



**FINAL DECISION**  
**ActewAGL distribution**  
**determination**  
**2015–16 to 2018–19**

**Attachment 10 – Capital**  
**expenditure sharing scheme**

April 2015

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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](mailto:AERInquiry@aer.gov.au)

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## Note

This attachment forms part of the AER's final decision on ActewAGL's revenue proposal 2015–19. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Annual revenue requirement

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

Attachment 9 - Efficiency benefit sharing scheme

Attachment 10 - Capital expenditure sharing scheme

Attachment 11 - Service target performance incentive scheme

Attachment 12 - Demand management incentive scheme

Attachment 13 - Classification of services

Attachment 14 - Control mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

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Attachment 19 - Pricing methodology

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	expenditure forecast assessment Guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
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

Shortened form	Extended form
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

## 10 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for distributors 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 ActewAGL in the 2015–19 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.<sup>1</sup> The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between distributors 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 distributor's share of the underspend or overspend should be.
- We calculate the CESS payments taking into account the financing benefit or cost to the distributor of the underspends or overspends.<sup>2</sup> We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB.<sup>3</sup>
- The CESS payments will be added or subtracted to the distributor's regulated revenue as a separate building block in the next regulatory control period.

Under the CESS a distributor 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 distributor keeps 30 cents of the benefit while consumers keep 70 cents of the benefit.

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

<sup>2</sup> 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.

<sup>3</sup> The capex incentive guideline outlines how we may exclude capex from the RAB. AER, *Capex incentive guideline*, November 2013, pp. 13–20.

## 10.1 Final decision

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline to ActewAGL in the 2015–19 regulatory control period.<sup>4</sup> This is consistent with the proposed approach we set out in our framework and approach paper.<sup>5</sup> We will not apply an exclusion for customer initiated capex as proposed by ActewAGL.

## 10.2 ActewAGL's revised proposal

In its revised proposal ActewAGL accepted our draft decision to apply the CESS, and not to allow an exclusion for equity raising costs. However, ActewAGL maintained its view that customer initiated capex should be excluded from the CESS.<sup>6</sup>

## 10.3 AER's assessment approach

In deciding whether to apply a CESS to a distributor, and the nature and details of any CESS to apply to a distributor, we must:<sup>7</sup>

- make that decision in a manner that contributes to the capex incentive objective<sup>8</sup>
- take into account the CESS principles,<sup>9</sup> the capex objectives,<sup>10</sup> other incentive schemes, and, where relevant the opex objectives, as they apply to the particular distributor, and the circumstances of the distributor.

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 other incentives ActewAGL faces to incur efficient opex, conduct demand management, and maintain or improve service levels.<sup>11</sup> We aim to incentivise distributors to make efficient decisions on when and what type of expenditure to incur, and to balance expenditure efficiencies with service quality. We discuss these interrelationships where relevant as part of our reasons below and in our capex attachment.

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<sup>4</sup> AER, *Capex incentive guideline*, November 2013, pp. 5–9.

<sup>5</sup> AER, *Stage 2 Framework and approach*, ActewAGL, January 2014, p. 28.

<sup>6</sup> ActewAGL, *Revised Regulatory Proposal, 2015–19 Regulatory control period, Distribution services provided by the ActewAGL Distribution electricity network in the Australian Capital Territory*, January 2015, p. 579 (ActewAGL, *Revised Regulatory Proposal*, January 2015).

<sup>7</sup> NER, clause 6.5.8A(e).

<sup>8</sup> NER, clause 6.4A(a); the capex criteria are set out in clause 6.5.7(c) of the NER.

<sup>9</sup> NER, clause 6.5.8A(c).

<sup>10</sup> NER, clause 6.5.7(a).

<sup>11</sup> Related schemes are the efficiency benefit sharing scheme (EBSS) for opex, the demand management innovation allowance (DMIA), and the service target performance incentive scheme (STPIS) for service levels.



## 10.4 Reasons for final decision

We maintain our draft decision to apply the CESS to ActewAGL as set out in the capex incentive guideline without any further exclusions. We are not satisfied ActewAGL's reasons in its revised proposal justify excluding customer initiated capex.

ActewAGL submitted that its actual expenditure on customer initiated capex was higher than forecast in each year of the 2009–14 regulatory control period. It considers this demonstrates the uncontrollable nature of this capex and the inherent forecasting uncertainty. Further, it submitted that this is unrelated to whether or not the expenditure is efficient. ActewAGL submitted the CESS is required to reward or penalise ActewAGL for improvements or declines in the efficiency of its capex. It considered that spending on unexpected customer initiated capex does not represent an efficiency loss and should therefore not be penalised under the CESS. ActewAGL considered it will be penalised by the CESS for undertaking any customer initiated capex over that which it forecast during the subsequent regulatory period.<sup>12</sup>

We assess forecast capex at an overall rather than component level. The purpose of the CESS is to provide a continuous incentive to deliver efficient overall capex and to share the benefits of capex efficiency gains (or costs of capex efficiency losses) between the service provider and consumers. We do not agree that ActewAGL will always be penalised under the CESS for any expenditure on customer initiated capex over its forecast for that category of expenditure. The CESS rewards and penalties are determined relative to total forecast capex.

ActewAGL disagreed with our view that customer initiated capex should be shared in the same way as all other capex because uncontrollable capex is not referable to capex efficiency improvements or declines. ActewAGL submits its customer initiated capex forecast for the 2014–19 period reflects only known requests for capex. Therefore additional customer requests for capex above its forecast will almost certainly occur during the period.<sup>13</sup>

We do not agree with the assumption that actual spend on customer initiated capex will always exceed ActewAGL's forecast. ActewAGL's forecast of customer initiated capex is not precise. ActewAGL states that where the nature and timing of the project is reasonably well known, customer initiated capex is typically forecast using a 'zero based approach'. It further submits that for some customer initiated expenditure categories, particularly in the outer years of the regulatory period, forecasts are based on historical expenditure levels. ActewAGL states that it has a database of known and probable new customer initiated projects, but it generally only becomes aware of customer initiated projects of this sort within about an 18 to 24 month timeframe before supply is required (sometimes shorter). Consequently, its 2014–19 customer initiated

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<sup>12</sup> ActewAGL, *Revised Regulatory Proposal*, January 2015, pp. 586–588.

<sup>13</sup> ActewAGL, *Revised Regulatory Proposal*, January 2015, pp. 589–590.

capital expenditure forecast is a hybrid of “known and probable” projects combined with trend analysis.<sup>14</sup>

Applying a symmetric CESS means that overs and unders will be treated equally. If the CESS did not apply, the amount to be borne by the distributor and consumers would depend on the year in which the underspend or overspend (expected or not) occurs, and declines over the period. We view a continuous 30 per cent retention of underspends or overspends as a fair sharing of these risks between distributors and their customers. We consider maintaining the same sharing ratio for all capex over the regulatory period is a relevant consideration as it relates to the incentive for ActewAGL to incur efficient total capex over the regulatory period.

ActewAGL submits it has limited ability to control the quantum of unexpected customer initiated capex, and that this will only be at the margin.<sup>15</sup> However, we consider ActewAGL will decide how much expenditure to incur on customer initiated capex within its total expenditure, for both expected and unexpected projects. Allowing exclusions increases the risk that we would dilute a distributor's incentives to incur efficient capex in that category.

ActewAGL also submitted that we did not consider its particular circumstances or the matters it raised in its proposal and simply repeated our reasoning from the incentives guideline development.<sup>16</sup> We are of the view that we have considered the specific matters ActewAGL raised in its proposal and revised proposal. Where we have used the reasoning that is the same as the reasoning in our incentives guideline explanatory statements it is because we remain of the view that it addresses the matters ActewAGL raised. Further, we have decided to apply the CESS as set out in the guideline to all NSW, QLD and SA distributors. We remain of the view that ActewAGL has not provided sufficient evidence to demonstrate why its circumstances warrant a departure from this approach.

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<sup>14</sup> ActewAGL, *Regulatory Proposal, 2015–19 Subsequent regulatory control period, Distribution services provided by the ActewAGL Distribution electricity network in the Australian Capital Territory, 2 June 2014 (resubmitted 10 July 2014)*, July 2014, pp. 176–177.

<sup>15</sup> ActewAGL, *Revised Regulatory Proposal*, January 2015, pp. 590–591.

<sup>16</sup> ActewAGL, *Revised Regulatory Proposal*, January 2015, p. 588.