DRAFT DECISION

TasNetworks Transmission Determination 2019 to 2024

Attachment 8 Efficiency benefit sharing scheme

September 2018

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165
Email: AERInquiry@aer.gov.au

AER reference: 60153

Note

This attachment forms part of the AER's draft decision on TasNetworks' 2019–24 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 a

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

Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP13	Consumer Challenge Panel, sub panel 13
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIAM	demand management innovation allowance (mechanism)
DMIS	demand management incentive scheme
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
F&A	framework and approach
MAR	maximum allowed revenue
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

Shortened form	Extended form
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in 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 section sets out our decision and reasons on our carryover calculations and the values that are to be attributed to the EBSS parameters for the purpose of the application of the EBSS to TasNetworks in the 2019–24 regulatory control period.

8.1 Draft decision

We have determined EBSS carryover amounts totalling $3.6 million ($2018–19) from the application of the EBSS in the 2014–19 regulatory control period.[1] This is $3.8 million higher than TasNetworks' proposal of –$0.1 million ($2018–19) because we have identified and corrected some errors relating to the inputs TasNetworks used to calculate its carryover amounts. We have also updated inflation to reflect the latest information.[2] These corrections are further discussed in section 8.4.

Our draft decision on the EBSS carryover amounts TasNetworks accrued during the 2014–19 regulatory control period is set out in Table 8-1 along with TasNetworks' proposal and the difference.

Table 8-1 Draft decision on carryover amounts ($million, 2018–19)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
TasNetworks' proposal	6.7	–1.6	–0.1	–5.1	–	**–0.1**
AER draft decision	8.4	–0.2	0.5	–5.1	–	**3.6**
Difference	**1.8**	**1.4**	**0.6**	**0.0**	**–**	**3.8**

Source: TasNetworks, *Post Tax Revenue Model (PTRM) PTRM Transmission*, 31 January 2018; AER, *Draft Decision – PTRM*, September 2018; AER analysis.

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

We will continue to apply version 2 of the EBSS to TasNetworks in the 2019–24 regulatory control period.[3]

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

2 Reserve Bank of Australia, *Statement on Monetary Policy*, May 2018; Australian Bureau of Statistics, 6401.0 - Consumer Price Index – Index Numbers All groups CPI Australia, Accessed on 22 August 2018. (http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6401.0Jun%202018?OpenDocument).

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

We will exclude debt raising costs and opex on network capability incentive projects from the scheme.[4] This is consistent with TasNetworks' proposal.[5]

Our draft decision on the target opex forecast for the EBSS we will use to calculate efficiency gains in the 2019–24 regulatory control period is set out in Table 8.2. It is based on TasNetworks' opex forecast, which we have accepted in this draft decision and is subject to further adjustments permitted by the EBSS.

We received one submission on TasNetworks' EBSS proposal from the AER's Consumer Challenge Panel 13, which supported the application of the scheme for TasNetworks' transmission network business.[6]

We discuss the reasons for our decision on applying the EBSS in the 2019-24 regulatory control period in section 8.4.

Table 8.2 Forecast total opex for the EBSS ($million, 2018–19)

	2017-18	2018-19	2019–20	2020–21	2021–22	2022–23	2023–24
Total opex forecast	44.9	44.4	38.9	38.7	38.5	38.2	**37.8**
Less debt raising costs	–1.0	–1.0	–1.0	–1.0	–1.0	–1.0	–1.0
Opex forecast for EBSS	**43.9**	**43.4**	**37.9**	**37.7**	**37.5**	**37.1**	**36.8**

Source: TasNetworks, *Post Tax Revenue Model (PTRM) PTRM Transmission*, 31 January 2018; AER, *Final Decision – PTRM*, April 2017; AER's analysis

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

8.2 TasNetworks' proposal

8.2.1 Carryover amounts from the 2017–19 regulatory control period

TasNetworks proposed we include EBSS carryover amounts totalling –$0.1 million ($2018–19) in its regulated revenue for the 2019–24 regulatory control period, from applying the EBSS in the 2014–19 regulatory control period.[7]

8.2.2 Application in the 2019–24 regulatory control period

TasNetworks proposed we apply version 2 of the scheme in the 2019–24 regulatory control period. It proposed we exclude the following cost categories from the scheme:[8]

---

4 AER, Explanatory statement – *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, Section 1.4, pp. 11–12.

5 TasNetworks, *Transmission and distribution regulatory proposal*, 31 January 2018, p. 176.

6 Consumer Challenge Panel subpanel 13, *Submission on Issues Paper – TasNetworks electricity network revenue proposal 2019-24*, 16 May 2018, p. 63.

7 TasNetworks, *Post Tax Revenue Model (PTRM) PTRM Transmission*, 31 January 2018.

- debt raising costs, and
- opex on network capability incentive projects under the service target performance incentive scheme.

TasNetworks also proposed we remove movement in provisions.

8.3 Assessment approach

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

(1) the revenue increments or decrements for each year of the 2019–24 regulatory control period arising from the application of the EBSS during the 2014–19 regulatory control period[9]

(2) how the values that are to be attributed to the EBSS will apply to TasNetworks in the 2019–24 regulatory control period.[10]

The EBSS must provide for a fair sharing between service providers and network users of opex efficiency gains and efficiency losses.[11] We must also have regard to the following matters when implementing the EBSS:[12]

- the need to provide the network service provider with continuous incentives to reduce opex
- the desirability of both rewarding the service providers for efficiency gains and penalising them for efficiency losses
- any incentives that service providers 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 forecasting approach. When we develop our opex forecast, the rules require us to have regard to whether the opex forecast is consistent with any incentive schemes.[13]

Our opex forecasting method relies on using the 'revealed costs' of the service provider in a chosen base year to develop a total opex forecast. 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

---

8 TasNetworks, *Transmission and distribution regulatory proposal*, 31 January 2018, p. 176.
9 NER, cl. 6A.5.4(a)(5).
10 NER, cl. 6A.14.1(1)(iv), cl. 6A.14.3(d)(2).
11 NER, cl. 6A.6.5(a).
12 NER, cl. 6A.6.5(b).
13 NER, cl. 6A.6.6(e)(8).

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 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 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 period. Therefore, we typically exclude costs that we do not forecast using a revealed cost forecasting approach.

8.4 Reasons for draft decision

This section provides the reasons for our draft decision on the carryover amounts that arise from applying the EBSS during the 2014–19 regulatory control period, and how we will apply the EBSS in the 2019–24 period.

8.4.1 Carryover amounts from the 2014–19 regulatory control period

We have determined that EBSS carryover amounts totalling $3.6 million ($2018–19) arise from the application of the EBSS in the 2014–19 regulatory control period. This is $3.8 million higher than TasNetworks' proposal of –$0.1 million ($2018–19) because we identified and corrected some errors relating to the inputs TasNetworks used in its calculations.

In examining TasNetworks' proposal we were unable to reconcile some inputs and we sought to clarify these with TasNetworks. Specifically:[14]

[14] AER, *AER information request IR#027 to TasNetworks Transmission*, 26 June 2018; TasNetworks, *Response to AER information request IR#027 to TasNetworks Transmission*, 5 July 2018.

- TasNetworks' actual total opex in its EBSS proposal for 2012–16 did not match the values reported in the annual regulatory accounts for the period 2012–16. We have relied on actual opex as reported in the regulatory accounts because they are independently audited. TasNetworks agreed to this correction but it also submitted updated regulatory accounts for 2015–16 as part of its response to our information request during this draft decision process. We took this information into account.
- TasNetworks' actual self-insurance costs for 2012–14 did not match the values reported in its annual regulatory accounts for the period 2012–14. We have relied on the regulatory accounts. TasNetworks agreed with our approach. However, it considered that 2012–14 insurance costs should also be excluded from the EBSS because our previous determination excluded this cost category from the EBSS. We acknowledge that our 2009 determination excluded insurance costs from the operation of the EBSS in 2009–14 period. However, we did not exclude them from the application of the EBSS in the 2014–19 period.[15] Therefore, insurance costs for 2012–14 should not be excluded from reported opex when calculating incremental efficiency gains for 2014–15. This follows from the workings of the formula used to calculate the incremental efficiency gains for 2014–15. Both we and TasNetworks have applied this formula. We explain this further below in section 8.4.1.1.
- TasNetworks did not exclude movements in provisions from the EBSS carryover calculations despite its economic benchmarking RIN showing non-zero movements in provisions for 2012–17. We have accounted for movements in provisions in our carryover calculations. TasNetworks agreed to this correction.

We have also updated inflation to reflect the latest information.[16]

In our final decision, we will update our calculation of the carryover amounts using actual opex for 2017–18. Our draft decision is based on an estimate because actual data for 2017–18 is not yet available. We will also update inflation.

8.4.1.1 Incremental efficiency gain in 2014–15

When TasNetworks calculated the incremental efficiency gain for 2014–15, it excluded insurance costs from its reported opex for 2012–13 and 2013–14 that we did not exclude from the EBSS in the 2014–19 regulatory control period. We have corrected this by not excluding these costs categories from TasNetworks' reported opex for 2012–13 and 2013–14.

8.4.2 Application in the 2019–24 control period

---

15 AER, *Draft decision TasNetworks transmission determination 2015-16 to 2018-19, Attachment 9 – Efficiency benefit sharing scheme*, November 2014, p. 9–13.

16 Reserve Bank of Australia, *Statement on Monetary Policy*, May 2018; Australian Bureau of Statistics, 6401.0 - Consumer Price Index – Index Numbers All groups CPI Australia, Accessed on 22 August 2018 (http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6401.0Jun%202018?OpenDocument).

We will continue to apply version 2 of the EBSS to TasNetworks during the 2019–24 regulatory control period (as is the case in the current period (2014–19)).[17] We consider implementing the scheme will result in benefits for electricity customers, provide continuous incentives for TasNetworks to reduce opex and reward (penalise) TasNetworks for efficiency gains (losses).[18] This is because in the future we expect TasNetworks will continue to respond to the incentive framework and operate efficiently, allowing us to rely on its revealed costs to forecast opex over the 2024-29 regulatory control period.

Our decision is that the value of the EBSS parameters are to be determined in accordance with the scheme.[19] Version 2 of the EBSS specifies our approach to determining the length of the carryover period and adjusting forecast or actual opex when calculating carryover amounts. These parameters are detailed below.

8.4.2.1 Length of carryover period

The length of the carryover period for the 2019–24 regulatory control period should be the same length as the regulatory control period commencing on 1 July 2024. This aligns the EBSS carryover period with the total length of TasNetworks' regulatory control period and ensures continuous incentives.[20] We expect TasNetworks' next regulatory control period will be five years, starting 1 July 2024.

8.4.2.2 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. This is designed to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through the EBSS and consumers receive a benefit through lower forecast opex in the next 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, lower actual opex will not necessarily be passed through to consumers. Consumers should not pay for EBSS benefits where they do not receive the benefits of a lower opex forecast.

Consistent with TasNetworks' proposal, we will exclude debt raising costs, network support costs and operating expenditure on network capability incentive projects under the service target performance incentive scheme from the EBSS. This is because we typically do not forecast these costs based on revealed expenditure in a single year.

---

17 TasNetworks, *Transmission and distribution regulatory proposal*, 31 January 2018, p. 176.

18 NER, cl. 6A.6.5(b)(1) and (2).

19 NER, cl 6A.4.2a)(5).

20 NER, cl. 6A.6.5(b)(1).

In addition to the excluded cost categories, we will adjust actual opex to reverse any movements in provisions.

Consistent with version 2 of the EBSS we will also:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination. This may include approved pass through amounts
- adjust actual opex to add capitalised opex that has been excluded from the RAB[21]
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 1 July 2024 where doing so better achieves the requirements of clause 6A.6.5 of the NER.[22]

[21] NER, cl. 6A.6.5(b)(3) requires us to have regard to any incentives the service provider may have to capitalise expenditure.

[22] AER, Explanatory statement - *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 11.