



FINAL DECISION

SA Power Networks Distribution Determination 2020 to 2025

Attachment 8 Efficiency benefit sharing scheme

June 2020

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to SA Power Networks for the 2020–25 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

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 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 17 – Connection policy

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Attachment A – Negotiating framework

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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 operating expenditure (opex), and provide for a fair sharing of these between distributors and network users. Consumers benefit from improved efficiencies through lower opex allowances in subsequent regulatory control periods.

This attachment sets out our final decision on the EBSS carryover amounts SA Power Networks accrued over the 2015–20 regulatory control period, and how we will apply the EBSS over the 2020–25 regulatory control period.

8.1 Final decision

Our final decision is to approve EBSS carryover amounts totalling \$4.5 million (\$2019–20) from the application of the EBSS in the 2015–20 regulatory control period.¹ This is \$0.1 million (\$2019–20) lower than SA Power Networks' proposal of \$4.6 million (\$2019–20). The difference is due to updating forecast inflation for the year to June 2020 using the trimmed mean inflation forecast in the Reserve Bank of Australia's (RBA) May 2020 *Statement on monetary policy*.² Our usual implementation is to use the (headline) consumer price index (CPI) forecast for the year ending June 2020. In the current COVID circumstances, we consider that the trimmed mean forecast better reflects core expectations of inflation as set out in the RBA's *Statement on monetary policy*. Further, the trimmed mean smooths the transient volatility in the CPI forecasts in the May *Statement on monetary policy*.

We set out our final decision on SA Power Networks' EBSS carryover amounts in Table 8.1.

Table 8.1 Final decision on carryover amounts (\$ million, 2019–20)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
SA Power Networks' revised proposal	12.3	-17.9	8.1	2.1	–	4.6
AER final decision	12.3	-17.9	8.1	2.1	–	4.5

Source: SA Power Networks Revised Proposal, *EBSS Model*, December 2019; AER analysis.

Note: Numbers may not add up due to rounding.

Our final decision is to apply version two of the EBSS to SA Power Networks for the 2020–25 regulatory control period.³ Consistent with SA Power Networks' revised

¹ NER, cl. 6.4.3(a)(5).

² Reserve Bank of Australia, *Statement on monetary policy*, May 2020.

³ NER, cl. 6.12.1(9); AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

proposal and our draft decision⁴ we will exclude debt-raising costs from the scheme as a pre-defined ‘excluded category’. We will also make other adjustments as permitted by the EBSS, such as removing demand management innovation allowance (DMIA) costs, and movement in provisions (as outlined in section 8.4)

We have set out in table 8.2 the opex forecasts we will use to calculate efficiency gains in the 2020–25 regulatory control period, including forecast debt raising costs.⁵

Table 8.2 Forecast opex for the EBSS (\$ million, 2019–20)

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Total forecast opex	276.8	280.2	287.9	291.0	294.4	296.9	299.3
Less debt raising costs	-2.3	-2.3	-2.2	-2.2	-2.3	-2.3	-2.2
Forecast opex for the EBSS	274.5	277.9	285.7	288.8	292.1	294.7	297.1

Source: AER, *SA Power Networks final decision - Post tax revenue model*, April 2020; SA Power Networks, *2020–2025 Revised regulatory proposal – Addendum to Attachment 6*, February 2020; AER analysis.

Note: Numbers may not add up due to rounding.

8.2 SA Power Networks’ revised proposal

8.2.1 Carryover amounts from the 2015–20 regulatory control period

SA Power Networks adopted our draft decision methodology to calculate its EBSS carryovers in its revised regulatory proposal. It updated the calculation to include actual opex for 2018–19, rather than the estimate we used in our draft decision. This resulted in EBSS carryovers totalling \$4.6 million for the 2020–25 regulatory period.⁶ We calculated a total of -\$30.7 million in our draft decision.⁷

The key driver for the change in EBSS carryover amount is due to a lower than forecast opex actual for 2018–19.

8.2.2 Application in the 2020–25 regulatory control period

SA Power Networks accepted our draft decision as it relates to the application of the EBSS in the 2020–25 regulatory control period.⁸

⁴ SA Power Networks, *2020–25 Revised Regulatory Proposal Attachment 8 – Efficiency benefit carryover scheme*, December 2019, p. 8.

⁵ Subject to other adjustments required by the EBSS.

⁶ SA Power Networks, *2020–25 Revised Regulatory Proposal Attachment 8 – Efficiency benefit carryover scheme*, December 2019, p. 6

⁷ AER, *SA Power Networks 2020–25 – Draft decision – Attachment 8 – Efficiency benefit carryover scheme*, October 2019, p. 6

⁸ SA Power Networks, *2020–25 Revised Regulatory Proposal Attachment 8 – Efficiency benefit carryover scheme*, December 2019, p. 8.

8.2.3 Stakeholder submissions

The EBSS was not a particularly strong focus of stakeholder submissions. The Consumer Challenge Panel, sub-panel 14 noted the key driver for the change in EBSS carryovers was a result of using actual opex in the base year.⁹ AGL commented that it was not convinced the operation of these regulatory schemes provided any benefit to customers. It raised concerns that of the scheme producing unintended consequences, resulting in under-investment and trade-off between short and long term interests.¹⁰

8.3 Assessment approach

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

- the revenue increments or decrements for each year of the 2020–25 regulatory control period arising from the application of the EBSS during the 2015–20 regulatory control period¹¹
- how the EBSS will apply to SA Power Networks in the 2020–25 regulatory control period.¹²

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between service providers and network users.¹³ We must also have regard to the following matters when implementing the EBSS:¹⁴

- the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme
- the need to provide SA Power Networks with a continuous incentive to reduce opex
- the desirability of both rewarding SA Power Networks for efficiency gains and penalising it for efficiency losses
- any incentives that SA Power Networks may have to 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 require us to have regard to whether the opex forecast is consistent with any incentive schemes.¹⁵

⁹ CCP14, *Advice to the AER on SA Power Networks Regulatory Determination 2020–25 Revised Proposal*, January 2020, pg. 25.

¹⁰ AGL, *Submission on SA Power Networks Draft Decision 2020-25*, January 2020, p 2.

¹¹ NER, cl. 6.4.3(a)(5).

¹² NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

¹³ NER, cl. 6.5.8(a).

¹⁴ NER, cl. 6.5.8(c).

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 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 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 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 SA Power Networks 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 SA Power Networks' opex.

8.4 Reasons for final decision

8.4.1 Carryover amounts from the 2015–20 control period

SA Power Networks addressed each of the issues we identified in our draft decision and adopted the same approach to calculate the EBSS carryover in its revised

¹⁵ NER, cl. 6.5.6(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).

regulatory proposal as we used in our draft decision.¹⁶ The only change we have made to SA Power Network's revised proposal is to update to the inflation forecast for the year to June 2020 to use the trimmed mean inflation forecast in the RBA's May 2020 *Statement on monetary policy*.¹⁷

We consider that the EBSS carryover amounts we have calculated, as set out in table 8.1, provide for a fair sharing of efficiency gains and losses between SA Power Networks and its network users. It both rewards SA Power Networks for the efficiency gains it has made and penalises it for its efficiency losses. Further, we consider that the benefit to networks users, through lower forecast opex, is sufficient to warrant the EBSS carryover amounts we have determined.

8.4.2 Application in the 2020–25 control period

Our final decision is to continue to apply version 2 of the EBSS to SA Power Networks during the 2020–25 regulatory control period. We consider applying the scheme will benefit long-term electricity customers as it will provide continuous incentives for SA Power Networks to reduce opex. Provided that we forecast SA Power Networks' future opex using its revealed costs in the 2020–25 regulatory control period, any efficiency gains that SA Power Networks achieves will lead to lower opex forecasts, and thus lower network tariffs.

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.¹⁸ We provide details on these below.

Length of carryover period

To ensure continuous incentives, the length of the carryover period for the 2020–25 regulatory control period will be the same as the length of SA Power Networks' following regulatory control period.¹⁹ We expect SA Power Networks' following regulatory control period will be five years, starting from 1 July 2025.

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. 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 network users receive a benefit through lower forecast opex in the next regulatory control period. This is the

¹⁶ SA Power Networks, *2020-25 Revised Regulatory Proposal Attachment 8 – Efficiency benefit carryover scheme*, December 2019, p. 8

¹⁷ Reserve Bank of Australia, *Statement on monetary policy*, May 2020.

¹⁸ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

¹⁹ NER, cl. 6.5.8(c)(2).

way network users 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 revealed efficiency gains to network users. It follows that network users should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

Consistent with version 2 of the EBSS, we will only exclude debt raising costs from the EBSS as a pre-defined 'excluded category'. This is because we do not forecast debt raising costs on a revealed cost basis. We instead forecast these based on a benchmark amount.

In addition we will also make the following adjustments when we calculate the EBSS carryover amounts for the next regulatory control 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 projects²⁰
- adjust actual opex to remove demand management innovation allowance opex because it is not included in the opex forecast (but is often reported by service providers as part of their standard control services opex)²¹
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base²²
- adjust forecast opex and actual opex for inflation²³
- adjust actual opex to reverse any movements in provisions
- adjust opex for any services that will not be classified as standard control services in the 2025–30 regulatory control period, to the extent these costs are not forecast using a single year revealed cost approach and excluding these costs better achieves the requirements of clauses 6.5.8 of the NER.²⁴

²⁰ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

²¹ Clause 6.5.8(c)(5) of the NER requires us to have regard to the possible effects of the scheme on incentives for the implementation of non-network options.

²² Clause 6.5.8(c)(4) of the NER requires us to have regard to any incentives the service provider may have to capitalise expenditure.

²³ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

²⁴ AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 14.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CCP14	Consumer Challenge Panel, sub-panel 14
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
NEL	National Electricity Law
NER	National Electricity Rules
opex	operating expenditure
RBA	Reserve Bank of Australia