

Draft Decision

ElectraNet Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 8 Efficiency benefit sharing scheme

September 2022

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Note

This attachment forms part of the AER’s draft decision on ElectraNet’s 2023–28 transmission determination. 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 – 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 – Demand management innovation allowance mechanism

Attachment 12 – Pricing methodology

Attachment 13 – Pass through events

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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 transmission businesses 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 ElectraNet has accrued over the 2018–23 regulatory control period, and how we will apply the EBSS over the 2023–28 regulatory control period (2023–28 period).

8.1 Draft decision

Our draft decision is to include EBSS carryover amounts totalling –\$11.0 million (\$2022–23) from the application of the EBSS in the 2018–23 period.¹ This is \$5.7 million less than ElectraNet’s updated proposal of –\$5.3 million.² ElectraNet’s initial proposal included EBSS carryover amounts of \$0.1 million, which ElectraNet subsequently updated by correcting some input errors in response to our request for additional information.³

This difference between our draft decision and ElectraNet’s updated proposal reflects adjustments we have made to account for:

- recent updates to actual and forecast inflation
- the inclusion of ElectraNet’s 2021–22 insurance cost pass through.

Table 8.1 sets out our draft decision on the EBSS carryover amounts.

Table 8.1 AER’s draft decision on EBSS carryover amounts (\$million, 2022–23)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
ElectraNet’s updated proposal	–7.8	0.7	3.2	–	–1.4	–5.3
<i>AER draft decision</i>	–8.2	0.7	3.4	–	–7.0	–11.0
Difference	–0.4	0.0	0.2	–	–5.6	–5.7

Note: Numbers may not add up to total due to rounding. Amounts of '0.0' and '-0.0' represent small amounts and '-' represents zero.

Source: ElectraNet, *2024–28 Revenue proposal – EBSS Model (Updated)*, 18 May 2022; AER analysis.

We will continue to apply version 2 of the EBSS to ElectraNet in the 2023–28 period.⁴ Consistent with ElectraNet’s proposal, we will exclude debt raising costs from the scheme because we have forecast them on a category specific basis and expect to continue doing so

¹ NER, cl. 6A.5.4(a)(5).

² ElectraNet, *2024–28 Revenue proposal – EBSS Model (Updated)*, 18 May 2022.

³ ElectraNet, *Information request 11 – Q1-4*, 18 May 2022, pp. 4-6.

⁴ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

in the 2028–33 regulatory control period.⁵ We will also make other adjustments as permitted by the EBSS, such as removing movements in provisions.

8.2 ElectraNet’s proposal

ElectraNet originally proposed an EBSS carryover amount of \$0.1 million (\$2022–23) in its proposal.⁶ ElectraNet subsequently updated its proposed carryover amount to –\$5.3 million, in response to our information request which queried some inputs to ElectraNet’s EBSS model.⁷

8.2.1 Carryover amounts from the 2018–23 regulatory control period

ElectraNet’s updated proposal included EBSS carryover amounts totalling –\$5.3 million (\$2022–23) in its revenues for the 2023–28 period from the application of the EBSS in the 2018–23 period. ElectraNet excluded the following cost categories in calculating its EBSS carryover amounts:⁸

- debt raising costs
- network support costs
- approved pass through amounts
- net movements in provisions related to opex.

8.2.2 Application in the 2023–28 regulatory control period

ElectraNet proposed to continue applying version 2 of the EBSS in the 2023–28 period. It proposed we exclude categories of opex not forecast using a single year revealed cost approach, including:⁹

- debt raising costs
- network support costs
- approved pass through amounts
- net movements in provisions related to opex
- operating expenditure arising from actionable Integrated System Plan (ISP) projects
- operating expenditure arising from Renewable Energy Zone (REZ) developments.

⁵ ElectraNet, *Attachment 8 – Efficiency benefit Sharing Scheme Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 8.

⁶ ElectraNet, *Attachment 8 – Efficiency benefit Sharing Scheme Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 7.

⁷ ElectraNet, *2024–28 Revenue proposal – EBSS Model (Updated)*, 18 May 2022.

⁸ ElectraNet, *Attachment 8 – Efficiency benefit Sharing Scheme Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 8.

⁹ ElectraNet, *Attachment 8 – Efficiency benefit Sharing Scheme Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 8.

ElectraNet stated that while the first four points are consistent with the operation of the EBSS during the current regulatory period, the final two exclusions are related to the following new Rules provisions:¹⁰

- Renewable Energy Zone (REZ) Planning Rules (13 May 2021) – Obligations for planning the staged development of REZs identified in the Australian Energy Market Operator’s (AEMO) ISP (recurrent costs only).
- General Power System Risk Review Rules (3 June 2021) – Comprehensive annual review to be undertaken by AEMO requiring additional input, analysis and information from Transmission Network Service Providers (TNSP) including additional modelling capability at an upfront cost of \$1 million.
- Connection to Dedicated Connection Assets Rule (8 July 2021) – Additional information publication and prescribed service obligations.
- Efficient Management of System Strength Rule (21 October 2021) – New obligations for forward looking planning for and provision of system strength services by TNSPs, subject to detailed RIT-T assessment.

Alongside the actionable ISP project and REZ development EBSS exclusions, ElectraNet proposed a rule changes step change¹¹ and two nominated cost pass through events (REZ design report event and system strength services event)¹² to account for these Rule changes.

8.3 Assessment approach

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

- the revenue increments or decrements for each year of the 2023–28 period arising from the application of the EBSS during the 2018–23 period¹³
- how the EBSS will apply to ElectraNet in the 2023–28 period.¹⁴

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between ElectraNet and network users.¹⁵ We must also have regard to the following matters when implementing the EBSS:¹⁶

¹⁰ ElectraNet, *Attachment 8 – Efficiency benefit Sharing Scheme Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 8.; ElectraNet, *Attachment 6 – Operating Expenditure Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 22.

¹¹ ElectraNet, *Attachment 6 – Operating Expenditure Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 22.

¹² ElectraNet, *Attachment 12 – Pass Through Events Revenue Proposal 2023–24 to 2027–28*, January 2022, pp. 12–16.

¹³ NER, cl. 6A.5.4(a)(5).

¹⁴ NER, cl. 6A.14.1(1)(iv) and cl. 6A.14.3(d)(2).

¹⁵ NER, cl. 6A.6.5(a).

¹⁶ NER, cl. 6A.6.5(b).

- the need to provide ElectraNet with continuous incentives to reduce opex
- the desirability of both rewarding ElectraNet for efficiency gains and penalising it for efficiency losses
- any incentives that ElectraNet 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 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.¹⁷

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 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 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 ElectraNet has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to

¹⁷ 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).

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 ElectraNet's opex.

8.4 Reasons for draft decision

8.4.1 Carryover amounts from the 2018–23 regulatory control period

Our draft decision is to include EBSS carryover amounts totalling –\$11.0 million (\$2022–23) from the application of the EBSS in the 2018–23 period. This is \$5.7 million lower than ElectraNet's updated proposal of –\$5.3 million. ElectraNet initially proposed EBSS carryover amounts of \$0.1 million, but subsequently updated its proposal by correcting some input errors in response to our information request.¹⁸

Our lower EBSS total carryover amount is due to us:

- updating actual inflation for 2021–22 and forecast inflation for 2022–23, which reduced total carryovers by \$2.4 million
- the inclusion of ElectraNet's 2021–22 insurance cost pass through, which was only approved after ElectraNet submitted its revenue proposal and reduced total carryovers by \$3.7 million.

We discuss each of these reasons in more detail below.

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

8.4.1.1 Inflation

Consistent with our standard approach and opex forecast, we and ElectraNet have used unlagged inflation to convert opex amounts to 2022–23 real terms.

However, we have updated consumer price index (CPI) index values compared to those ElectraNet used. For 2021–22, we have used the actual headline June quarter 2022 CPI figure published by the Australian Bureau of Statistics (ABS), which was released after ElectraNet submitted its revenue proposal.¹⁹ For 2022–23, we have used the inflation forecast for the year to June 2023 in the Reserve Bank of Australia's (RBA) August 2022 Statement on monetary policy, which was published after ElectraNet submitted its revenue proposal.²⁰

¹⁸ ElectraNet, *Information request 11 – Q1-4*, 18 May 2022, pp. 4-6.

¹⁹ ABS, *Consumer Price Index, Australia*, released on 27 July 2022 (accessed on 28 July 2022).

²⁰ RBA, *Statement on monetary policy*, August 2022.

8.4.1.2 ElectraNet’s 2021–22 insurance cost pass through event

Consistent with the EBSS, we have included the approved 2021–22 insurance cost pass through amount in forecast opex in our EBSS calculations to incentivise efficient cost allocation and investment for all revenue allowed to ElectraNet. In December 2021, ElectraNet submitted a cost pass through application to recover costs related to insurance premiums incurred in the 2021–22 financial year.²¹ We approved this application on 23 March 2022.²² The approved pass through amount was not reflected in ElectraNet’s EBSS model. Any cost pass throughs we approve for the 2022–23 regulatory year will be included in our final decision EBSS model calculations.

8.4.2 Application in the 2023–28 regulatory control period

Our draft decision is to continue to apply version 2 of the EBSS to ElectraNet during the 2023–28 period. We consider applying the scheme will benefit the long-term interests of electricity consumers as it will provide continuous incentives for ElectraNet to reduce opex. Provided we forecast ElectraNet future opex using its revealed costs in the 2023–28 period, any efficiency gains that ElectraNet achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.²³ We provide details on these below.

8.4.2.1 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 in the following control period. We do this to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through lower forecast opex in the next regulatory control period. This is the way consumers 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 these revealed efficiency gains to consumers. It follows that consumers should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

We do not forecast debt raising costs using a single year revealed cost approach. Instead, we provide a benchmark allowance. Accordingly, we have excluded these costs from the EBSS for the 2023–28 period since any achieved efficiency gains or losses would not be passed on to network users.

We will also exclude Network Capability Incentive Parameter Action Plan projects approved under the network capability component of the service target performance incentive scheme, because including them in the EBSS would distort the incentives provided under the schemes.

²¹ ElectraNet, *Insurance Costs 2021–22 – Cost Pass Through Application*, 15 December 2021.

²² AER, *Determination – ElectraNet’s 2021–22 insurance cost pass through*, 23 March 2022.

²³ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

In addition to the excluded cost categories discussed above, consistent with the application of the EBSS, we will also make the following adjustments when we calculate the EBSS carryover amounts accrued during the 2023–28 period:²⁴

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass through amounts or opex for contingent projects
- adjust reported actual opex for the 2023–28 period to reverse any movements in provisions
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base
- adjust forecast opex and actual opex for inflation
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2028, where doing so better achieves the requirements of clause 6A.6.5 of the NER.

We have not made the following exclusions proposed by ElectraNet:²⁵

- opex arising from actionable ISP projects – ElectraNet proposed that opex resulting from obligations on transmission networks to progress early works in relation to actionable ISP projects identified by AEMO be excluded from the EBSS. It stated that by its nature, this opex would be unexpected, and no allowance would have been provided. ElectraNet considered that no purpose is served by applying an EBSS penalty in respect of it, and in fact, applying an EBSS penalty would actively encourage it to proceed with a project contrary to the economically efficient outcome.
- opex arising from REZ developments – ElectraNet proposed to exclude REZ development costs from the EBSS, as these costs have not been recognised in its opex allowance.

ElectraNet considered that the incentive to proceed with both the ISP actionable projects and REZ planning process is best preserved by excluding these costs from the EBSS. Both proposed EBSS exclusions are linked to the ElectraNet’s REZ design report nominated cost pass through event and its proposed rule changes step change.²⁶

Consistent with our standard approach, we will not exclude these expenditure categories from the EBSS on the grounds of uncontrollability. The EBSS explanatory statement outlined our reasoning for this approach, as detailed in the following passage:²⁷

²⁴ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

²⁵ ElectraNet, *Attachment 8 – Efficiency benefit Sharing Scheme Revenue Proposal 2023–24 to 2027–28*, January 2022, p. 8.

²⁶ AER, Draft decision, *ElectraNet Transmission Determination 2023 to 2028 (1 July 2023 to 30 June 2028)*, Attachment 6 – Operating expenditure, September 2022, pp. 23–25; AER, Draft decision, *ElectraNet Transmission Determination 2023 to 2028 (1 July 2023 to 30 June 2028)*, Attachment 13 – Pass through events, September 2022, pp. 3–4.

²⁷ AER, *Explanatory Statement – Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 21.

By including such costs in the EBSS, uncontrollable cost decreases or increases are shared between NSPs and consumers in the same way as any efficiency gain or loss (that is, approximately 30:70 with a five-year carryover period). If we excluded such costs, uncontrollable cost increases would be shared in the same way as an efficiency loss would be without an EBSS. Without an EBSS, NSPs' share of cost increases differs across the regulatory control period. We saw no reason why uncontrollable cost increases should be shared differently between NSPs and consumers in different regulatory years.

While some events may be uncontrollable, NSPs usually have some control over the costs associated with such events. Allowing exclusions would reduce the incentive to respond to such events efficiently. Any material risks can be managed through pass through events and contingent projects. We do not think there is a compelling argument to share the cost of uncontrollable events differently to all other costs facing NSPs.

Glossary

Term	Definition
ABS	Australian Bureau of Statistics
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CPI	Consumer price index
EBSS	Efficiency benefit sharing scheme
ISP	Integrated System Plan
NEL	National Electricity Law
NER	National Electricity Rules
NSP	Network service providers
opex	Operating expenditure
RBA	Reserve Bank of Australia
REZ	Renewable Energy Zone
TNSP	Transmission network service provider
