SA Power Networks

Attachment 8

Efficiency benefit sharing scheme

2020-25 Regulatory Proposal

31 January 2019

This section outlines:

› the outcomes from the Efficiency Benefit Sharing Scheme (EBSS) during the 2015-20 Regulatory Control Period; and

› the manner in which the EBSS will apply during the 2020-25 Regulatory Control Period.

Company information

SA Power Networks is the registered Distribution Network Service Provider (**DNSP**) for South Australia. For information about SA Power Networks visit www.sapowernetworks.com.au

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Disclaimer

This document forms part of SA Power Networks' Regulatory Proposal (**the Proposal**) to the Australian Energy Regulator (**AER**) for the 1 July 2020 to 30 June 2025 regulatory control period (2020-25 **RCP**). The Proposal and its attachments were prepared solely for the current regulatory process and are current as at the time of lodgment.

This document contains certain predictions, estimates and statements that reflect various assumptions concerning, amongst other things, economic growth and load growth forecasts. The Proposal includes documents and data that are part of SA Power Networks' normal business processes, and are therefore subject to ongoing change and development.

Whilst care was taken in the preparation of the information in this Regulatory Proposal, and it is provided in good faith, SA Power Networks, its officers and shareholders accept no responsibility or liability for any loss or damage that may be incurred by any person acting in reliance on this information or assumptions drawn from it for a different purpose or in a different context.

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Note

This attachment forms part of our Proposal for the 2020-25 RCP. It should be read in conjunction with the other parts of the Proposal.

Our Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 18:

Document	Description
	Regulatory Proposal overview
	Customer and Stakeholder Engagement
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	**[illegible]**
Attachment 9	Capital expenditure sharing scheme
Attachment 10	Service target performance incentive scheme
Attachment 11	Demand management incentives and allowance
Attachment 12	Classification of services
Attachment 13	Pass through events
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8.1 Overview

The Efficiency Benefit Sharing Scheme (**EBSS**) provides a continuous incentive for distribution network service providers (**DNSP**s) to pursue efficiency improvements in operating expenditure (**opex**) and provides for a fair sharing of savings between DNSPs and customers. Customers benefit from improved efficiencies through lower network prices in future regulatory control periods (**RCP**s).

SA Power Networks' carryover for the 2015-20 RCP has been calculated in accordance with version 2 of the EBSS, as applied by the Australian Energy Regulatory (**AER**) in our distribution determination for the 2015-20 RCP (**2015 Determination**)[1]. Although we forecast that our opex will be below AER allowances in each regulatory year of the 2015-20 RCP, the timing of expenditure has resulted in a forecast carryover loss to the 2020-25 RCP of $30.1 million.

The EBSS is intrinsically linked to the forecasting approach for opex. As noted in Attachment 6 - Operating expenditure, we have applied the base-step-trend method to determine our opex forecast for the 2020-25 RCP and contend that our base year expenditure is efficient. Accordingly, SA Power Networks proposes to continue to apply version 2 of the EBSS for the 2020-25 RCP.

8.2 Rule requirements

The National Electricity Rules (**NER**) set out two relevant requirements in relation to the EBSS:

- the building blocks used to calculate the annual revenue requirement for each regulatory year of the 2020-25 RCP must include (amongst other things) any revenue increments or decrements for the relevant regulatory year arising from the application of the EBSS[2]; and
- the building block determination must also specify how any applicable EBSS is to apply to a DNSP in the 2020-25 RCP[3].

The AER applied version 2 of the EBSS to SA Power Networks for the 2015-20 RCP as specified in the 2015 Determination. The 2015 Determination also identified certain categories of operating costs which are to be adjusted or excluded from the operation of the EBSS for the 2015-20 RCP. SA Power Networks must calculate the carryover gain or loss for the 2015-20 RCP in accordance with the EBSS and the 2015 Determination[4].

The EBSS to apply in the 2020-25 RCP must be developed and implemented in accordance with clause 6.5.8 of the NER. In developing and implementing the EBSS for the 2020-25 RCP, the AER must have regard to the following factors[5]:

- 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;

[1] *AER, Final decision: SA Power Networks determination 2015-16 to 2019-20, Attachment 9 – Efficiency benefit sharing scheme, October 2015.*
[2] *NER 6.4.3(a)(5).*
[3] *NER 6.3.2(a)(3).*
[4] *AER, Final decision: SA Power Networks determination 2015-16 to 2019-20, Attachment 9 – Efficiency benefit sharing scheme, October 2015.*
[5] *NER 6.5.8(c).*

- the desirability of both rewarding SA Power Networks for efficiency gains and penalising SA Power Networks for efficiency losses;
- any incentives that SA Power Networks may have to capitalise expenditure; and
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

In its final Framework and Approach (**F&A**) paper for the 2020-25 RCP, the AER stated that it intends to continue to apply version 2 of the EBSS to SA Power Networks for the 2020-25 RCP if it is satisfied the scheme will fairly share efficiency gains and losses between SA Power Networks and consumers.[6] This will only occur if the opex forecast for the 2020-25 RCP is based on SA Power Networks' revealed costs. The distribution determination for SA Power Networks for the 2020-25 RCP will specify if and how the AER will apply the EBSS.[7]

In addition, the AER stated that it would only apply the EBSS in the 2020-25 RCP if it expects it will use a revealed cost forecasting approach to forecast opex for the 2025-30 RCP[8].

8.3 Carryover amounts for the 2015-20 RCP

The increments and decrements (**carryover amounts**) to be included in the building blocks for the 2020-25 RCP are those arising from the application of the EBSS in the 2015-20 RCP.

As noted above, the EBSS which applies to SA Power Networks for the 2015-20 RCP is version 2 of the EBSS as specified in the 2015-20 determination.

8.3.1 Actual adjustments and excluded categories of cost for the 2015-20 RCP

The EBSS allows for the exclusion of categories of operating costs that have not been derived using a single revealed year cost forecasting approach. In its 2015 Determination, the AER excluded the following categories of costs from the EBSS for the purposes of the 2015-20 RCP[9]:

- debt raising costs; and
- demand management innovation allowance (**DMIA**).

The AER excluded these categories of costs because the forecasts for these categories was not based on a single year of revealed expenditure. Debt raising costs are forecast using benchmark data, whilst the DMIA is not included in the opex forecast.

In addition to these excluded categories of operating costs, the AER determined that in accordance with the EBSS it would:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial 2015 Determination;
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base (**RAB**); and
- exclude categories of opex not forecast using a single year revealed cost approach for the 2020-25 RCP where doing so better achieves the requirements of clause 6.5.8 of the NER.

[6] *AER, Final framework and approach: SA Power Networks 2020-25, July 2018, page 68.*
[7] *AER, Efficiency benefit sharing scheme, 29 November 2013.*
[8] *AER, Final framework and approach: SA Power Networks 2020-25, July 2018, page 69.*
[9] *AER, Final Decision SA Power Networks determination 2015-16 to 2019-2020, Attachment 9 – Efficiency benefit sharing scheme, page 9-12.*

No adjustment has been made to the EBSS carryover for the 2015-20 RCP for these categories of operating costs.

The AER also determined that when calculating actual opex under the EBSS, it would adjust reported actual opex to reverse any movements in provisions, to best reflect the actual opex incurred by SA Power Networks during the 2015-20 RCP[10].

We forecast that our actual opex for the 2015-20 RCP (as calculated by making each of the above adjustments and exclusions) will be below the allowances determined by the AER for each regulatory year of the 2015-20 RCP.

Customers will benefit from this through lower opex for the 2020-25 RCP, which demonstrates that SA Power Networks is responding to the incentive based regulatory regime established by the EBSS.

8.3.2 Calculation of carryover amounts

The EBSS works in combination with a revealed cost base-step-trend forecasting approach to provide the same reward for an underspend and the same penalty for an overspend in each regulatory year of the relevant RCP.

Incremental efficient gains/losses for each regulatory year of the 2015-20 RCP have been calculated in accordance with the EBSS and the 2015 Determination.

Due to the timing of expenditure in the 2015-20 RCP, we have a forecast carryover EBSS loss of $30.1 million as shown in Table 8-1 below:

Table 8-1: Forecast EBSS carry-over loss for the 2015-20 RCP

June 2020, $ million	2020/21	2021/22	2022/23	2023/24	2024/25	Total
EBSS Carryover	**9.0**	**-24.0**	**-5.1**	**-9.9**	**0.0**	**-30.1**

Our detailed calculation of the EBSS carryover loss for the 2015-20 RCP as set out in Table 8-1 is contained in Reset RIN template 7.5 in Workbook 5.

8.4 EBSS to apply for the 2020-25 RCP

8.4.1 Proposed application of EBSS

SA Power Networks proposes that the AER continue to apply version 2 of the EBSS for the 2020-25 RCP as intended by the AER in its F&A. As mentioned above, the AER stated that it would only take this approach if our opex forecast is based on our revealed costs under the base-step-trend methodology[11]. This approach relies on the AER assessing that our revealed costs (or actual costs) for the 2015-20 RCP are not materially higher than the opex that would have been incurred by a benchmark efficient DNSP[12].

We have nominated the 2018/19 regulatory year as our base year[13]. The base year must reflect a suitable foundation for the forecast opex for the 2020-25 RCP. We believe that the 2018/19 regulatory year best represents this as it:

[10] *AER, Final Decision SA Power Networks determination 2015-16 to 2019-2020, Attachment 9 – Efficiency benefit sharing scheme, page 9-11.*

[11] *AER, Final framework and approach, SA Power Networks 2020-25, July 2018, page 68.*

[12] *Ibid, page 71.*

[13] *See Attachment 6 – Operating expenditure for full details.*

- will be the most recent regulatory year for which actual audited data will be available for the AER's final decision;
- will best reflect the future costs required to efficiently maintain and operate our network; and
- incorporates efficiency gains that we will have achieved up to 30 June 2019.

As highlighted above, we forecast that our actual opex for the 2015-20 RCP will be below the allowances set by the AER for each regulatory year of the 2015-20 RCP, including our 2018/19 base year.

One of the primary techniques the AER will use to assess the efficiency of our base year will be their benchmarking of SA Power Networks against other DNSP businesses. Benchmarking is a quantitative, or data driven, approach used to measure how productive (or efficient) DNSPs are at producing outputs compared with their peers.

The AER releases an annual benchmarking report to provide consumers with useful information about the relative efficiency of networks and released its 2018 Annual Benchmarking Report in November 2018[14].

SA Power Networks has consistently been amongst the most efficient DNSPs in the National Electricity Market (**NEM**).[15] For opex multilateral partial factor productivity (**MPFP**) we currently rank third against other DNSPs and contend that our benchmarking results would be more favourable if other operating environment factors were considered, in particular the capitalisation of corporate overheads by other DNSPs. Further, higher emergency response costs and Guaranteed Service Level (**GSL**) inconvenience payments resulting from unprecedented severe weather events contributed significantly to a productivity decline for the 2016/17 regulatory year.

The AER has included additional category specific partial performance indicators (**PPI**s) in its 2018 Annual Benchmarking Report, which further shows that we are consistently one of the lowest cost DNSP businesses across most levels of opex. All of these factors support that our base year opex is efficient. Further information on the efficiency of our base year is contained in Attachment 6 – Operating expenditure.

In addition, as mentioned above, the AER stated in its F&A that it would only apply the EBSS in the 2020-25 RCP if it expects it will use a revealed cost forecasting approach to forecast opex for the 2025-30 RCP[16]. SA Power Networks anticipates that the AER will continue to use a revealed cost forecasting approach to forecast opex for the 2025-30 RCP.

Consequently, SA Power Networks proposes that continuing to apply version 2 of the EBSS for the 2020-25 RCP is appropriate. This will ensure that we are provided with a continuous incentive to pursue opex efficiency improvements that will ultimately benefit our customers. We will also continue to apply the Capital Expenditure Sharing Scheme (**CESS**) for the 2020-25 RCP, to ensure that incentives to improve opex and capital expenditure (**capex**) are balanced.

By applying the EBSS, the CESS, the Service Target Performance Incentive Scheme (**STPIS**) and the new Demand Management Incentive Scheme (**DMIS**) to SA Power Networks, the incentives for capex, opex, service performance and for identifying and undertaking efficient demand management options will be balanced to promote efficient decision making in relation to expenditure and service quality.

[14] AER, *Annual Benchmarking Report, Electricity distribution network service providers*, *November 2018, includes benchmarking data up to 2017.*

[15] *AER, Annual Benchmarking Report, Electricity distribution network service providers, November 2018, page iv.*

[16] *AER, Final framework and approach: SA Power Networks 2020-25, July 2018, page 71.*

8.4.2 Proposed length of carryover period

In accordance with the EBSS, SA Power Networks proposes the length of the carryover period for the 2020-25 RCP should be five years. This aligns the EBSS carryover period with the length of SA Power Networks' RCP.

8.4.3 Proposed adjustments and excluded cost categories

We propose that the same adjustments and cost exclusions from the EBSS that apply to the 2015-20 RCP be applied to the EBSS for the 2020-25 RCP.

As set out in the EBSS, this includes when calculating the carryover amounts accrued in the 2020-25 RCP and applied in the 2025-30 RCP:

- adjusting forecast opex to add (subtract) any approved revenue increments (decrements) made after the distribution determination for the 2020-25 RCP. This may include approved pass through amounts or opex for contingent projects;
- adjusting actual opex to add capitalised opex that has been excluded from the RAB;
- excluding categories of opex not forecast using a single year revealed cost approach for the 2025-30 RCP where doing so better achieves the requirements of clause 6.5.8 of the NER, including costs associated with:
    - debt raising costs; and
    - the DMIA;
- adjusting forecast opex and/or actual opex in the 2020-25 RCP for inflation so that the real value of the carryover amounts is consistent with the real value of the other components of SA Power Networks' regulated revenue in the 2025-30 RCP; and
- adjusting reported actual opex to reverse any movements in provisions.

Shortened Forms

2015 Determination	*Distribution determination for the 2015-20 RCP*
AER	*Australian Energy Regulator*
capex	*Capital Expenditure*
CESS	*Capital Expenditure Sharing Scheme*
DMIA	*Demand Management Incentive Allowance*
DMIS	*Demand Management Incentive Scheme*
DNSP	*Distribution Network Service Providers*
EBSS	*Efficiency Benefit Sharing Scheme*
F&A	*Framework and Approach*
GSL	*Guaranteed Service Level*
MPFP	*Multilateral Partial Factor Productivity*
NEM	*National Electricity Market*
NER	*National Electricity Rules*
opex	*Operating Expenditure*
PPI	*Partial Performance Indicator*
RAB	*Regulatory Asset Base*
RCP	*Regulatory Control Period*
STPIS	*Service Target Performance Incentive Scheme*