Draft Decision

Multinet Gas Networks
Access Arrangement 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 13
Capital expenditure sharing scheme

December 2022

AUSTRALIAN
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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to Multinet Gas Networks (MGN) for the 2023–28 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital 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 carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

Contents

13 Capital expenditure sharing scheme

This attachment outlines our assessment of MGN's proposal for a capital expenditure sharing scheme (CESS) for the 2023–28 access arrangement period. This includes CESS rewards or penalties to be applied next period based on MGN's performance this period. The CESS is designed to incentivise efficient spending on capital expenditure (capex) by rewarding Network Service Providers (NSP) for lowering their capex below the amount approved for the access arrangement period. The rewards are shared between the NSPs and consumers. To ensure lower capex does not compromise service standards, the reward amounts are modified by a contingent payment factor (CPF). If service standards fall below target levels, reward amounts are reduced. Below a certain threshold, rewards are multiplied by zero. Conversely, the CESS will lead to a penalty if the NSP spends above its approved capex. The CPF does not apply to penalties, so if a penalty is incurred, it will not be reduced.

MGN's proposal also includes updates to the design of MGN's CESS for the next period. MGN's proposed CESS design for the 2023–28 period is based on our approved CESS for the Victorian gas businesses (2018–2022) but with adjustments. The most significant of which is that CESS will not apply to connections capital expenditure (capex).

13.1 Draft decision

MGN spent more capex in the 2018–22 access arrangement period than our forecast in the final decision for the 2018-22 access arrangement period. This results in a CESS penalty being deducted from MGN's revenue in the 2023–28 access arrangement period. MGN's proposed penalty and our draft decision penalty for the Victorian network is set out in Table 13.1. Our draft decision is to reject a CESS penalty of $4.6 million ($2022/23) for MGN. Our draft decision figure is a penalty of $3.7 million ($2022/23).

Table 13.1 Our draft decision on MGN's CESS amounts ($ million, $2022/23)

	2023-24	2024–25	2025–26	2026–27	2027–28	Total
MGN's proposed CESS penalty	-0.9	-0.9	-0.9	-0.9	-0.9	-4.6
AER draft decision penalty	-0.7	-0.7	-0.7	-0.7	-0.7	-3.7

Source: AER analysis. MGN, *Access arrangement proposal 2023–28, Attachment 13 Victoria RIN – Workbook 6 Capital expenditure sharing scheme model – Consolidated – Public*, July 2022. Numbers may not add up due to rounding

The difference between our decision and MGN's proposal owes to us updating consumer price index (CPI) and real vanilla weighted average cost of capital (WACC) figures.[1] We also updated total actual capex inputs consistent with our 2023–28 draft decision roll forward model (RFM). We require MGN to use our updated inputs. We are otherwise satisfied that

[1] Attachment 2 on the capital base sets out our CPI draft decision, while Attachment 3 on rate of return details our vanilla WACC draft decision.

MGN's application of the CESS is appropriate, and consistent with the CESS mechanism set out in its access arrangement.

We accept MGN's proposal to retain a CESS for the 2023–28 Access Arrangement period. We accept MGN's proposed update to the CESS to exclude new connections capex from the CESS. This is in line with our most recent decisions for AGN (SA), Jemena Gas Network (JGN) and Evoenergy.[2]

13.2 MGN's proposal

13.2.1 CESS amounts from the 2018–22 access arrangement period

MGN proposed a $4.6 million ($2022/23) penalty be subtracted from its revenue in the 2023–28 access arrangement period.[3]

MGN has adopted measures to monitor service performance. The five target measures are:

- unplanned System Average Interruption Frequency Index (SAIFI) (weighting 25%)
- unplanned System Average Interruption Duration Index (SAIDI) (weighting 25%)
- mains leaks (weighting 31.2%)
- service leaks (weighting 15.6%)
- meter leaks (weighting 3.2%)

Performance targets for each measure have been set using the previous five years of historical data. The performance targets are weighted to produce a CPF. The CPF is used to scale down rewards if service performance is less than the target level. Consistent with the previous access arrangement period's CESS, the threshold of performance below which no reward is payable to MGN for an under-spend is an index score of 80 (base is 100).

13.2.2 Application of CESS in the 2023–28 access arrangement period

MGN proposes to continue using a CESS into the next Access Arrangement period. It proposes to update the CESS used in the 2018–22 access arrangement period by excluding new connections capex. MGN states that new connections capex is largely outside a NSP's

2 The operation of the CESS is set out in: MGN, *Multinet Gas Access Arrangement, Victorian Distribution Network, 2023/4-2027/8*, Section 5, p.25-9.

3 MGN, *Access arrangement proposal 2023–28, Attachment 13 Victoria RIN – Workbook 6 Capital expenditure sharing scheme model – Consolidated – Public*, July 2022.

control, making it unresponsive to incentive mechanisms. This would bring the CESS in line with previous AER decisions for JGN and AGN (SA).[4]

13.3 Assessment approach

A full access arrangement may include (or we may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.[5] Incentive mechanisms may provide for carrying over increments for efficiency gains, or decrements for efficiency losses, from one access arrangement period into the next.[6] An incentive mechanism must be consistent with the revenue and pricing principles.[7]

We consider the following revenue and pricing principle is most relevant for assessing MGN's proposed incentive scheme:

> 'A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides.
>
> The economic efficiency that should be promoted includes—
>
> (a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and
>
> (b) the efficient provision of pipeline services; and
>
> (c) the efficient use of the pipeline.'[8]

13.4 Reasons for draft decision

13.4.1 CESS amounts from the 2018–22 access arrangement period

We consider MGN's proposed penalty of $4.6 million ($2022/23) is broadly consistent with the CESS mechanism in its 2018–22 access arrangement. We note that, as MGN is incurring a penalty, the CPF does not apply. We disagree with a few inputs in MGN's calculation of CESS amounts. However, as detailed in Attachments 2 and 3 of this draft decision, we do not agree with MGN's proposed CPI and vanilla WACC inputs. We also updated total actual capex inputs consistent with our 2023-28 draft decision RFM. Consequently, we have updated the CESS calculations to reflect our draft decision on CPI, real vanilla WACC and total capex.

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4 AGN, *Attachment 1.2, Draft Plan: Five year plan for our Victorian network, Final Plan 2023/24-2027/28, July 2022*, Section 12, pg. 116

5 NGR, r. 98(1).

6 NGR, r. 98(2).

7 NGR, r. 98(3).

8 NGL, s. 24(3).

These updates lead to a CESS penalty of $0.7 million ($2022/23) per year and $3.7 million ($2022/23) overall. We require MGN to use our updated CPI and real vanilla WACC inputs, as well as our updated capex inputs in its calculation of the CESS.

13.4.2 Updates to CESS in the 2023–28 access arrangement period

In agreeing to implement an updated CESS for MGN, we have had regard to:

- the potential benefits and risks of the updated CESS, and
- how MGN's proposed CESS mitigates these risks.

MGN has proposed to remove connections capex from the CESS as the volume of new connections is largely outside a NSP's control. We view the benefit of this updated CESS is that it avoids windfall gains or losses for the NSP that are unrelated to the incentive mechanism. Potential risks associated with this update have been raised in the submissions. As explained below, we do not view these risks to be significant.

13.4.3 Submissions

The Energy User Association of Australia (EUAA) acknowledge and agree with the exclusion of connections capex from the CESS. They do not believe this will have a material impact on efficiency incentives.[9]

The Brotherhood of St Laurence (BSL), however, disagrees with the exclusion of connections capex.[10] A draft report carried out by TRAC Partners explains BSL's reasons. They argue that NSPs do control some aspects of connections capex, such as unit rates for contractors. They also consider the size of connections capex means its exclusion would not be a minor change to CESS.[11]

While we agree that the cost of each actual connection can be controlled to some extent, we note that an NSP cannot control whether the volume of connections is higher or lower than forecast. This may lead to large windfall gains or losses for the NSP that are unrelated to the incentive mechanism. Consequently, we are of the view that connections capex is largely outside of its control, and so it is not responsive to incentive mechanisms. In line with our recent decisions for AGN (SA), JGN and Evoenergy, we accept the exclusion of connections capex from the CESS.

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9 EUAA, *Submission: Victorian Gas Access Arrangement Proposal 2023-2028, 30 September 2022,* pg. 7

10 BSL, *2023-2028 Victorian Gas Distributors' Access Arrangement, Submission from the Brotherhood of St. Laurence,* Section 12, pg. 29

11 TRAC Partners*, [DRAFT] Response to VIC DBS' 2023-28 Access Arrangement Proposals, TRAC Partners, Prepared for Brotherhood of St Laurence*, pg. 51

13.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 13.2.

Table 13.2 MGN's CESS revisions

Revision	Amendment
Revision 13.1	Make revisions necessary to update CPI, real vanilla WACC, and reported capex inputs in the calculation of the CESS, in line with our draft decision.

Glossary

Term	Definition
AER	Australian Energy Regulator
AGN (SA)	Australian Gas Networks (South Australia)
BSL	Brotherhood of St Laurence
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
CPF	Contingent Payment Factor
CPI	Consumer price index
EUAA	Energy Users Association of Australia
JGN	Jemena Gas Networks (NSW) Ltd
MGN	Multinet Gas Networks
NGL	National Gas Law
NGR	National Gas Rules
NSP	Network Service Provider
NSW	New South Wales
RFM	Roll forward model
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
WACC	Weighted average cost of capital