Draft Decision

ElectraNet Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 9
Capital expenditure 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

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9 Capital expenditure sharing scheme

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

This attachment sets out our decision for both the determination of the revenue impacts as a result of the CESS applying in the 2018–23 regulatory control period, and the application of the CESS for ElectraNet in the 2023–28 regulatory control period.

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. Under the CESS a service provider retains 30% of an under-spend or over-spend, while consumers retain 70% of the under-spend or over-spend. 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.

The CESS works as follows:

1. We calculate the cumulative efficiency gains or losses for the current regulatory control period in net present value terms.
2. We apply a ratio of 30% to the cumulative under-spend or over-spend to work out the service provider's share of the under-spend or over-spend.
3. We calculate the CESS revenue increment/decrement taking into account the financing benefit, or cost, to the service provider of the under-spend or over-spend.[1] We can also make a further adjustment to account for deferral of capex and ex post exclusions of capex from the regulatory asset base (RAB).[2]
4. The CESS revenue increment/decrement is added or subtracted to the service provider's regulated revenue as a separate building block in the next regulatory control period.

9.1 Draft decision

9.1.1 Revenue impacts in the 2023–28 period from applying the CESS in the 2018–23 period

Our draft decision is to apply a CESS revenue decrement amount of $8.8 million ($2022–23) from the application of the CESS in the 2018–23 regulatory control period.[3] CESS revenue decrements arise as a result of an overspend in capex against the forecast for the relevant period (in this case, the 2018–23 period).

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[1] We calculate benefits as the benefits to the service provider of financing the under-spend since the amount of the under-spend 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 over-spend.

[2] The capex incentive guideline outlines how we may exclude capex from the RAB. AER, *Capex incentive guideline*, November 2013, pp. 13–20.

[3] NER, cl. 6A.14.1(5A).

Our draft decision on the revenue impact of the application of the CESS in the 2018–23 period is summarised in Table 9.1.

Table 9.1 AER's draft decision on ElectraNet's CESS revenue ($ million, 2022–23)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
ElectraNet's proposal	-2.22	-2.22	-2.22	-2.22	-2.22	-11.10
AER draft decision	-1.75	-1.75	-1.75	-1.75	-1.75	-8.77

Source: ElectraNet, *2023–28 Revenue proposal, Capital expenditure sharing scheme model,* January 2021 and AER analysis.

Note: Numbers may not add up due to rounding.

Given the timing of this draft decision, we calculated the CESS revenue decrements in Table 9.1 using estimates of ElectraNet's capex for 2020–21 and 2021–22 regulatory years. The CESS revenue decrement we calculated ($8.8 million) is different to the revenue decrement that ElectraNet proposed ($11.1 million) because we applied updated modelling inputs.

9.1.2 Application of the CESS in the 2023–28 period

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline (Guideline) to ElectraNet in the 2023–28 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]

9.2 ElectraNet's proposal

9.2.1 Revenue impacts in the 2023–28 period from applying the CESS in the 2018–23 period

ElectraNet proposed a $11.1 million ($2022–23) CESS revenue decrement to its regulated revenue in the 2023–28 regulatory control period.[7]

9.2.2 Application of the CESS in the 2023–28 period

ElectraNet proposed that the CESS for the 2023–28 regulatory control forecast period is the same as that applied to the current regulatory control period.[8]

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4 AER, *Capital Expenditure Incentive Guideline*, November 2013, pp. 5–9.

5 AER, *Capital Expenditure Incentive Guideline*, November 2013, p. 6.

6 AER, *Framework and approach ElectraNet Regulatory control period commencing 1 July 2023*, July 2021.

7 ElectraNet, *Revenue Proposal 2023–28 - Capital expenditure sharing scheme model,* January 2021.

8 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022.

9.3 Assessment approach

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

- the revenue impacts on ElectraNet arising from applying the CESS in the 2018–23 regulatory control period
- whether or not to apply the CESS to ElectraNet in the 2023–28 regulatory control period and how any applicable scheme will apply.[9]

We must determine the appropriate revenue increments or decrements (if any) for each year of the 2023–28 period arising from the application of the CESS during the 2018–23 period.[10]

We must also determine how any applicable CESS is to apply to ElectraNet in the 2023–28 period.[11] In deciding whether to apply a CESS to ElectraNet for the 2023–28 period, and the nature and details of the scheme, we must:[12]

- make that decision in a manner that contributes to the capex incentive objective[13]
- take into account the CESS principles,[14] the capex objectives and, where relevant, the operating expenditure (opex) objectives,[15] the interaction with other incentive schemes,[16] and the circumstances of the service provider.[17]

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 CESS revenue increment/decrement determines the associated CESS building block as part of ElectraNet's overall forecast revenue requirement for the 2023–28 regulatory control period.

The CESS relates to other incentives ElectraNet 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, and the STPIS for service levels. 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 NER, cl. 6A.14.1(5A).

10 NER, cl. 6A.5.4(a)(5).

11 NER, cl. 6A.14.1(5A).

12 NER, cl. 6A.6.5A(e).

13 NER, cl. 6A.6.5A(e)(3); the capex incentive objective is set out in cl. 6A.5A(a).

14 NER, cl. 6A.6.5A(e)(4)(i); the CESS principles are set out in cl.6A.6.5A(c).

15 NER, cll. 6A.6.5A(e)(4)(i) and 6A.6.5A(d)(2); the capex objectives are set out in cl. 6A.6.7(a); the opex objectives are set out in cl. 6A.6.6(a).

16 NER, cll. 6A.6.5A(e)(4)(i) and 6A.6.5A(d)(1).

17 NER, cl. 6A.6.5A(e)(4)(ii).

9.4 Reasons for draft decision

We consider ElectraNet should receive a CESS revenue decrement of $8.8 million ($2022–23) from the application of version 1 of the CESS during the 2018–23 regulatory control period. This means that ElectraNet's allowed revenue in the 2023–28 regulatory control period is $8.8 million less than it would otherwise have been due to the application of the CESS to ElectraNet in the 2018–23 period.

The timing of our draft decision means that the 2021–22 and 2022–23 regulatory year incurred capex figures used to calculate the CESS revenue decrements are estimates. Our capital expenditure incentive guideline provides for the calculation of CESS revenue amounts to use both actual and estimated capex for all years of the current period to determine the CESS revenues in the forecast period.[18]

Given that the 2022–23 regulatory year capex will be an estimate, at the time of our final decision we may need to make further adjustments to the revenue amount where actual underspending or overspending in the 2022–23 regulatory year is different to the estimate. These adjustments will be made when we undertake our revenue determination for the subsequent regulatory control period.[19]

Our calculation of the CESS is in accordance with section 2.3 of version 1 of the capital expenditure incentive guideline.[20]

In the 2018–23 period, ElectraNet was subject to version 1 of the CESS. Under this scheme the CESS revenue increments or decrements are to be based on the difference between:

- approved forecast capex set out in our determination for ElectraNet for the 2018–23 period
- actual capex for the 2018–23 period, after the removal of any excluded cost categories such as network capability incentive parameter action plan (NCIPAP) capex, asset disposals and deferred capex in the current regulatory control period.[21]

ElectraNet proposed to defer $60.2 million ($nominal) in capital expenditure on Project EnergyConnect into the 2023–28 regulatory control period.[22] ElectraNet acknowledged that this amount is likely to be considered material if viewed in isolation.[23]

ElectraNet discussed its deferral of $60.2 million ($nominal) of Project EnergyConnect with its Consumer Advisory Panel (CAP) Working Group. ElectraNet reported that the CAP Working Group's view was that an adjustment for the deferral of Project EnergyConnect should be made under the CESS to ensure that ElectraNet does not receive a windfall gain

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18 AER, *Capital Expenditure Incentive Guideline*, November 2013, pp. 7–8.

19 AER*, Explanatory Statement - Capital Expenditure Incentive Guideline*, November 2013, p. 21.

20 AER, *Capital Expenditure Incentive Guideline*, November 2013, p. 6.

21 An estimate of 2021-22 and 2022–23 capex has been used for the draft decision.

22 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022, p. 7.

23 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022, p. 7.

from the movement in the project. ElectraNet submitted that on this basis, it made an adjustment to the CESS to account for this deferral.[24]

ElectraNet stated that it reprioritised capital expenditure into the current period to rebalance its capital program from a delivery perspective, consistent with the objectives of the CESS. We sought further information relating to ElectraNet's decision to bring forward capital expenditure to rebalance its capital program to offset the partial deferral of Project EnergyConnect into the 2023-28 regulatory control period.[25] In its response, ElectraNet provided a summary of movements in its capex forecast for 2023-2028. These movement showed that ElectraNet brought forward some capex initially planned for 2023-28 into 2018-23.[26] ElectraNet considers that its reprioritised capital expenditure program minimises the net impact on customers in the coming period by offsetting the movement in Project EnergyConnect.

ElectraNet noted in its submissions that its proposed adjustment for the deferred expenditure on Project EnergyConnect under the CESS is not strictly required, nor is it consistent with the requirements of the scheme, and that this should therefore be redressed during the AER assessment of the Revenue Proposal to ensure the objectives and requirements of the CESS are met.[27]

ElectraNet submission 9 May 2022

ElectraNet's submission on the CESS on 9 May 2022 acknowledged that if a Network Service Provider (NSP) were to defer capex in one period and increase its capex correspondingly in the following period, with no adjustment to the CESS targets, a 'false efficiency' would be created. ElectraNet considers that this 'false efficiency' would lead to the NSP receiving a windfall gain that would not be in the interests of customers. ElectraNet noted that to prevent such windfall gains from occurring the AER will adjust CESS payments where the three materiality conditions (outlined below) are met.[28]

ElectraNet submitted the way it applied the CESS in its initial proposal is not strictly correct or consistent with the AER objectives and requirements of the scheme. ElectraNet considers that the deferral adjustment made by it in its initial revenue proposal is incorrect because it penalises ElectraNet by seeking to remove a windfall gain that does not exist. ElectraNet also submitted that without the deferral adjustment for Project EnergyConnect, ElectraNet would receive a CESS increment of $7.3 million, a swing of $18.4 million compared with its revenue proposal.[29]

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24 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022, p. 7.

25 AER, *Information request #15*, dated 23 May 2022.

26 ElectraNet, *Second Response to AER Information request #15 – Capital expenditure #15 (Public),* 20 June 2022.

27 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022, p. 7 and *Capital expenditure sharing scheme model,* January 2021.

28 ElectraNet, *Application of the CESS*, 9 May 2022.

29 ElectraNet, *Application of the CESS*, 9 May 2022.

ElectraNet submitted that a windfall gain does not exist because, in its view, none of the three conditions requiring the deferral adjustment have been met. ElectraNet considers that the rebalancing of its capital program by bringing forward capital works that had previously been deferred into the forthcoming period due to capital and resource constraints has 'filled the gap' created by the deferral of Project EnergyConnect. ElectraNet claimed that, in net terms, there is no material change in its forward capital expenditure program due to the deferral of Project EnergyConnect, which minimises the impact on customers in the coming period.[30]

CESS Guideline

Our capital expenditure incentive guideline states that to help consumers share in the benefits from deferred capex, the AER will make an adjustment to the CESS payments where an NSP has deferred capex in the current regulatory control period and:[31]

a. the amount of the deferred capex in the current regulatory control period is material, and

b. the amount of the estimated underspend in capex in the current regulatory control period is material, and

c. total approved forecast capex in the next regulatory control period is materially higher than it is likely to have been if a material amount of capex was not deferred in the current regulatory control period.

As we do not define the materiality threshold in the CESS guideline, we consider the materiality on a case by case basis. We reviewed ElectraNet's claim that none of the three materiality conditions requiring the deferral adjustment have been met:

The amount of deferred capex into the next regulatory control period is material

The $60.2 million ($nominal) of deferred Project EnergyConnect capex is 4.3% of ElectraNet's total capex forecast and its actual capital expenditure for the 2018–23 period. ElectraNet acknowledged that the deferral amount of $60 million, if viewed in isolation, is likely to be considered material.[32] We consider this amount of deferred capex to be material.

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30 ElectraNet, *Application of the CESS*, 9 May 2022.

31 AER, *Better Regulation - Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, pp. 10–11.

32 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022, p. 7.

The amount of the estimated underspend in capex in the current regulatory control period is material

ElectraNet's proposal indicates a capex underspend amount of $22.6 million ($nominal) for the current regulatory control period.[33] This is equivalent to 1.6% of ElectraNet's estimated actual capex for the 2018–23 period, which we consider to be material. We have also taken into account the circumstances of the deferral, having regard to the capital expenditure incentive objective[34] and the CESS principles.[35]

ElectraNet deferred $60.2 million ($nominal) capex for Project EnergyConnect and reported a capex underspend of $22.6 million ($nominal). This indicates that ElectraNet has reprioritised its capex. However, ElectraNet has used funds that were originally forecast for Project EnergyConnect to reduce its underspend during the 2018–23 period. This underspend was achieved by ElectraNet either spending more than forecast on projects included in its capex forecast in our final decision and/or undertaking capex for projects that were not included in our forecast for the 2018-23 period. Although this has the effect of reducing the capex underspend during the 2018-23 period, we consider capex of $22.6 million to be material noting a large project was deferred.

We do not consider that it is desirable or consistent with the intent of the Guideline for a network to choose to spend their capex on projects that have not been consulted on with consumers, and/or assessed by us, and ask for capex for important projects that we have approved before again. The purpose of the underspend criteria was to ensure that networks have the scope to reprioritise their capex when it was efficient to do so.

Total capex in the forthcoming period has materially increased.

ElectraNet's Project EnergyConnect deferred capex of $60.2 million ($nominal) is reproposed without any mitigating changes such as a lower capex number for this project. It is a like for like capex repositioning. ElectraNet's reproposed capex is 8.5% of forecast capex. We consider that the increase in capex in the forthcoming period from the deferral of Project EnergyConnect to be material.

Conclusions on materiality of deferred capex for an adjustment to the CESS revenue

We consider that based on the objectives of the CESS, the intent of the deferral mechanism in the Guideline and our previous CESS decisions, ElectraNet's deferred Project EnergyConnect capex of $60.2 million ($nominal) has satisfied all three materiality conditions for the treatment of the materiality of deferred capex for an adjustment to the CESS revenue increments/decrements.

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33 See ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 9: Capital Expenditure Sharing Scheme*, 31 January 2022, Table 9.1 Historical cost performance for CESS carryover calculation ($m nom), p. 7.

34 NER, cl. 6A.5A(a).

35 NER, cl. 6A.6.5A(e)(4)(i); the CESS principles are set out in cl.6A.6.5A(c).

The Guideline states that if a NSP's capex forecast materially increases because capex was deferred in the current regulatory control period, its reward from deferring capex through the CESS will likely exceed the benefit to consumers from the deferral.[36] We consider that ElectraNet's submission is not consistent with the sharing of efficiency gains and losses between networks and network users under the Guideline and is not in the long term interests of consumers.

We also have concerns that ElectraNet's approach would permit a network to propose a major project, undertake other capex by spending on its own preferred projects, including projects that have not been consulted on with consumers and/or assessed by us, and bypass any CESS implications of a deferral.

ElectraNet's CAP Working Group supports our position that ElectraNet should not receive a windfall gain from any capex deferral. The CAP Working Group's position is that it does not want customers to pay twice for what should have been a firm project that should have already been undertaken.

The formulas for calculating the revenue decrements are set out in our determination CESS model.[37]

The CESS revenue decrement we calculated ($8.8 million) is different to the revenue decrement that ElectraNet proposed ($11.1 million) because we have used:

- more recent inflation figures; and
- an updated weighted average cost of capital input information.

9.5 Application of the CESS in the 2023–28 period

The reasons for our preference for a CESS are set out in our capital expenditure incentive guideline.[38] In developing the Guideline we took into account the capex incentive objective, capex criteria, capex objectives and the National Electricity Objective.

We will apply version 1 of the CESS to ElectraNet in the 2023–28 regulatory control period.[39] As we have set out in the framework and approach paper, we consider the CESS is needed to provide ElectraNet with a continuous incentive to pursue efficiency gains. This approach is consistent with ElectraNet's revenue proposal.[40]

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36 AER, *Better Regulation - Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 10.

37 AER, *Draft decision, ElectraNet transmission determination 2023–28, CESS model*, September 2022.

38 AER, *Capital Expenditure Incentive Guideline*, November 2013.

39 AER, *Capital Expenditure Incentive Guideline*, November 2013.

40 ElectraNet, *Revenue Proposal 2023-24 to 2027-28, Attachment 5: Capital Expenditure*, 31 January 2022, p. 11.

Glossary

Term	Definition
AER	Australian Energy Regulator
CAP	Consumer Advisory Panel
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
EBSS	Efficiency benefit sharing scheme
Guideline	Capital Expenditure Incentive Guideline
NCIPAP	Network capability incentive parameter action plan
NER	National Electricity Rules
NSP	Network Service Provider
Opex	Operating expenditure
RAB	Regulatory asset base
STPIS	Service target performance incentive scheme