Incentive Schemes

An Overview | January 2021
2023-27 Revenue Proposal

What are incentive schemes?

The national regulatory framework for electricity transmission network businesses has three incentive schemes:

- Efficiency Benefit Sharing Scheme (EBSS) – which applies to operating expenditure (or opex);
- Capital Expenditure Sharing Scheme (CESS) – which applies to capital expenditure (or capex); and
- Service Target Performance Incentive Scheme (STPIS) – which applies to network service performance.

Why do we have incentive schemes?

Incentive schemes are designed to encourage behaviour that results in improvements in costs or performance that will benefit both the business and network users (customers). This is done through financial rewards or penalties.

Typically targets are set by the Australian Energy Regulator (AER) at the start of a regulatory period (usually five years) and the business has the opportunity to outperform these targets each year. Expenditure targets are intended to represent the efficient cost for the business to meet its regulatory obligations.

In the case of *expenditure*, if the business spends less than the target, it keeps the difference. If the business spends more than the target, it has to fund the difference itself. At the end of the regulatory period, the AER calculates the net benefit/cost and shares this with consumers in the next regulatory period.

All three incentive schemes above are similar in principle, but operate differently in practice.

Efficiency Benefit Sharing Scheme

The EBSS aims to provide a *continuous incentive* for a network business to pursue cost savings in operating and maintenance expenditure over a regulatory period. Spend under the target is treated as an efficiency gain and spend over the target is treated as an efficiency loss.

At a high-level, the EBSS:

- is *symmetrical,* i.e. it applies to efficiency gains and losses;
- calculates gains/losses on an *incremental basis,* i.e. from one year to the next;
- works so that the business keeps the incremental gain/loss for 5-years beyond the year in which it was incurred; and
- results in an approximate sharing arrangement of 70:30 in favour of customers.

Our 2023-27 Revenue Proposal includes a total net carryover for the EBSS of $8.4 million of revenue into the 2023-27 regulatory period.

Capital Expenditure Sharing Scheme

The CESS provides an incentive to make efficient capital expenditure (investment) decisions. The capex targets in each year represent the efficient cost to buy, construct and/or install assets like transmission lines and substations. At a high-level, the CESS:

- is symmetrical, i.e. it applies to gains and losses;
- compares the target and actual spend in each year and also works out the finance costs (for overspends) and finance savings (for underspends);
- allows the business to keep the gain/loss for 5-years beyond the year in which it was incurred; and
- like the EBSS, also results in an approximate sharing arrangement of 70:30 in favour of customers.

Under the scheme, deferrals of expenditure from one year to the next could be treated as an efficiency loss, even though this could be a prudent course of action for the business. Typically the AER would investigate any significant differences in expenditure to understand the reasons behind them.

Our 2023-27 Revenue Proposal includes a total net carryover for the CESS of minus $3.7 million of revenue into the 2023-27 regulatory period.

Service Target Performance Incentive Scheme

The STPIS is designed to incentivise a network business to improve or maintain a high level of service for the benefit of participants in the National Electricity Market and end users of electricity (customers).

The STPIS has been progressively expanded and revised over many years. The current version that applies to electricity transmission networks is Version 5, finalised in October 2015.

Each electricity transmission business must report various information to the AER on its performance against targets by 1 February each year.

The STPIS *operates on a calendar year basis*. However, the financial bonus (or penalty) calculated for network performance in a calendar year is applied to the Maximum Allowed Revenue (MAR) that can be recovered from customers through prescribed transmission prices in the *next financial year*.

Unlike the EBSS and CESS, while network performance *targets* are determined by the AER as part of a revenue determination process every 5-years, performance *outcomes* relative to those targets are *reviewed and determined by the AER each year.*

There are three components to the STPIS as outlined below.

Component	Key features	Indicative revenue at risk* ($m)
Service Component (SC) Aims to improve network reliability.	▪ Consists of four parameters that measure the frequency and duration of unplanned network outages and loss of supply. ▪ Revenue at risk is ±1.25% MAR.	± 9.0
Market Impact Component (MIC) Aims to improve network availability at times of most importance to the market.	▪ Considers the number of instances that network outages impact the wholesale price of electricity. ▪ Target based on average of the median 5 years from the past 7 years' performance. ▪ Revenue at risk ±1.0% MAR.	± 7.0
Network Capability Component (NCC) Aims to deliver improved capability from existing network assets.	▪ We may propose Network Capability Incentive Parameter Action Plan (NCIPAP) projects as part of our Revenue Proposal and/or during a regulatory period. ▪ Priority projects are identified in the NCIPAP together with the forecast cost and value of the benefit delivered: - pro-rata based allowance up to 1% MAR each year - incentive of 1.5 times average annual project cost - penalty of up to 3.5% final year MAR.	Nil We have not proposed any NCIPAP projects in our 2023-27 Revenue Proposal.

* Assumes an indicative annual MAR of $700 million, consistent with our average forecast MAR in our 2023-27 Regulatory Proposal.

We have proposed SC and MIC targets consistent with the AER's historical data figures. We have also proposed an alternative data range to incorporate the most recent calendar year. This is to ensure our 2023-27 targets capture the impact of significant changes in our operating environment.

For more information about the EBSS, CESS and STPIS refer to our 2023-27 Revenue Proposal, Chapter 14 Expenditure Incentive Schemes and Chapter 15 Service Target Performance Incentive Scheme.