gains that Directlink achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version two of the EBSS specifies our approach to determining the length of the carryover period and adjusting forecast or actual opex when calculating carryover amounts.¹² We provide details on these below.

Length of carryover period

To ensure continuous incentives, the length of the carryover period for the 2020–25 regulatory control period will be the same as the length of Directlink's following regulatory control period.¹³ We expect Directlink's next regulatory control period will be five years, starting from 1 July 2025. This is consistent with Directlink's proposed five year carryover period.

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.¹⁴ 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 network users receive a benefit through lower forecast opex in the next regulatory control period. This is the way network users 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 revealed efficiency gains to network users. It follows that network users should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

Consistent with version two of the EBSS, we will exclude debt raising costs from the EBSS as a pre-defined 'excluded category'. This is because we typically do not

¹² AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

¹³ NER, cl. 6A.6.5(b)(1).

¹⁴ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, Section 1.4, p. 7.

forecast debt raising costs on a revealed cost basis. We instead forecast these based on a benchmark amount.

Consistent with version two of the EBSS we will also:¹⁵

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination. This may include approved pass through amounts or opex for contingency projects
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base¹⁶
- adjust forecast opex and actual opex for inflation¹⁷
- adjust actual opex to reverse any movements in provisions
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 1 July 2025 where doing so better achieves the requirements of clause 6A.6.5 of the NER.

¹⁵ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

¹⁶ NER, cl. 6A.6.5(b)(3) requires us to have regard to any incentives that transmission network service providers may have to inappropriately capitalise operating expenditure.

¹⁷ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.