# DRAFT DECISION
# Evoenergy
# Access Arrangement

# 2021 to 2026

# Attachment 13
# Capital expenditure sharing scheme

November 2020

AUSTRALIAN ENERGY REGULATOR

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# Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital 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 carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

# Contents

# 13 Capital expenditure sharing scheme

This attachment outlines our assessment of Evoenergy's proposal for a capital expenditure sharing scheme (CESS) for the 2021–26 access arrangement period. The design of Evoenergy's proposed CESS is based on Jemena Gas Networks (NSW) Ltd's (JGN) approved CESS.[1] Significantly, Evoenergy's CESS will not apply to connections capital expenditure (capex). As the CESS is new for Evoenergy, it will not impact revenues in the upcoming access arrangement period, but rather, future access arrangement periods. Consequently, our draft decision relates to the design of the scheme.

## 13.1 Draft decision

Our draft decision approves the application of a CESS to Evoenergy in the 2021–26 access arrangement period.

## 13.2 Assessment approach

A full access arrangement may include (or we may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.[2] Incentive mechanisms may provide for carrying over increments for efficiency gains, or decrements for efficiency losses, from one access arrangement period into the next.[3]

An incentive mechanism must be consistent with the revenue and pricing principles (RPP).[4] We consider the following principle is most relevant for assessing Evoenergy's proposed incentives:

> "A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides.
>
> The economic efficiency that should be promoted includes—
>
> (a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and
>
> (b) the efficient provision of pipeline services; and
>
> (c) the efficient use of the pipeline."[5]

1 AER, Final decision, Jemena Gas Networks (NSW) - Access arrangement 2020-25, Attachment 13
2 NGR, r. 98(1).
3 NGR, r. 98(2).
4 NGR, r. 98(3).
5 NGL, s. 24(3).

## 13.3 Evoenergy's proposal

If implemented in our final decision, this will be the first time that we apply a CESS to Evoenergy in an access arrangement. The scheme that Evoenergy proposes we apply is similar to our recent decision on JGN's network in NSW.[6] These schemes are both designed differently to the schemes applied to the earlier Victorian gas distribution businesses decisions,[7] particularly in that they exclude certain classes of capex that were included in Victoria.

Evoenergy believes that a CESS is in the long term interests of its customers, and will help further improve the efficiency of its capex program, keeping downward pressure on bills.[8]

Similar to JGN, Evoenergy's proposed CESS only applies to capex within Evoenergy's control. Consequently, capex for new connections is excluded. This means Evoenergy's proposed CESS removes approximately $24 million of capex.

The CESS mechanism is described in Evoenergy's access arrangement. In a simple form, the CESS rewards Evoenergy for spending less than forecast capex, and penalises it for spending more. The CESS is designed so that Evoenergy retains 30 per cent of the benefit or cost, and shares the remaining 70 per cent with its customers.

As the CESS provides an incentive to reduce levels of capex, safeguards have to be provided so that a service provider is not merely rewarded for underinvesting in its network at the expense of performance. A Contingent Payment Mechanism (CPM) is included in the CESS, which acts to reduce the reward Evoenergy can retain if its performance falls.

Evoenergy has developed measures to monitor service performance. Four target measures have been proposed, these are:

- unplanned System Average Interruption Frequency Index (SAIFI) (weighting 30 per cent)
- unplanned System Average Interruption Duration Index (SAIDI) (weighting 30 per cent)
- mains and service leads (weighting 20 per cent)
- meter leaks (weighting 20 per cent).

Performance targets for each measure have been set using the last three years of historical data. The performance targets are weighted to produce a Contingent

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6 AER, Final decision, Jemena Gas Networks (NSW) - Access arrangement 2020-25, Attachment 13

7 For example, see AER, Final decision, Australian Gas Networks (Victoria and Albury) - Access Arrangement 2018-22, Attachment 14

8 Evoenergy, *Attachment 9 Incentive schemes*, June 2020, p. 4.

Payment Index (CPI). Evoenergy's actual performance will be measured against this index. Its reward for reducing capex will be scaled down if it does not meet this performance standard in a linear scale from 100 per cent (where it will receive a full benefit) to 80 per cent (where it will receive no benefit). This is consistent with the thresholds set in the CESS schemes for Victorian and NSW gas network businesses.

### 13.3.1 Interrelationships

The incentive scheme Evoenergy proposes relates to various areas of the business covered by the 2021–26 access arrangement.[9] For example, the introduction of a CESS will affect the size of the capital base and may alter the balance of investment signals between operating expenditure (opex) and capex. We aim to incentivise service providers, such as Evoenergy, to make efficient decisions on when and what type of expenditure to incur, and to balance expenditure efficiencies with service standards.

### 13.3.2 Stakeholders

The ACT Council of Social Service (ACTCOSS) noted that, if a CESS is adopted, it is essential that the measures use metrics that represent decisions that are under Evoenergy's control, and reflect the importance to or impact on customers.[10]

The Consumer Challenge Panel (CCP24) supports the proposed CESS, the exclusion of expansion capex, the Contingency Payment Factor (CPF) and associated performance measures and targets. They note that the proposed adjustments are consistent with recent AER gas network CESS decisions.[11]

Energy Consumers Australia (ECA) noted that the CESS should match the scheme approved by AER for JGN, and that it is unclear what differences are being proposed by Evoenergy.[12]

Origin Energy supports the CESS, subject to appropriate safeguards to ensure service quality does not deteriorate as a result of any efficiencies.[13]

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9 The efficiency carryover mechanism for opex is a related scheme.

10 ACTCOSS, *Submission: Evoenergy's gas network 2021–26 access arrangement proposal to the Australian Energy Regulator,* August 2020, p. 19.

11 CCP24, *Advice to the Australian Energy Regulatory on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 39.

12 Energy Consumers Australia, *Evoenergy and Australian Gas Networks (SA) Gas access arrangement proposals 2021–26 submission*, August 2020, p 27

13 Origin Energy, *Evoenergy access arrangement proposal*, August 2020.

## 13.4 Reasons for draft decision

### 13.4.1 Exclusion of new connections capex from CESS targets

We consider Evoenergy's proposal to exclude new connections capex from the CESS is likely to better achieve the RPP in the NGR. The amount of capex spent on new connections is largely outside of Evoenergy's control. The volume of new connections capex is largely driven by the number of new dwellings constructed, which is outside of Evoenergy's control. Also, given the new connections are installed using a tender process, Evoenergy has limited scope to obtain lower unit rates once it has selected its preferred provider. Evoenergy's performance against its performance targets is also largely unrelated to the amount of new connections capex it undertakes. We note that this is likely to address stakeholder concerns about the scheme only rewarding/penalising Evoenergy for capex within its control.

### 13.4.2 Contingent payment factor range

The CESS proposed by Evoenergy contains a mechanism to vary CESS payments based on how Evoenergy performs against certain service targets. This is known as the CPF. The CPF is in place to balance the incentive for Evoenergy to make efficiency savings on capex and maintain its quality of service.

The CPF allows CESS payments to be made to Evoenergy on a sliding scale. Evoenergy has proposed the range for the CPF be set from 80 to 100 per cent. Under this arrangement, if Evoenergy achieves 100 per cent of its performance targets, it will receive a full payment (in the event it spends less than its benchmark capex). The payment will then reduce on a sliding scale if Evoenergy does not achieve 100 per cent, and Evoenergy will not receive a CESS payment if its performance is less than 80 per cent.

We have accepted Evoenergy's proposal to apply a CPF range from 80–100 per cent for the 2021–26 period. We consider the performance targets proposed and calculations used are broadly similar to those approved previously by the AER for NSW and Victorian gas network businesses.

### 13.4.3 Performance targets for the contingent payment factor

Evoenergy's CPF includes a series of targets that its actual performance is compared to.

We have reviewed the historical data Evoenergy used to develop these targets. We consider these are relatively stable, and not impacted by the presence of significant outliers. Consequently, we consider these are a sound basis to assess the actual performance of Evoenergy over the access arrangement period.

# Shortened forms

| Shortened form | Extended form |
|---|---|
| ACTCOSS | ACT Council of Social Service |
| AER | Australian Energy Regulator |
| Capex | Capital expenditure |
| CCP / CCP24 | Consumer Challenge Panel, sub-panel 24 |
| CESS | Capital expenditure sharing scheme |
| CPF | Contingency payment factor |
| CPI | Contingent payment index |
| CPM | Contingent payment mechanism |
| EBSS | Efficiency benefit sharing scheme |
| ECA | Energy Consumers Australia |
| JGN | Jemena Gas Networks (NSW) Ltd |
| NGL | National Gas Law |
| NGO | National Gas Objective |
| NGR | National Gas Rules |
| NSW | New South Wales |
| Opex | Operating expenditure |
| RPP | Revenue and pricing principles |
| SAIDI | System Average Interruption Duration Index |
| SAIFI | System Average Interruption Frequency Index |
| WACC | Weighted average cost of capital |