

# Essential Energy

## 5.08 EBSS and CESS approach

January 2023

## Attachment summary

- > The Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS) provide incentives for continuous efficiency improvements that are shared between network businesses and customers.
- > We forecast a \$118 million penalty for the EBSS over the 2024–29 regulatory period.
- > We forecast a \$8 million penalty for the CESS over the 2024–29 regulatory period.

### Key points

As part of its determination for the 2019–24 regulatory period, the Australian Energy Regulator (AER) applied the Efficiency Benefit Sharing Scheme (EBSS) to Essential Energy's operating expenditure for the first time.

Essential Energy is aware that there are different versions of the EBSS model, with different circumstances indicating their relevant application. Essential Energy overspent its allowances in some of the years during the 2019–24 regulatory period. Technically, Essential Energy considers Option 1 to be the correct version to be applied in this instance, which would result in an EBSS penalty of \$94 million. However, in the interests of customer affordability, we have applied Option 2. This results in a more favourable outcome for customers in 2024–29, delivering a \$118 million penalty to Essential Energy. Our proposed EBSS revenue decrements are shown in the table below.

#### Proposed Efficiency Benefit Sharing Scheme revenue decrement (\$m, real June 2024)

\$m, real June 2024	2024–25	2025–26	2026–27	2027–28	2028–29	Total 2024–29
EBSS penalty	-31	-31	-15	-41	0	-118

As part of its determination for the 2019–24 regulatory period, the AER applied the Capital Expenditure Sharing Scheme (CESS) to Essential Energy's capital expenditure.

Essential Energy is forecasting a CESS penalty over the 2024–29 regulatory period. This includes the impact of a delay in a billing system that was in our 2019–24 capex forecasts, until 2024–29. Essential Energy has therefore reflected this capex deferral in the calculations undertaken for the CESS. Our proposed CESS revenue decrements are shown in the table below.

#### Proposed Capital Expenditure Sharing Scheme revenue increment (\$m, real June 2024)

\$m, real June 2024	2024–25	2025–26	2026–27	2027–28	2028–29	Total 2024–29
CESS penalty	-2	-2	-2	-2	-2	-8

## Efficiency Benefit Sharing Scheme

The EBSS is intended to provide a continuous incentive for distributors to pursue efficiency improvements in opex and enable them to be fairly shared between network businesses and network users. Consumers benefit from improved efficiencies through lower regulated prices.

As part of its determination for the 2019–24 regulatory period, the AER decided to apply Version 2 of the EBSS. Its final decision was that when it applies the EBSS, it will:

- > exclude debt-raising costs from the EBSS as a pre-defined ‘excluded category’
- > adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass-through amounts
- > adjust actual opex to remove Demand Management Innovation Allowance (DMIA) opex
- > adjust actual opex to add capitalised opex that has been excluded from the Regulatory Asset Base (RAB)
- > adjust actual opex to reverse any movements in provisions
- > adjust opex for any services that will not be classified as standard control services (SCS) in the 2024–29 regulatory control period to the extent that this better achieves the requirements of clauses 6.5.8 of the National Energy Rules (NER).

The AER also published the opex forecasts for 2017–18 to 2023–24 that it will use to calculate efficiency gains in the 2019–24 regulatory period. We understand that the AER will consider two approaches to calculating these gains.

- > Option 1 would reward Essential Energy for the efficiency gain made in 2018–19, even though the scheme was not operating in that year.
- > Option 2 would apply an incremental efficiency gain of zero in 2019–20 when an efficiency gain was made in 2018–19 (because the scheme was not operating in that year).

The EBSS penalty as calculated under Option 1 and Option 2 are set out in the table below.

### Proposed Efficiency Benefit Sharing Scheme revenue decrement (\$m, real June 2024)

\$m, real June 2024	2024–25	2025–26	2026–27	2027–28	2028–29	Total 2024–29
Option 1 EBSS penalty	-8	-31	-15	-41	0	<b>-94</b>
Option 2 EBSS penalty	-31	-31	-15	-41	0	<b>-118</b>

Please refer to **Attachment 5.05** for the EBSS model that has been used in our Proposal. We have adjusted the total opex allowance for 2019–24 in this model, to include the impact of the approved cost pass through amounts for the 2019–20 bushfires and changes in critical infrastructure licence conditions.

## Capital Expenditure Sharing Scheme

The CESS financially rewards network service providers that deliver more efficient capex, and financially penalises those that become less efficient. Consumers benefit from improved efficiency through lower regulated prices.

The CESS approximates efficiency gains and efficiency losses by calculating the difference between approved forecast and actual capex. It shares these gains or losses between Distribution Network Service Providers (DNSPs) and consumers. Under the CESS, a DNSP retains 30 per cent of an under-spend or over-spend. This means that for a one dollar saving in capex, the DNSP keeps 30 cents of the benefit while consumers keep 70 cents.

The CESS works by applying the following steps:

1. calculating the cumulative efficiency gains or losses for the current regulatory period in net present value terms
2. applying a ratio of 30 per cent to the cumulative under-spend or over-spend to work out what the service provider's share of the under-spend or over-spend should be
3. calculating CESS payments by considering the financing benefit or cost to the service provider of the under-spends or over-spends – the AER can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the RAB
4. adding or subtracting the CESS payments to or from the service provider's regulated revenue as a separate building block in the next regulatory control period.

The AER's guidelines also provide for an adjustment to be made in calculating CESS payments where capital expenditure has been deferred from the current regulatory period if:

- > the amount of deferred capital expenditure is material
- > the underspend in the current period is material, and
- > the total capital expenditure in the forthcoming period is materially increased.

In our 2019–24 capex forecasts we included expenditure for a billing system that has now been delayed until 2024–29. Please refer to **Attachment 10.07 ICT Business Plan** for details of the capex deferral. We consider that an adjustment for this deferred expenditure is consistent with the AER's guidelines and have therefore reflected this capex deferral in the calculations undertaken for the CESS. This results in a CESS penalty over 2024–29 of \$8 million. Our proposed CESS revenue decrements are shown in the table below.

### Proposed Capital Expenditure Sharing Scheme revenue increment (\$m, real June 2024)

\$m, real June 2024	2024–25	2025–26	2026–27	2027–28	2028–29	Total 2024–29
CESS penalty	-2	-2	-2	-2	-2	-8

Please refer to **Attachment 5.06** for the CESS model that has been used in our Proposal. We have adjusted the total capex allowance for 2019–24 in this model, to include the impact of the approved cost pass through amounts for the 2019–20 bushfires and changes in critical infrastructure licence conditions.