Draft Decision

Transgrid Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 8
Efficiency benefit sharing scheme

September 2022

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on Transgrid'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

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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 Transgrid has accrued over the 2018–23 regulatory control period (2018–23 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 $19.3 million ($2022–23) from the application of the EBSS in the 2018–23 period.[1] This is $15.6 million less than Transgrid's proposal of $34.9 million.[2] This difference reflects adjustments we have made to:

- include a non-recurrent efficiency gain related to bushfire remediation work undertaken in 2022–23
- align the accounting treatment of actual and estimated leases and software-as-a-service (SaaS) expenditure to be consistent with approved expenditure in the 2018–23 regulatory determination
- update actual and forecast inflation
- correct the movement in provisions removed from total opex for 2020–21.

We set out our draft decision in table 8.1.

Table 8.1 Draft decision on Transgrid's carryover amounts ($million, 2022–23)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Transgrid's proposal	19.3	5.3	–3.8	–6.1	20.2	34.9
AER's draft decision	22.1	7.2	–2.6	–1.5	–5.9	19.3
Difference	**2.9**	**1.9**	**1.2**	**4.6**	**–26.1**	**–15.6**

Note: Numbers may not add up due to rounding.
Source: Transgrid, *2023–28 Revenue proposal*, 31 January 2022, p. 139; AER analysis.

We will continue to apply version 2 of the EBSS to Transgrid in the 2023–28 period.[3] Consistent with Transgrid's proposal, we will exclude debt raising costs from the scheme because we have forecast them on a category specific basis and will continue doing so in the 2028–33 period.[4] We will also make other adjustments as permitted by the EBSS, such as removing movements in provisions.

1 NER, cl. 6A.5.4(a)(5).
2 Transgrid, *Revenue proposal 2023–28*, 31 January 2022, p. 138.
3 AER, *Efficiency benefit sharing scheme for electricity network service providers,* November 2013.
4 Transgrid, *Revenue proposal 2023–28*, 31 January 2022, p. 139.

8.2 Transgrid's proposal

8.2.1 Carryover amounts from the 2018–23 regulatory control period

Transgrid included EBSS carryover amounts totalling $34.9 million ($2022–23) in its revenues for the 2023–28 period from the application of the EBSS in the 2018–23 period. Transgrid excluded the following cost categories in calculating its EBSS carryover amounts:[5]

- debt raising costs
- network support costs
- movements in provisions related to opex.

8.2.2 Application in the 2023–28 regulatory control period

Transgrid proposed to continue applying version 2 of the EBSS in the 2023–28 period. Transgrid supported the following adjustments and exclusions:[6]

- approved pass through amounts or opex for contingent projects
- capitalisation policy changes
- categories of opex not forecast using a single year revealed cost approach, including debt raising costs, network support costs, network capability incentive parameter action plan (NCIPAP) opex, and demand management innovation allowance mechanism (DMIAM) opex
- inflation.

8.2.3 Stakeholder submissions

The AER's Consumer Challenge Panel (CCP25) supported the application of the EBSS on the basis that it is genuinely based on the business's revealed efficient opex costs and will fairly share efficiency gains and losses between the business and consumers.[7] It considered the AER should apply the EBSS if, and only if, it is satisfied that this is the case.

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 period[8]
- how the EBSS will apply to Transgrid in the 2023–28 period.[9]

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5 Transgrid, *Revenue proposal 2023–28*, *EBSS Model*, 31 January 2022.

6 Transgrid, *Revenue proposal 2023–28*, 31 January 2022, p. 139.

7 CCP25, *Transgrid - Advice to the AER on the 2023–28 Electricity Transmission Regulatory Revenue Proposal,* 11 May 2022, p. 18.

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

9 NER, cll. 6A.14.1(1)(iv) and cl. 6A14.3(d)(2).

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between Transgrid and network users.[10] We must also have regard to the following matters when implementing the EBSS:[11]

- the need to provide Transgrid with continuous incentive to reduce opex
- the desirability of both rewarding Transgrid for efficiency gains and penalising it for efficiency losses
- any incentives that Transgrid 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 requires us to have regard to whether the opex forecast is consistent with any incentive schemes.[12]

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 therefore serves two important functions:

- 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
- 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

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10 NER, cl. 6A.6.5(a).

11 NER, cl. 6A.6.5(b).

12 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).

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 Transgrid has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to 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 Transgrid'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 $19.3 million ($2022–23) from the application on the EBSS in the 2018–23 period. This is $15.6 million lower than Transgrid's proposal of $34.9 million. This difference is because we:

- included a non-recurrent efficiency gain of $5.9 million for bushfire related cost pass through costs, which decreased carryovers by $29.7 million
- aligned the accounting treatment of actual and estimated leases and SaaS expenditure to be consistent with approved expenditure in the 2018–23 regulatory determination, which reduced carryovers by $5.0 million
- updated actual and forecast inflation for 2021–22 and 2022–23, respectively, which increased carryovers by $15.8 million
- corrected movements in provisions for 2020–21, which increased carryovers by $3.3 million.

We discuss each of these in detail below.

We consider that the EBSS carryover amounts we have calculated provide for a fair sharing of efficiency gains and losses between Transgrid and its network users. It provides for rewards to Transgrid for any efficiency gains it has made and penalises Transgrid for any 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 Non-recurrent efficiency gain adjustment for bushfire cost pass through costs

Transgrid's proposed EBSS model[13] correctly accounted for the approved opex amounts from the 2019–20 bushfire cost pass through. However, Transgrid did not apply a consistent approach in its proposed forecast opex model. In its opex model, it did not include these approved opex amounts in its total reported opex allowances. This impacts the estimate of opex for 2022–23 which is then used to forecast opex for the new regulatory control period.

13 Transgrid, *Revenue proposal 2023–28*, *EBSS Model*, 31 January 2022.

One of the opex factors we must have regard to when assessing a service provider's opex forecast is whether the opex forecast is consistent with the EBSS.[14] Under our expenditure forecast assessment guideline approach, the level of opex used as the starting point to forecast opex (that is, 2022–23) should be consistent with the opex used to calculate the EBSS rewards and penalties. This consistency is essential to ensure that the business is only rewarded (or penalised) for any efficiency gains (or losses) that are passed on to networks users through lower (higher) forecast opex.

In this way, Transgrid's inconsistent treatment between the opex model and the EBSS model did not correctly share efficiency gains or losses from the bushfire remediation work between Transgrid and its customers. Due to this inconsistent treatment, Transgrid in effect assumed that its bushfire remediation costs will be –$5.9 million ($2022–23) in 2022–23 in the EBSS model. This then resulted in approximately $38.2 million of EBSS benefits for efficiency gains that it would not pass on to consumers through lower opex forecasts under its proposal.

In order to address this problem, we first added the approved bushfire cost pass through to the 2018–23 forecast opex in our draft decision opex model[15] to ensure consistent treatment with the EBSS. This reduced the alternative forecast opex for the 2023–28 period by $5.9 million per year, or $29.7 million over 5 years. The net impact of the $38.2 million EBSS carryover, and the $29.7 million reduction to forecast opex, is $8.6 million. This shares the overspend on Transgrid's bushfire remediation costs by allowing it to recover the overspent costs six years after incurring them. However, Transgrid, submitted[16] that this approach understates its efficient opex over the 2023–28 period, given it effectively assumes bushfire remediation costs of –$5.9 million in each year of the 2023–28 period.

To address this, we included a non-recurrent efficiency gain of $5.9 million in the base year opex. This increased our estimate of opex for 2022–23 by the same amount. Under this approach, we effectively assume zero bushfire remediation costs going forward in both the opex forecast and the EBSS. This results in the same forecast opex outcome as Transgrid's proposal, all else equal. However, when this non-recurrent efficiency adjustment is consistently applied in the EBSS, it reduces the EBSS carryover by $29.7 million. Therefore, our draft decision includes EBSS carryovers of $8.6 million for Transgrid's bushfire remediation costs, instead of the $38.2 million included in Transgrid's proposal. Transgrid has not raised any concerns with the approach.[17]

8.4.1.2 Treatment of SaaS and leases

There are two accounting changes implemented by the Australian Accounting Standards Board (AASB) and the International Financial Reporting Interpretations Committee (IFRIC) which have impacted Transgrid's expenditure reporting in the 2018–23 period. These are:

1. SaaS, which was considered as capex and potentially included in approved capex for the 2018–23 period but, depending on its nature, is now considered as opex under new IFRIC guidance published in April 2021

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14 NER, cl. 6A.6.6(e)(8).

15 AER, *Draft decision, Transgrid transmission determination 2023–28, opex model*, September 2022.

16 Transgrid, *Information request 29,* 6 June 2022, pp. 1–2.

17 Transgrid, *Information request 029,* 9 June 2022.

2. leases, which were included in approved opex for the 2018–23 period, but are now considered as capex under AASB16 which came into effect 1 July 2019.

Transgrid's proposal adopted the new accounting standards for SaaS and leases for the last two years of its current regulatory period (that is, 2021–22 and 2022–23). However, it continued to report its expenditures as per the previous accounting standards for earlier years. Transgrid further made a non-recurrent efficiency gain adjustment of $20.2 million ($2022–23) to its base year (2021–22) to remove the non-recurrent portion of its SaaS costs from its forecast opex for 2023–28.

We expect a business's capitalisation policies to generally align with the relevant accounting standards. We note there is no requirement in the NER to align regulatory reporting with statutory accounts. However, we require the businesses to clearly explain instances where their regulatory reports don't align with statutory accounts. Our usual preference is for businesses to minimise any adjustments to their regulatory reporting and align the reporting of actual capex and opex with their statutory accounts as per the latest accounting standards. We consider that businesses should not arbitrarily change their capitalisation policies in the middle of their regulatory period. However, they are impacted by any external accounting standard changes such as those implemented by the AASB or IFRIC.

We have previously not been concerned regarding such mid-period accounting policy changes as we expect the overall impact of such changes to be net present value (NPV) neutral. However, we have undertaken analysis which demonstrates that the movement of expenditure from opex to capex and vice-versa can cause windfall gains/losses for businesses under the incentive schemes in the case of short-lived assets such as SaaS and leases. Given this result, we consider it is more appropriate to align the accounting treatment of expenditure within a period with the approved expenditure for that period, i.e., to not implement any mid-period accounting changes until the start of the new period. We consider that this approach will not result in any windfall gains or losses that would have resulted purely from movement of expenditure between opex and capex due to mid-period accounting changes implemented by the AASB or the IFRIC.

Accordingly, to prevent such windfall gains or losses, we have applied this approach to Transgrid's 2018–23 expenditure. This means we will treat SaaS as capex and leases as opex for the remainder of the 2018–23 period.

For the EBSS, this means that we have amended 2021–22 reported opex to include $1.0 million ($nominal) in leases and remove $24.1 million ($nominal) in SaaS to align with the accounting standard applied in the 2018–23 regulatory determination. Further, we have removed the non-recurrent efficiency gain adjustment of $20.2 million for SaaS for the base year. The net impact of these changes has decreased EBSS carryovers by $5.0 million ($2022–23).

The change in treatment of SaaS and leases for the 2018–23 period also impacts the CESS and regulatory asset base (RAB) calculations, the details of which are covered in Attachments 9 and 2, respectively.

We also discuss the impact of the new accounting policies for SaaS and leases on forecast opex for the 2023–28 period in Attachment 6.

8.4.1.3 Inflation

Consistent with our standard approach and opex forecast, we used unlagged inflation to convert opex amounts to 2022–23 real terms. This approach is also consistent with the approach Transgrid adopted in its proposal.[18]

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

8.4.1.4 Movements in provisions

Transgrid's EBSS model removed movements in provisions for 2020–21 that did not align with the provisions amounts allocated to opex in Transgrid's Economic Benchmarking Regulatory Information Notice (EB RIN) for 2020–21. The difference appeared to be due to the incorrect inclusion of reversed amounts during the year. We have updated the value for 2020–21 to be consistent with the EB RIN for 2020–21, which resulted in an increase in EBSS carryover amounts of $3.3 million ($2022–23).

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 Transgrid during the 2023–28 period. We consider applying the scheme will benefit the long-term interests of electricity consumers by providing a continuous incentive for Transgrid to reduce its opex. Provided we forecast Transgrid's future opex using its revealed costs in the 2023–28 period, any efficiency gains (losses) that Transgrid achieves will lead to lower (higher) future opex forecasts, and thus lower (higher) network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.[21] 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 the EBSS and consumers receive 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.

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18 Transgrid, *Revenue proposal 2023–28, opex Model*, 31 January 2022.

19 Australian Bureau of Statistics, *Consumer Price Index, Australia*, released on 27 July 2022 (accessed on 28 July 2022).

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

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

We do not forecast debt raising costs using a single year revealed cost forecasting approach. Instead, we provide a benchmark forecast. 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 NCIPAP projects approved under the network capability component of service target performance incentive scheme, and projects under the DMIAM, because including them in the EBSS would distort the incentives provided under these schemes and allowances.

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

- 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 reported opex to add capitalised opex that has been excluded from the regulatory asset base
- adjust forecast opex and actual opex for inflation[22]
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2023, where doing so better achieves the requirements of clause 6A.6.5 of the NER.[23]

22 AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 7.

23 AER, *Explanatory Statement - Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November, p. 14.

Glossary

Term	Definition
AASB	Australian Accounting Standards Board
AER	Australian Energy Regulator
Capex	Capital expenditure
CCP25	Consumer Challenge Panel, sub-panel 25
CPI	Consumer price index
CESS	Capital expenditure sharing scheme
DMIAM	Demand Management Innovation Allowance Mechanism
EB RIN	Economic Benchmarking Regulatory Information Notice
EBSS	Efficiency benefit sharing scheme
IFRIC	International Financial Reporting Interpretations Committee
NCIPAP	Network Capability Incentive Parameter Action Plan
NEL	National Electricity Law
NER	National Electricity Rules
NPV	Net present value
Opex	Operating expenditure
RAB	Regulatory asset base
RBA	Reserve Bank of Australia
SaaS	Software-as-a-service