



Draft Decision

Evoenergy* 2014–19 electricity distribution determination

September 2018

* Formerly known as ActewAGL Distribution

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Invitation for submissions

Interested parties are invited to make submissions on this draft decision paper by 5 October 2018.

Submissions should be sent to: ActewAGLremittal2014-19@aer.gov.au

Alternatively, submissions can be sent to:

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Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy (June 2014), which is available on our website.¹

¹ <https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information>

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1 Executive Summary

The Australian Energy Regulator (AER) regulates energy markets and networks under national energy market legislation and rules. Our network regulatory functions, which relate to energy networks in all Australian states and territories, except Western Australia, include setting the amount of revenue that monopoly network businesses can recover from customers for using networks (electricity poles and wires and gas pipelines) that transport energy.

The National Electricity Law (NEL) and Rules (NER) provide the regulatory framework governing electricity networks. Our work under this framework is guided by the national electricity objective (NEO):²

“... to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.”

This is our remade draft decision on the distribution determination for ACT electricity distributor, Evoenergy (formerly known as ActewAGL Distribution), for the 2014-19 regulatory control period, commencing 1 July 2014 to 30 June 2019. We set out the issues we have covered, our conclusions, and our reasons for why we are satisfied the decision, on the basis of the information before us, contributes to the achievement of the NEO to the greatest degree.

Our remade draft decision is to accept Evoenergy’s proposal to recover total revenues of \$815.6 million (\$, nominal) from consumers over the five-year 2014-19 regulatory control period.³ If this remade draft decision becomes our final decision, the decision will provide consumers with tariff stability and predictability and will maintain distribution network charges at current levels.⁴

Our decision has been informed by our analysis, supported by a series of stakeholder engagement processes that have occurred since the second-half of 2017 involving interested stakeholders, including consumer groups and affected distribution businesses. The purpose of these discussions has been to identify and develop a common position on

² NEL, s. 7.

³ Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018. In consultation with Evoenergy, we will continue to update the revenue amount for any new information until our final decision is made (e.g. annual cost of debt updates, actual consumer price index (CPI) and service target performance incentive scheme (STPIS) amounts). <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

⁴ In May 2016, we accepted undertakings given by Evoenergy (formerly ActewAGL) under section 59A of the NEL that set out how network revenues and tariffs will be determined in 2016–17. Evoenergy’s Network Use of System (NUoS) tariffs in 2016–17 were set at their 2015–16 approved tariffs adjusted for changes in the CPI. As of May 2017, the Full Federal Court had not yet handed down its decision, so we accepted further undertakings given by Evoenergy to establish new interim arrangements to govern the setting of network tariffs in 2017–18. As of March 2018, as the remittal process was not yet settled, we accepted further undertakings from Evoenergy for 2018-19. See *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2018*, 21 March 2018.

key matters that, in turn, could be put to us for consideration as being in the long-term interests of consumers.

There are a number of factors behind our decision to accept Evoenergy's proposal, including:

- we are satisfied it is likely to contribute to the achievement of the NEO to the greatest degree and is in the long-term interests of consumers
- it is consistent with our forecasts of operating expenditure (opex) and the cost of debt in light of the information before us now
- it is supported by key consumer groups following consultation undertaken by Evoenergy
- it will promote price certainty and stability for consumers
- it will provide a timely and certain resolution of Evoenergy's distribution determination for the 2014-19 regulatory control period, which will benefit both consumers and Evoenergy

Our remade draft decision for the 2014-19 regulatory control period will result in a revenue allowance of \$26 million⁵ above the revenue we approved in our 2015 final decision that was set aside by the Australian Competition Tribunal (Tribunal), and will lead to an estimated \$1 million being returned to consumers in the next regulatory control period.⁶ The substantive proportion of these additional revenues relate to the efficient and prudent redundancy costs that Evoenergy has incurred since our 2015 final decision in reforming its business to meet the opex expenditure targets set out in our 2015 final decision.

We have had to remake our decision following the outcome of limited merits and judicial review processes relating to our 2015 final decision. The Tribunal remitted our decision to us, specifically requiring that we remake our decision in relation to Evoenergy's opex forecast, the rate of return with respect to the trailing average approach and how the service target performance incentive scheme (STPIS) is to apply, and otherwise vary the distribution determination as set out in our 2015 final decision as we consider appropriate.^{7, 8}

In January 2015, Evoenergy was seeking \$1,036.2 million in revenue for the 2014-19 regulatory control period, but we approved a revenue allowance of \$764.1 million in our April 2015 final decision (or \$272.1 million less than what Evoenergy proposed). In response, Evoenergy sought limited merits review of our decision by the Tribunal. To address pricing uncertainty during the period that the limited merits and judicial review processes were on foot, we accepted enforceable undertakings from Evoenergy. These undertakings set distribution network charges to increase by changes in the consumer price index (CPI). Under these undertakings, we estimate that Evoenergy will recover \$816.5 million during the 2014-19 regulatory control period.

⁵ This difference is based on the revenue under this remade draft decision compared with our 2015 Final Decision, excluding the revenue impact of the difference in forecast and out-turn demand.

⁶ The estimated \$1 million that is expected to be returned to customers in the 2019-24 regulatory control period is our best estimate at this point in time as we will not know the exact amount until after the 2014-19 regulatory control period.

⁷ See Appendix A for background on our remade decision.

⁸ Australian Competition Tribunal, *Application by ActewAGL Distribution [2016] ACompT 4*, 26 February 2016. On 24 May 2017, the Full Federal Court dismissed our appeal and upheld the Tribunal's decision in relation to opex and cost of debt. It upheld the AER's appeal in relation to gamma. See Appendix A of this draft decision for further background.

On 24 July 2018, Evoenergy submitted a new proposal to us to resolve all outstanding issues relating to the decision we need to remake.⁹ It is a total revenue proposal of \$815.6 million (\$, nominal) for the five-year 2014-19 regulatory control period. This amount is \$26 million more than what we provided for in our 2015 final decision, after adjusting for data updates over time including the impact of actual demand being greater than what was forecast under its price control. However, this is \$98 million less than the amount at issue (key elements of the 2015 final decision that were disputed were approximately \$83 million for operating expenditure and \$41 million in return on debt).

Evoenergy's proposal is based on:¹⁰

- our 2015 final decision, including the constituent decision we made on the rate of return (including the cost of debt) and the constituent decisions we made on opex and STPIS with relevant amendments
- the revenue that Evoenergy has recovered thus far for the 2014-19 regulatory control period, up to \$26 million above our 2015 final decision (of which \$20.9 million has been attributed to labour redundancy costs)

We have remade our 2015 final decision in accordance with the NEL and NER. Among other things, this means we have taken into account the revenue and pricing principles (RPP) and are satisfied that the remade decision is likely to contribute to the achievement of the NEO to the greatest degree.

It is important to draw attention to the novel circumstances that we have faced in making this remade draft decision. These circumstances materially differ to what we faced when we made our 2015 final decision, and what we would generally face in making a distribution determination. As a result, it is likely that this remade draft decision will have limited precedent value. Specifically, we are making the remade draft decision at a time:

- That is four years into the applicable five-year 2014-19 regulatory control period.
- When we have applied interim pricing measures for the 2016-17, 2017-18 and 2018-19 regulatory years by accepting enforceable undertakings to address pricing uncertainties arising from the limited merits and judicial review processes.
- When we have information on Evoenergy's actual performance for the first three years of the five-year 2014–19 regulatory control period and updated forecasts for the remaining two years. Since our 2015 final decision, Evoenergy has embarked on a reform program that has reduced its opex to a level consistent with our 2015 final decision.
- When we have had a number of Tribunal and Federal Court processes, since the Tribunal's decision on Evoenergy, that have considered and clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt.
- When our remade decision has the potential to create significant retail price fluctuations if it differs materially from our 2015 final decision (recognising that this prospect is to some extent alleviated by the rule made by the Australian Energy Market Commission

⁹ Evoenergy, *Proposal for the remittal of Evoenergy's 2014-19 determination*, 24 July 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

¹⁰ Ibid.

(AEMC) on 1 August 2017 that allows us to let Evoenergy recover any additional revenues that result from our remade decision across both the 2014–19 and 2019–24 regulatory control periods).¹¹

- When we have received Evoenergy’s revenue proposal for the forthcoming 2019-24 regulatory control period.
- When there is strong support from a range of consumer groups that Evoenergy’s proposal is in the long-term interests of consumers.

The novel circumstances we find ourselves in also heightens the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.¹²

Evoenergy participated in the stakeholder roundtable meeting we convened on 16 August 2017, the purpose of which was to discuss possible options for resolving outstanding remittal-related matters in a manner that is in the long-term interests of consumers.¹³ Some of the key themes raised by participating stakeholders, which included industry and consumer representatives, were:

- an expedited resolution of the remaking of our 2015 final decision, if possible, would provide a number of benefits for stakeholders, including greater certainty for the running of the businesses and certainty of price outcomes for consumers, compared to an extended timeframe of potentially up to 18 months for a regular determination process
- recognition that there is an increasing effort and goodwill towards better, and more clearly, aligning consumer and network business interests
- rising electricity prices have made affordability a key concern for consumers

Evoenergy also engaged with key energy consumers groups to inform its proposal, including Energy Consumers Australia, the ACT Energy Consumers Policy Consortium¹⁴, the Evoenergy Energy Consumer Reference Council¹⁵ and the AER Consumer Challenge Panel. The general consensus of these stakeholders is that Evoenergy’s proposal is in the long-term interests of its customers.¹⁶

¹¹ AEMC, *Rule determination: National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017 No. 7, commencing 15 August 2017*; AEMC, *Rule determination: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - NSW DNSPs Revenue Smoothing) Rule 2017 No. 6, commencing 15 August 2017*.

¹² Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

¹³ AER, *NSW and ACT remittal roundtable (16 August 2017) summary note*, August 2017:

<https://www.aer.gov.au/communication/aer-hosts-nsw-act-electricity-distribution-network-revenue-roundtable>

¹⁴ The ACT Energy Consumers Policy Consortium (ECPC) includes the ACT Council of Social Service, Care Financial Counselling Service, Conservation Council ACT Region, SEE-Change and the Small Business Taskforce of the Canberra Business Chamber.

¹⁵ The Evoenergy Energy Consumer Reference Council (ECRC) includes the Tuggeranong Community Council, Australian National University, Engineers Australia, Canberra Business Council, Master Builders Association, SEE-Change, Gungahlin Community Council, Council of the Ageing, Property Council of Australia, ACT Council of Social Services, ACT Youth Advisory Council, Canberra Urban and Regional Futures.

¹⁶ The written advice we received from stakeholders on Evoenergy’s proposal is published on the AER’s website.

In light of the novel circumstances we are faced with, and the information before us, our remade draft decision is to accept Evoenergy’s proposal for the 2014-19 regulatory control period. We are satisfied that this will result in a remade decision that is likely to contribute to the achievement of the NEO to the greatest degree and is in the long-term interests of consumers.

1.1 Next steps

Subject to stakeholder submissions received in response to this remade draft decision, we expect to publish our remade final decision in November 2018, as per Table 1-1.

Table 1-1 Indicative timeline for finalising Evoenergy’s determination

Determination process	Indicative date
AER publishes remade draft decision for consultation	6 September 2018
Stakeholder submissions on remade draft decision close	5 October 2018
AER publishes remade final decision	November 2018

1.2 Decisions for other NSW/ACT distribution businesses

We released our 2014-19 remade final decision for Essential Energy on 31 May 2018.¹⁷ Our 2014-19 remade draft decision for Endeavour Energy was released on 20 July 2018 and we expect to publish our final decision by October.¹⁸

We are yet to remake our 2014-19 draft decision for Ausgrid¹⁹ and 2015-20 draft decision for Jemena Gas Networks, but expect to do so later this year.

In late-2017, we sought stakeholder feedback on an opex Issues Paper²⁰ and cost of debt Position Paper²¹ for the purpose of progressing the outstanding remittal decisions that we

<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-determination-2014-19-remittal/proposal>

¹⁷ AER, *Final Decision Essential Energy 2014-19 electricity distribution determination*, May 2018.

<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/essential-energy-determination-2014-19-remittal>

¹⁸ AER, *Draft Decision Endeavour Energy 2014-19 electricity distribution determination*, July 2018.

<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/endeavour-energy-determination-2014-19-remittal>

¹⁹ Ausgrid submitted its remittal proposal to the AER on 15 August 2018. Ausgrid, *Proposal for the remake of Ausgrid’s 2014-19 distribution determination (Proposal)*, 15 August 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausgrid-determination-2014-19-remittal/proposal>

²⁰ AER, *Issues Paper – Remitted decisions for NSW/ACT 2014–19 electricity distribution determinations, Operating Expenditure*, October 2017.

²¹ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.

need to remake. All stakeholder submissions received in response to these papers have or will be considered when remaking our decisions.

1.3 Structure of this document

This document is structured as follows:

- Section 2 presents our remade draft decision for Evoenergy
- Section 3 presents Evoenergy's proposal
- Section 4 presents stakeholders' views on Evoenergy's proposal
- Section 5 presents the reasons for our remade draft decision
- Appendix A presents background to our remade draft decision

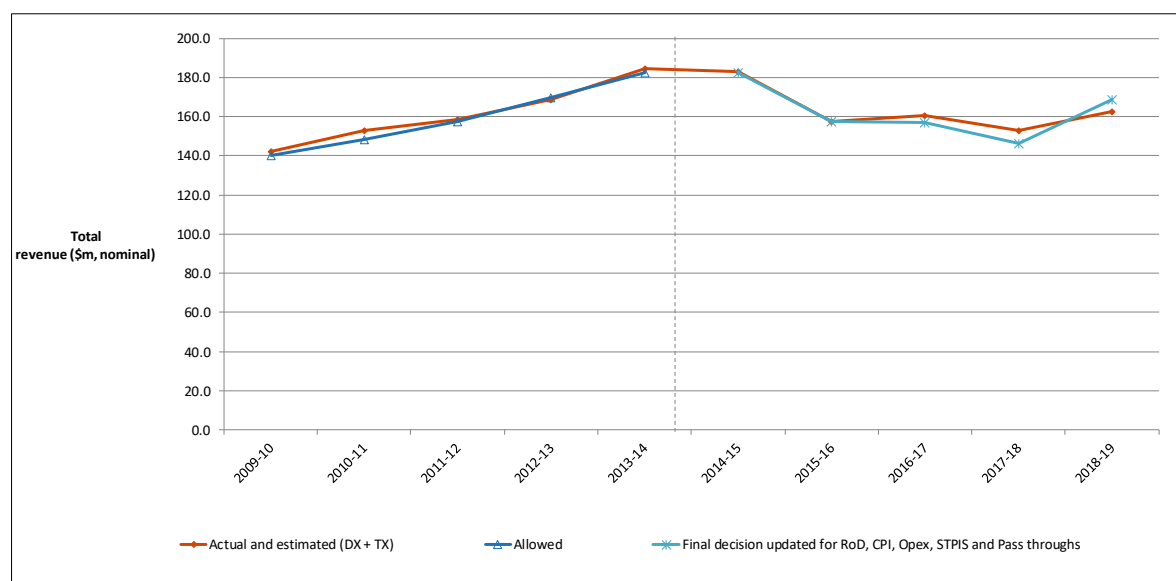
2 Our remade draft decision

Our remade draft decision after remaking the constituent decisions for opex, rate of return and STPIS, as well as correcting some other minor aspects relating to our 2015 final decision in accordance with the Tribunal’s directions, is to accept Evoenergy’s proposal.²²

This means Evoenergy can recover total revenues of \$815.6 million (\$, nominal) from consumers over the 2014–19 regulatory control period.²³ This outcome is \$26 million above the revenue allowance we set for Evoenergy in our 2015 final decision. Any additional revenues (currently estimated at \$1 million) in excess of the \$26 million limit will be returned to customers in subsequent regulatory years from 2019–20. The estimated \$1 million that is to be returned to Evoenergy’s customers in the next (2019–24) regulatory control period is our best estimate at this point in time, as we will not know the exact amount until after the current (2014-19) regulatory control period.

We are satisfied that this remade draft decision, taking into account the RPP, is likely to contribute to the achievement of the NEO to the greatest degree.²⁴ Figure 2-1 below illustrates our overall decision.

Figure 2-1 Evoenergy’s past total revenue and AER draft decision total revenue allowance (\$million, nominal)



Source: AER analysis.

²² Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

²³ Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018. In consultation with Evoenergy, we will continue to update the revenue amount for any new information until our final decision is made (e.g. annual cost of debt updates, actual consumer price index (CPI) and service target performance incentive scheme (STPIS) amounts). <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

²⁴ NEL, ss. 16(1)(d)(i) and 16(2).

The network component of customers' bills were set by our 2015 final decision and following the Tribunal's decision, by interim pricing measures in 2016–17, 2017–18 and 2018–19.

In the 2014-15 transitional year, distribution network charges reduced, on average, by 1.7 per cent.²⁵

In 2015-16, distribution network charges fell significantly, reflecting a reduction in Evoenergy's real revenues resulting from our 2015 final decision. At the time of our decision, this impact was estimated as a \$112 (5.8 per cent) reduction in the average bill for a residential customer and a \$168 (5.8 per cent) reduction in the bill for a small business customer.²⁶

During 2016-17, 2017-18 and 2018-19, distribution network charges increased by changes in the CPI in accordance with enforceable undertakings we accepted. The undertakings from Evoenergy addressed pricing uncertainties arising from the limited merits and judicial review processes.

At the same time as releasing this remade draft decision, we have released a separate draft decision adjustment determination for Evoenergy that has relevance to revenues recovered from metering (alternative control services) for both 2014–19 and 2019–24 regulatory control periods.²⁷ In the adjustment determination, we determine a metering variation amount that corrects a previously made error in the calculation of Evoenergy's metering opex allowance.²⁸

Under the NER, we are required to make an adjustment determination in order to ensure Evoenergy recovers only the revenue to which it is entitled and should not receive any windfall gains or losses as a result of the appeals process.²⁹ The key component of our adjustment determination for Evoenergy is the additional revenue it can recover from customers for the provision of metering services in the 2019–24 regulatory control period. In the adjustment determination, we determine that the metering variation amount is \$3.7 million (\$2018–19) which Evoenergy is to recover in the 2019–24 regulatory control period.³⁰ We will incorporate this amount in our upcoming draft decision on the 2019–24 distribution determination for Evoenergy.³¹

To avoid doubt, the metering adjustment amount set out in our adjustment determination does not apply to standard control services.

²⁵ AER, *Transitional Decisions: NSW/ACT 2014-15 Factsheet*, April 2014.

https://www.aer.gov.au/system/files/AER%20factsheet%20-%20placeholder%20determinations%20NSWACT_3.PDF

²⁶ AER, *Final decision ActewAGL distribution determination - Fact Sheet*, April 2015. The analysis assumed distribution network charges made up 35 per cent of customers' bills on average. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-determination-2014-19/final-decision>

²⁷ AER, *Draft decision Evoenergy adjustment determination*, September 2018.

²⁸ Australian Competition Tribunal, *Application by ActewAGL Distribution [2016] ACompT 4*, 26 February 2016, paragraphs 57–71.

²⁹ NER, cl 8A.15.5.

³⁰ We note that Evoenergy, in its 2014-19 remittal proposal, estimated the value of this error as approximately \$3.8 million. We have since confirmed the metering variation amount to equal \$3.7 million (\$2018–19).

³¹ NER, cl 8A.15.5(c)(3) and (5).

3 Evoenergy's proposal

On 24 July 2018, we received Evoenergy's proposal for the remaking of the its revenue determination for the 2014–19 regulatory control period.³²

It is a total revenue proposal. That is, it is not directly presented in terms of the building block components as was the case in its initial and revised regulatory proposals which preceded our April 2015 final decision (and the associated constituent decisions).

In its proposal, Evoenergy states:³³

“While Evoenergy's proposal comprises a number of different parts, it is a holistic proposal submitted on the basis that all components are assessed as a complete package for resolving the 2014-19 remittal in an expedited manner.”

Key aspects of Evoenergy's proposal are summarised below:³⁴

“This proposal is aimed at achieving an expedited resolution to the remade determination that is in the long-term interests of consumers by providing price stability and certainty and enabling Evoenergy to continue to maintain a safe, reliable and secure supply of electricity for ACT consumers. The proposal follows consultation with the AER and consumer groups on achieving these key objectives...

This proposal, if accepted, would allow the AER to remake its 2015 determination without a need to increase prices for standard control services (SCS) in the 2019-24 regulatory control period...

The Tribunal and Federal Court directed the AER to remake its decision for (among other things) SCS operating expenditure (opex) and the cost of debt. Evoenergy estimates that the value of these matters, if remade in accordance with the Court orders, would be approximately \$124 million (this and all other amounts in this letter are expressed in terms of 2018/19 dollars).

Evoenergy's proposal does not seek to recover \$124 million, but instead limits the revenue recovered under the remade determination as compared to the 2015 determination to \$26 million. This includes redundancy expenses of \$20.9 million, service target performance incentive scheme (STPIS) penalties of -\$1.2 million and the retention of \$6.5 million in revenues as part of the overall resolution of the remittal proposal. Limiting the additional revenue recovered by Evoenergy to \$26 million provides consumers with a benefit of \$98 million. Evoenergy therefore considers its proposal to be in the long-term interests of consumers.

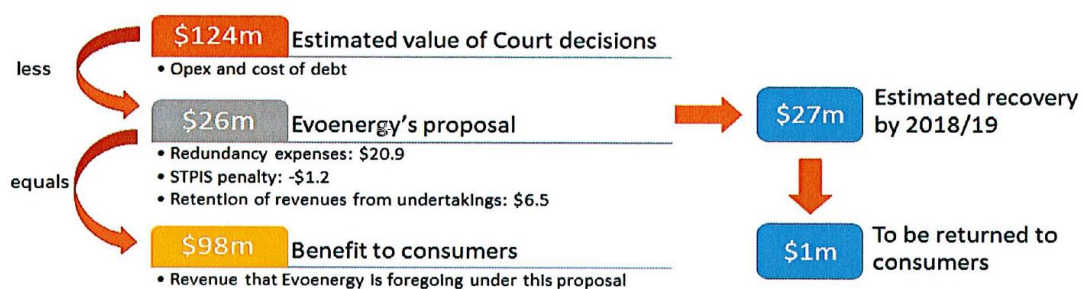
Significantly, Evoenergy's SCS revenues for the 2014-19 regulatory proposal under the undertakings are expected to exceed the revenue allowance in this proposal...[by]...\$1 million, [which] would be returned to consumers in the 2019-24 regulatory period. That is, Evoenergy's proposal will ensure that there is no increase in prices for SCS in the 2019-24 regulatory period as a consequence of remaking of the 2015 determination. Evoenergy's proposal is summarised in Figure 1 below.”

³² Evoenergy, *Proposal for the remittal of Evoenergy's 2014-19 determination*, 24 July 2018.
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

³³ Ibid.

³⁴ Ibid.

Figure 1: Summary of Evoenergy's remittal proposal



Evoenergy further explains what acceptance of its proposal would mean for stakeholders:³⁵

“The key benefit of this proposal is that it would provide price stability and certainty for consumers. Other benefits include:

- Resolution of the long-running difference between the AER and Evoenergy, allowing the AER to finalise its remade 2015 determination.
- Passing onto consumers the 22 per cent reduction in opex achieved in the current regulatory period (compared with the 2009-14 regulatory period), which will also flow through to the 2019-24 regulatory period.
- Maintenance of a safe, reliable and secure supply of electricity for ACT consumers at an efficient cost.
- For all stakeholders, including Evoenergy and its customers, this proposal would provide certainty about the application of the AER's methodology and approach in the forthcoming AER determination for Evoenergy for the 2019-24 regulatory control period, in particular:
 - This proposal would resolve the methodology to calculate the cost of debt for the 2019-24 regulatory control period.
 - This proposal would provide certainty for the methodology used to calculate opex. In particular, given the substantial opex efficiencies achieved by Evoenergy over the current regulatory period, this proposal would deliver a resulting base year opex for forecasting 2019-24 opex in line with the AER's opex allowance in the 2015 determination and an anticipated return to a revealed cost methodology.
- The continued application of incentive schemes designed to encourage efficiencies and to share these with consumers, including the re-instatement of the efficiency benefit sharing scheme (EBSS) for 2019-24.”

Evoenergy engaged with consumer groups on a draft version of its proposal prior to submitting its finalised proposal to the AER. The next section summarises the stakeholder comments we received on Evoenergy's finalised proposal.

³⁵ Ibid.

4 Stakeholders' views on the proposal

Following early discussions between Evoenergy and our staff on the key aspects of the decisions the Tribunal has required us to remake, Evoenergy engaged with consumer groups on a near-final version of its proposal. Subsequently, the following consumer groups issued letters expressing their views on Evoenergy's proposal:

- Energy Consumers Australia (ECA)
- Energy Consumers Policy Consortium (ECPC)
- Evoenergy Energy Consumer Reference Council (ECRC)
- AER Consumer Challenge Panel, Sub-panel 10 (CCP10)

The general consensus of these consumer groups is that Evoenergy's proposal for the 2014-19 regulatory control period is in the long-term interests of its customers. The letters in their entirety are available on our website, excerpts from which are provided below.

4.1 Energy Consumers Australia

In its letter on Evoenergy's proposal, ECA submitted:³⁶

"I write to express Energy Consumers Australia's support for the proposal for the remittal of Evoenergy's 2014-19 determination (the Proposal), based on the draft [Proposal] for comment...

In forming our view of the Proposal, we have considered whether taken as a whole the Proposal is in the long-term interests of the consumers served by the Evoenergy network...

In our view, on balance, the benefits of the Proposal outweigh the costs."

4.2 Energy Consumers Policy Consortium

In its letter on Evoenergy's proposal, ECPC submitted:³⁷

"I am writing to advise that the ACT Energy Consumer Policy Consortium supports the proposal from Evoenergy for resolution of the 2014-2019 regulatory period. We have been briefed by staff in Evoenergy and members of the Consumer Challenge Panel, which was very important to our understanding of the proposal...

We hope the adoption of this proposal leads to a prompt resolution of the outstanding matters between Evoenergy and the Australian Energy Regulator..."

³⁶ Energy Consumers Australia, *Proposal for the remittal of Evoenergy's 2014-19 determination*, 25 June 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

³⁷ The ACT Energy Consumers Policy Consortium (ECPC) includes the ACT Council of Social Service, Care Financial Counselling Service, Conservation Council ACT Region, SEE-Change and the Small Business Taskforce of the Canberra Business Chamber. Energy Consumers Policy Consortium, *Response from ACT ECPC to Evoenergy proposal regarding resolution of 2014-2019 regulatory determination*, 29 June 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

ECPC also suggested:³⁸

“We would like to suggest that the estimated \$1m revenue collected in 2014-2019 that Evoenergy propose will be used to reduce prices in the future should be put into a ‘Consumer Interest Fund’ that is held in a quarantined interest bearing account, with the interest on this fund allocated to projects that will increase consumer engagement and to develop and fund domestic, community organisation and small business programs that reduce the network/distribution costs in their bill.”

While we understand the intent behind the ECPC’s suggestion, under the NER the AER does not have the power to require that additional revenues be allocated in this manner. The NER require that we must make remade decision in accordance with the RPP. That is, our remade decision must give Evoenergy the ability to recover revenue that reflects efficient costs.

4.3 Evoenergy Energy Consumer Reference Council

In its letter on Evoenergy’s proposal, the Evoenergy ECRC submitted:³⁹

“At our most recent meeting, it was the firm view of our council’s consumer representatives that they are supportive of Evoenergy’s holistic remittal proposal, which is designed to bring this ongoing process to a satisfactory conclusion and which we consider to be a very good compromise between the interests of the ACT consumer and the reasonable requirements of Evoenergy...

Extensive briefings and two way dialogue with ActewAGL/Evoenergy staff has resulted in a much better understanding on our members part of what makes up an energy bill and the balance between price, reliability and business sustainability...

We believe that the Evoenergy ECRC is a highly representative body on behalf of ACT energy consumers and our members would welcome the AER’s favourable consideration of Evoenergy’s remittal proposal.”

4.4 Consumer Challenge Panel

The AER established the CCP in July 2013 to assist us to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to us to better balance the range of views considered as part of our decisions. In its letter on Evoenergy’s proposal, CCP10 submitted:⁴⁰

“Evoenergy has engaged with consumer groups about this proposal. The proposal has been disclosed by Evoenergy to and discussed with consumer groups in the following meetings:

³⁸ Ibid.

³⁹ The Evoenergy Energy Consumer Reference Council (ECRC) includes the Tuggeranong Community Council, Australian National University, Engineers Australia, Canberra Business Council, Master Builders Association, SEE-Change, Gungahlin Community Council, Council of the Ageing, Property Council of Australia, ACT Council of Social Services, ACT Youth Advisory Council, Canberra Urban and Regional Futures. Evoenergy Energy Consumer Reference Council, Evoenergy 2014-2019 determination: remittal proposal, 27 June 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

⁴⁰ Consumer Challenge Panel, *Evoenergy 2014–19 revenue allowance remittal proposal*, 21 June 2018. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

Stakeholder Group	Dates
Bilateral discussions CCP10 and ECA	7 th June 2018
Evoenergy's Energy Consumer Reference Council (ECRC)	7 th June 2018, with Chair of ECRC 13 th June, with full ECRC – 7 community / stakeholder representatives with ECA and CCP also in attendance
ACTCOSS CEO, Susan Helyar and CCP	7 th June 2018
Energy Policy Consortium, comprising ACTCOSS, ACT Business Chamber, Care Financial Counselling, See Change and Conservation Council	13 th June 2018

It is our observation that between the ECRC and Energy [Consumers] Policy Consortium (coordinated by ACTCOSS) there is a significant representation of consumer views from across the ACT...

As the AER is aware, CCP10 had the following involvement during this engagement process:

- we gave feedback to Evoenergy on the draft proposal as it was being developed between December 2017 and June 2018;
- we gave feedback on the draft proposal letter on 7th June 2018;
- we participated in bilateral discussions involving ACTCOSS and ECA during June, also providing some background briefing to these organisations; and
- we participated in the ECRC meeting of 13th June. We observe that Evoenergy uses its ECRC as a significant focus for consumer engagement, and it includes a good range of ACT consumer and stakeholder interests.”

CCP10 confirms that Evoenergy was very receptive to comments from consumer groups and that it has taken steps to incorporate that feedback in the final proposal and the infographic...

A feature of the proposal is that the revenue effects will be smoothed over the 2019-24 period, contributing to price stability for Evoenergy's consumers...

CCP10 supports Evoenergy's proposal for resolving its regulatory allowance for 2014-19, following the remittal of that determination to the AER by the Federal Court. We commend Evoenergy on its recent consumer engagement on its proposal and on the way it has listened to that feedback and reflected it in its revised proposal...

CCP10 believes that the Evoenergy proposal is in the long-term interests of Evoenergy's customers. We understand that this involves Evoenergy retaining up to \$26 million in revenue that could otherwise be returned to consumers, but this needs to be considered in the context of the overall proposal...

It is our opinion that the benefits outweigh the costs, in aggregate, for consumers from this proposal.”

5 Reasons for our remade draft decision

Our reasons for arriving at our position in this remade draft decision are set out below. The steps we took to arrive at our position are:

- remake the constituent decisions for opex, STPIS and the return on debt in accordance with the Tribunal's directions and reasons (as clarified by the Full Federal Court (Court))
- identify any other aspects of our April 2015 final decision that may be appropriate to vary, as a consequence of remaking the constituent decisions for opex, STPIS and the return on debt
- consider Evoenergy's proposal, as well as each of the consumer groups' letters on the proposal
- of all the possible outcomes available, decide whether we are satisfied that the position we have arrived at, taking into account the RPP, is likely to contribute to the achievement of the NEO to the greatest degree⁴¹

5.1 Our approach

As is the case with making any distribution determination, there may be several possible overall decisions that we could potentially make that will, or are likely to, contribute to the achievement of the NEO. In these circumstances, the NEL directs us to make the decision that we are satisfied will, or is likely to, contribute to the achievement of the NEO to the greatest degree.⁴²

Determining whether any particular decision will, or is likely to, contribute to achieving the NEO is a matter of regulatory judgment which involves assessing the decision as a whole, having regard to stakeholder views, taking into account the RPP and complying with the specific requirements of the NER. Implicit in this task is recognising that a distribution determination is more than just the sum of its constituent decisions or component parts as determined in accordance with Chapter 6 of the NER.

5.1.1 The novel circumstances we face

The approach we have applied in remaking this draft decision has necessarily been influenced by the novel circumstances that we face now. These are novel circumstances because they materially differ from those we faced when we made our 2015 final decision, and what we would generally face in making a distribution determination. As a result, it is likely that this remade draft decision will have limited precedent value.

Specifically, we are making this remade draft decision at a time:

- that is four years into the applicable five-year 2014-19 regulatory control period

⁴¹ NEL, ss. 16(1)(d)(i) and 16(2).

⁴² NEL, ss. 16(1)(d)(i) and 16(2).

- when we have applied interim pricing measures for the 2016-17, 2017-18 and 2018-19 regulatory years by accepting enforceable undertakings to address pricing uncertainties arising from the limited merits and judicial review processes
- when we have had a number of Tribunal and Federal Court processes, since the Tribunal's decision on Evoenergy, that have considered and clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt
- when we have information on Evoenergy's actual performance for the first three years of the five-year 2014–19 regulatory control period and updated forecasts for the remaining two years
- when our decision has the potential to create significant retail price fluctuations if it differs materially from our 2015 final decision⁴³
- when we have received Evoenergy's revenue proposal for the forthcoming 2019-24 regulatory control period
- when there is strong support from a range of consumer groups that Evoenergy's proposal is in the long-term interests of consumers

5.1.2 Assessing the overall decision

Ultimately, assessing whether this remade draft decision achieves the NEO to the greatest degree involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of Evoenergy's network that is in the long-term interests of consumers. This involves us balancing the various, and at times competing, factors referred to in the NEO. We must also take into account the RPP in determining how the NEO may be achieved to the greatest degree.⁴⁴

This is the same approach that we applied in making our 2015 final decision. As we stated in that decision:⁴⁵

"Energy Ministers have provided us with a substantial body of explanation that guides our understanding of the NEO. The long-term interests of consumers are not delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision.

...The NEL and NER aim to remedy the absence of competition by providing that we, as regulator, make decisions that are in the long-term interests of consumers. In particular, we might need to require the distributors to offer their services at a different price than they would

⁴³ Recognising that this prospect is to some extent alleviated by the rule made by the AEMC on 1 August 2017 that allows us to let Evoenergy recover any additional revenues that result from our decision across both 2014–19 and 2019–24 regulatory control periods. See AEMC, AEMC, *Rule determination: National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017 No. 7, commencing 15 August 2017*; AEMC, *Rule determination: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - NSW DNSPs Revenue Smoothing) Rule 2017 No. 6, commencing 15 August 2017*.

⁴⁴ See NEL, s. 16(2). As affirmed by the Federal Court in *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [36].

⁴⁵ AER, *Final decision, ActewAGL distribution determination 2015–16 to 2018–19, Overview*, April 2015, pp. 53-54.

choose themselves. By its nature, this process will involve exercising regulatory judgement to balance the NEO's various factors.

It is important to recognise that there are a number of plausible outcomes that may contribute to the achievement of the NEO. The nature of decisions under the NER is such that there may be a range of economically efficient decisions, with different implications for the long-term interests of consumers. At the same time, however, there are a range of outcomes that are unlikely to advance the NEO to a satisfactory extent. For example, we do not consider that the NEO would be advanced if allowed revenues encourage over-investment and result in prices so high that consumers are unwilling or unable to efficiently use the network. This could have significant longer term pricing implications for those consumers who continue to use network services.

Equally, we do not consider the NEO would be advanced if allowed revenues result in prices so low that investors are unwilling to invest as required to adequately maintain the appropriate quality and level of service, and where customers are making more use of the network than is sustainable. This could create longer term problems in the network and could have adverse consequences for safety, security and reliability of the network.”

This approach was also affirmed by the Tribunal in its reasons of 26 February 2016:⁴⁶

“The ultimate objective reflected in the NEO and NGO [National Gas Objective] is to direct the manner in which the national electricity market and the national natural gas market are regulated, that is, in the long-term interests of consumers of electricity and natural gas respectively with respect to the matters specified. The provisions proceed on the legislative premise that their long-term interests are served through the promotion of efficient investment in, and efficient operation and use of, electricity and natural gas services. This promotion is to be done ‘for’ the long-term interests of consumers. It does not involve a balance as between efficient investment, operation and use on the one hand and the long-term interest of consumers on the other. Rather, the necessary legislative premise is that the long-term interests of consumers will be served by regulation that advances economic efficiency.”

In considering whether this remade draft decision is likely to contribute to the achievement of the NEO to the greatest degree, in respect of our assessment of Evoenergy’s proposal, we note that there are potentially a range of possible outcomes that may meet the Tribunal’s directions.

5.2 Assessment of Evoenergy’s proposal

As set out in section 3, Evoenergy’s proposal for a revenue allowance for the 2014-19 regulatory control period is summarised as follows:⁴⁷

“While Evoenergy’s proposal comprises a number of different parts, it is a holistic proposal submitted on the basis that all components are assessed as a complete package for resolving the 2014-19 remittal in an expedited manner...

⁴⁶ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1, [77] and [78].

⁴⁷ Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018.
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

The Tribunal and Federal Court directed the AER to remake its decision...Evoenergy estimates that the value of these matters, if remade in accordance with the Court orders, would be approximately \$124 million...

Evoenergy's proposal does not seek to recover \$124 million, but instead limits the revenue recovered under the remade determination as compared to the 2015 determination to \$26 million...Limiting the additional revenue recovered by Evoenergy to \$26 million provides consumers with a benefit of \$98 million."

In light of the novel circumstances we are faced with, and the information before us, we are satisfied that accepting Evoenergy's proposal will result in an outcome that is likely to contribute to the achievement of the NEO to the greatest degree and is in the long-term interests of consumers.

Key reasons for our decision to accept Evoenergy's proposal are outlined below.

First, remaking the cost of debt constituent decision reveals a result that is consistent with the revenue that we arrived at in our 2015 final decision. Similarly, our remade opex decision is based on our 2015 final decision with the addition of redundancy costs that Evoenergy has incurred in meeting these forecast levels. This is discussed in sections 5.3.1 and 5.3.2. This result also aligns with Evoenergy's proposal that is in part premised on the revenue allowance set in our 2015 final decision. In summary:

- Evoenergy has undertaken reforms such that its opex has reduced to a level broadly in line with the opex forecasts set out in our 2015 final decision.
- Recent Tribunal and Court processes have clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt. A revenue neutral transition from the on-the-day approach to a trailing average approach is appropriate and consistent with the achievement of the allowed rate of return objective (ARORO) and will contribute to achieving the NEO.

Second, the novel circumstances we find ourselves in heightens the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.⁴⁸ Resolving the uncertainty created by the limited merits and judicial review processes in a timely manner, by expediting this remittal process where possible compared to an extended timeframe of potentially up to 18 months for a regular determination process, is supported by several consumer groups and Evoenergy (particularly in light of its 2019-24 regulatory proposal which has now been submitted to the AER).⁴⁹

If this remade draft decision becomes our final decision, it will resolve this uncertainty and addresses the crucial issue of price stability, which informs consumers of their budgetary and investment decisions on the use of electricity services. Price stability, or minimising

⁴⁸ Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

⁴⁹ For example, several participants expressed support to expedite this remittal process at the NSW and ACT remittal roundtable we held on 16 August 2017: AER, *NSW and ACT remittal roundtable summary note*, p. 4. Also, section 4 of this decision summarises the views of consumer groups on the Evoenergy remittal proposal and they have expressed similar views on this matter.

price volatility, is also in the long-term interests of consumers and is one of the primary reasons we accepted the enforceable undertakings that Evoenergy gave to us to govern prices for the 2016–17, 2017–18 and 2018–19 regulatory years.⁵⁰ It is also one of the primary reasons that, on 1 August 2017, the AEMC made a rule to avoid significant retail price fluctuations following the remaking of our decision by enabling us to allow Evoenergy to recover any additional revenues that result from remaking our decision, across both the 2014–19 and 2019–24 regulatory control periods.⁵¹

To that end, we agree with the following statement of the AEMC in its rule determination:⁵²

“A significant revenue adjustment could result from the remaking of ActewAGL’s distribution determinations for the current regulatory control period. This may lead to consumers experiencing a large network price increase or decrease between 2018–19 and 2019–20. This price volatility may lead some consumers to make inefficient budgetary decisions on energy spending, or inefficient investment decisions on the use of electricity services. The Commission has considered whether minimising price volatility would be in the long-term interests of consumers in this case.”

Third, we consider that, given the novel circumstances for this decision, a revenue allowance of \$26 million above that set in our 2015 final decision is likely to contribute to the achievement of the NEO to the greatest degree. In support of this, Evoenergy noted in its proposal that:⁵³

“This proposal is aimed at achieving an expedited resolution to the remade determination that is in the long-term interests of consumers by providing price stability and certainty and enabling Evoenergy to continue to maintain a safe, reliable and secure supply of electricity for ACT consumers.”

In coming to this revenue allowance, we have considered the following factors:

- It represents an outcome that quantifies and appropriately balances the risk and uncertainty of a protracted decision process faced by affected stakeholders, including consumers. This is in the context where stakeholders have stated a clear preference for us to remake the decision in a timely manner and to resolve uncertainty in light of the novel circumstances described above.
- It provides greater certainty and price stability for customers for the remainder of this and over the next regulatory period.⁵⁴

⁵⁰ See AER, *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2017*, 19 April 2017; and *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2018*, 21 March 2018.

⁵¹ AEMC, *Rule determination: National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017 No. 7, commencing 15 August 2017*; AEMC, *Rule determination: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - NSW DNSPs Revenue Smoothing) Rule 2017 No. 6, commencing 15 August 2017*.

⁵² AEMC, *Rule Determination: National Electricity Amendment (Participant derogation – ACT DNSP revenue smoothing) Rule 2017, 1 August 2017*, pp. 10-11.

⁵³ Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018.

<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

⁵⁴ AEMC, *Rule Determination: National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017, 1 August 2017*, p. 33.

We have given weight to the expressions of support from the ECA, ECPC, Evoenergy ECRC and CCP10 in respect of Evoenergy’s proposal. Notably, given the circumstances, each of these stakeholders considers that this revenue allowance results in an outcome that is in the long-term interests of Evoenergy’s customers.⁵⁵ For example, the CCP10 stated:⁵⁶

“CCP10 believes that the Evoenergy proposal is in the long-term interests of Evoenergy’s customers. We understand that this involves Evoenergy retaining up to \$26 million in revenue that could otherwise be returned to consumers, but this needs to be considered in the context of the overall proposal...It is our opinion that the benefits outweigh the costs, in aggregate, for consumers from this proposal.”

The implications for our control mechanism constituent decisions for the 2014-19 and 2019-24 regulatory control periods are discussed in section 5.4.1.

Overall, we consider that Evoenergy’s revenue proposal represents an efficient level of expenditure necessary for it to provide safe and reliable electricity services to its consumers. As we discussed at section 5.1.2, the approach we have applied in this remade draft decision involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of Evoenergy’s network that is in the long-term interests of consumers. In other words, the long-term interests of consumers are served by us identifying how the level of electricity supply services delivered by Evoenergy so far during the 2014-19 regulatory control period may be done prudently and efficiently, in light of consumer preferences.

As the Tribunal has previously stated:⁵⁷

“The national electricity objective provides the overarching economic objective for regulation under the Law: the promotion of efficient investment in the long-term interests of consumers. Consumers will benefit in the long run if resources are used efficiently, i.e. resources are allocated to the delivery of goods and services in accordance with consumer preferences at least cost. As reflected in the revenue and pricing principles, this in turn requires prices to reflect the long run cost of supply and to support efficient investment, providing investors with a return which covers the opportunity cost of capital required to deliver the services.”

Evoenergy’s proposal as accepted in this draft decision:

- is effectively \$124 million less than its January 2015 revised regulatory proposal on the issues of opex and the cost of debt
- represents a reduction in its opex of around 31 per cent relative to its January 2015 revised regulatory proposal (n.b. Evoenergy has incurred significant redundancy costs in

⁵⁵ Energy Consumers Australia, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 25 June 2018; Energy Consumers Policy Consortium, *Response from ACT ECPC to Evoenergy proposal regarding resolution of 2014-2019 regulatory determination*, 29 June 2018; Evoenergy Energy Consumer Reference Council, *Evoenergy 2014-2019 determination: remittal proposal*, 27 June 2018; Consumer Challenge Panel, *Evoenergy 2014–19 revenue allowance remittal proposal*, 21 June 2018.

⁵⁶ Consumer Challenge Panel, *Evoenergy 2014–19 revenue allowance remittal proposal*, 21 June 2018.
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

⁵⁷ *Application by ElectraNet Pty Limited (No 3)* [2008] ACompT 3, [15].

the first three years of the 2014-19 regulatory period to downsize its workforce and achieve this lower level of opex.)

We note that Evoenergy has made the commitment that its actual opex for 2017-18 (which will be at or below our 2015 final decision) will form the base year for its opex forecast for the 2019-24 regulatory control period.⁵⁸

5.3 Remaking the constituent decisions for operating expenditure, return on debt and service target performance incentive scheme

The Tribunal's directions that we are to comply with in remaking our decision for Evoenergy are as follows:⁵⁹

- (a) the AER is to make the constituent decision on opex under r 6.12.1(4) of the National Electricity Rules in accordance with these reasons for decision including assessing whether the forecast opex proposed by the applicant reasonably reflects each of the operating expenditure criteria in r 6.5.6(c) of the National Electricity Rules including using a broader range of modelling, and benchmarking against Australian businesses, and including a 'bottom up' review of ActewAGL's forecast operating expenditure;
- (b) the AER is to make the constituent decision on the service target performance incentive scheme in the light of such variations as are made to the Final Decision by reason of (a) hereof;
- (c) the AER is to make the constituent decision on return on debt in relation to the introduction of the trailing average approach in accordance with these reasons for decision;
- ...
- (d) the AER is to consider, and to the extent to which it considers appropriate to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 16(1)(d) of the National Electricity Law in the light of such variations as are made to the Final Decision by reason of (a)-(c) hereof."

In the context of the Evoenergy decision, the Tribunal also noted that:⁶⁰

"...as the Tribunal has concluded that the opex fixed by the AER exposes the grounds of review referred to above, one of the foundations or reference points from which the AER based its decision on STPIS is flawed.

In that circumstance, the Tribunal considers that the STPIS determination by the AER is also flawed. As the Tribunal has also decided that it should remit the ActewAGL Final Decision to the

⁵⁸ Evoenergy, *Proposal for the remittal of Evoenergy's 2014-19 determination*, 24 July 2018.

<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

⁵⁹ Australian Competition Tribunal, *Application by ActewAGL Distribution [2016] ACompT 4*, 26 February 2016. Note direction (d) is omitted following the Court's decision in relation to gamma: *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [738]-[784].

⁶⁰ *Application by ActewAGL Distribution [2016] ACompT 4*, paras 53-55.

AER (see below) for the same general reasons as expressed in the *PIAC-Ausgrid Decision*, it is appropriate that this element of the ActewAGL Final Decision should also be set aside.

There is an interrelatedness between opex and the form of the STPIS, although not a directly linear one. However, it is sufficiently direct to require the STPIS element of the ActewAGL Final Decision to be set aside and reconsidered at the same time as the AER reconsiders and potentially resets the opex allowance for ActewAGL.”

The rules in the NER and provisions in the NEL that govern our assessment of operating expenditure, STPIS and debt remain unchanged on remittal.

In the following sections, we set out our remade constituent decisions for opex, the cost of debt and STPIS, as well as the implications for our control mechanism constituent decisions for the 2014-19 and 2019-24 regulatory control periods.⁶¹

5.3.1 Operating expenditure constituent decision

Operating expenditure (opex) refers to operating, maintenance and other non-capital expenses. Forecast opex for prescribed distribution services is one of the building blocks that typically make up a service provider’s total revenue requirement.

In our April 2015 final decision, we estimated Evoenergy’s total forecast opex of \$240.6 million (\$2013-14) over the 2014-19 regulatory control period. This was \$130.6 million lower than Evoenergy’s revised proposal of \$371.2 million (\$2013-14).

In making our 2015 final decision, we found that the actual opex incurred by Evoenergy in its proposed base year of 2012-13 was materially greater than what a prudent and efficient network service provider would incur in delivering safe and reliable network services to customers. As a result, Evoenergy’s actual opex for this year could not be used as a basis to forecast opex for the 2014-19 regulatory control period.

Consistent with the NER, we substituted a lower base opex amount as the starting point of our substitute estimate for the 2014-19 regulatory control period.⁶² We relied on one of our economic benchmarking models (the Cobb Douglas Stochastic Frontier Analysis (SFA) model), with appropriate adjustments to estimate our substitute base opex amount. We also noted that, based on the information available to us at the time, any costs incurred by Evoenergy in transitioning from its actual higher level of opex to a lower level could not be included as part of an opex forecast that reasonably reflected the opex criteria.

The Tribunal found that our decision to reject Evoenergy’s opex forecast was not in error. However, the Tribunal did determine that we erred in the emphasis we placed on the Cobb Douglas SFA benchmarking model in arriving at our substitute estimate. This decision was subsequently upheld by the Federal Court.

⁶¹ At the same time as releasing this remade decision, we have released a separate adjustment determination decision for Evoenergy that has relevance to both 2014-19 and 2019-24 regulatory control periods. In the adjustment determination, we determine a metering variation amount that corrects a previously made error in the calculation of Evoenergy’s metering opex allowance. See AER, *Draft Decision Evoenergy adjustment determination*, September 2018.

⁶² NER, cl. 6.5.6(d) and 6.12.1(4)(ii).

As the Tribunal refers to in its directions, we must remake our opex decision under clause 6.12.1(4) of the NER. This means we must either accept a distributor's proposed opex forecast, or reject it and determine our own substitute estimate.

Clause 6.5.6 of the NER sets out the opex objectives, opex criteria and opex factors, under which we must make our constituent decision on opex. In summary, we must identify a level of forecast opex that is efficient and prudent and at a level that sustainably maintains the safety and reliability of the network in the long-term interests of consumers.

Evoenergy proposes to accept our 2015 final decision opex forecast, with the addition of the labour redundancy costs it has actually incurred in reducing its opex:⁶³

“In the interests of an expedited resolution on opex, Evoenergy proposes to accept the AER's final determination on opex for SCS with the addition of redundancy expenses. Evoenergy's understanding of the AER's issues paper is that, given the principles and remarks made by the Tribunal and the Federal Court, the AER would reconsider its approach to transition costs for the purposes of the remade determination.”

Evoenergy's proposal states that the inclusion of redundancy expenses will result in an increase to our 2015 final decision opex forecast of \$20.9 million (\$2018-19), or 6 per cent, over the 2014-19 period.⁶⁴

Our assessment has been informed by the Tribunal's directions to us, and the new and updated information available to us since our 2015 final decision (in particular, Evoenergy's actual and estimated opex for the current regulatory period). We have also been informed by our extensive consultation with Evoenergy and consumer representatives. This consultation has included:

- a stakeholder roundtable in August 2017
- the publication of an Issues Paper in October 2017
- submission to the Issues Paper received in November 2017
- letters of support from consumer representatives to Evoenergy's remittal proposal

In the context of all the information available to us, our remade opex forecast consists of two components:

- an estimate of a prudent and efficient level of recurrent (or underlying) opex that Evoenergy would need for the safe and reliable provision of electricity services — see section 5.3.1.1
- an estimate of the non-recurrent costs (including transition costs), if any, above this level of underlying opex that can be considered efficient and prudent costs consistent with the opex criteria — see section 5.3.1.2

For the reasons set out in these sections, we are satisfied that Evoenergy's proposed opex forecast is consistent with the opex criteria. Table 5-1 sets out this opex forecast.

⁶³ Evoenergy, *Proposal for remittal of Evoenergy's 2014-19 determination*, 24 July 2018, pp. 4-5

⁶⁴ *Ibid.* p. 5.

Table 5-1 AER 2014-19 remade draft decision opex forecast (\$million, 2013–14)

	2014-15	2015–16	2016–17	2017–18	2018–19	Total
Opex forecast	61.52	46.60	48.41	48.90	50.30	255.72

5.3.1.1 Our assessment of recurrent opex for 2014-19

This section provides our view on the prudent and efficient level of recurrent (or underlying) opex that Evoenergy would need for the safe and reliable provision of electricity services over the 2014-19 period.

In reaching our view, we have primarily relied on Evoenergy's actual costs over the first three years of the 2014-19 regulatory control period and its opex estimates for the last two years. This information was not available to us at the time of our 2015 final decision or the Tribunal and Federal Court decisions. Specifically, we examine changes in Evoenergy's opex over time and compare its actual and forecast opex over 2014-19 to its original 2012-13 base year. This provides information on the extent to which the efficiency of Evoenergy's opex has increased or decreased over the 2014-19 regulatory control period.⁶⁵

The revealed data shows that Evoenergy achieved significant reductions in opex between 2012-13 and 2016-17. This was driven primarily by a restructuring program that saw Evoenergy decrease its workforce by 133 full-time equivalent staff (FTEs). Evoenergy's opex between 2015-16 and 2018-19 is consistent with (or below) our opex forecast set in our 2015 final decision, and Evoenergy expects that it will be able to sustain these savings into the next regulatory period.⁶⁶ To this effect, it has proposed its 2017-18 opex estimate as the base year for its 2019-24 revenue forecast.⁶⁷

Evoenergy appears to have responded to the strong incentives imposed by the regulatory regime and use of economic benchmarking.

Having regard to the Tribunal's directions, we have cross-checked the above finding using two supplementary tools to test the efficiency of Evoenergy's revealed opex. These are:

- Benchmark modelling of Evoenergy's actual opex for 2016-17 and opex forecast for 2017-18. This shows that Evoenergy's opex up until 2017-18 represents a significant improvement in opex productivity relative to 2012-13 and to that of the other networks' productivity levels as measured in 2016.
- Category level cost analysis that examines some of the underlying reasons for Evoenergy's reductions in opex since 2012-13. This shows that Evoenergy has made significant reductions in various cost categories, namely labour costs, vegetation expenditure, maintenance costs and overheads.

⁶⁵ In 2015, we found that Evoenergy's 2012-13 opex (proposed as its base year for the 2014-19 period) was materially inefficient and the Tribunal found this decision was not in error in its 2016 decision.

⁶⁶ Evoenergy, *Regulatory proposal 2019-24, Attachment 6: Operating Expenditure*, January 2018, p.6-2.

⁶⁷ *Ibid.* p.6-9.

Taken together, this supplementary analysis shows that Evoenergy's revealed opex is not materially inefficient when compared to its peers.

Below we outline our consideration of Evoenergy's proposed opex using the revealed costs information, benchmarking results and category level costs analysis.

Revealed and forecast costs

This section examines Evoenergy's revealed costs between 2012-13 (its proposed base year for its 2014–19 revenue proposal) and 2018-19 (the end of the regulatory period).

As outlined in our Expenditure Assessment Forecast Guideline, our preferred approach for forecasting opex is to use the revealed cost approach.⁶⁸ This is because opex is largely recurrent and stable at a total level between regulatory periods. Underpinning this revealed cost approach is the incentive-based regulatory regime established in Chapter 6 of the NER. Incentive regulation is designed to encourage network businesses to improve their efficiency over time. Where a distributor is responsive to the financial incentives under the regulatory framework, the actual level of opex it incurs should provide a good estimate of the efficient costs required for it to operate a safe and reliable network and meet its relevant regulatory obligations. So long as we do not identify any material inefficiency in a distributor's revealed costs or a change in the costs associated with the business' operating environment,⁶⁹ our preference is to rely on revealed costs in assessing the distributor's proposed opex forecast, and if necessary, in determining a substitute estimate.⁷⁰

At our stakeholder roundtable meeting in August 2017, the distribution businesses stated they had faced a very strong incentive to reduce costs over the current 2014–19 regulatory control period given that our opex forecasts were significantly below the businesses' actual costs at the start of the period.⁷¹

Figure 5-1 suggests that Evoenergy has responded to the strong incentives imposed by the regulatory regime and use of economic benchmarking. Since our 2015 final decision, Evoenergy had made substantial inroads in reducing costs. Between 2014-15 and 2015-16, Evoenergy reduced its opex by 45 per cent. This significant reduction meant that its opex in 2015-16 and 2016-17 was below the opex forecast we set in the 2015 final decision. For 2017-18, Evoenergy estimates that its opex will be consistent with the 2015 final decision forecast.

⁶⁸ AER, *Better Regulation, Expenditure Forecast Assessment Guideline for Electricity Distribution*, November 2013, p.31.

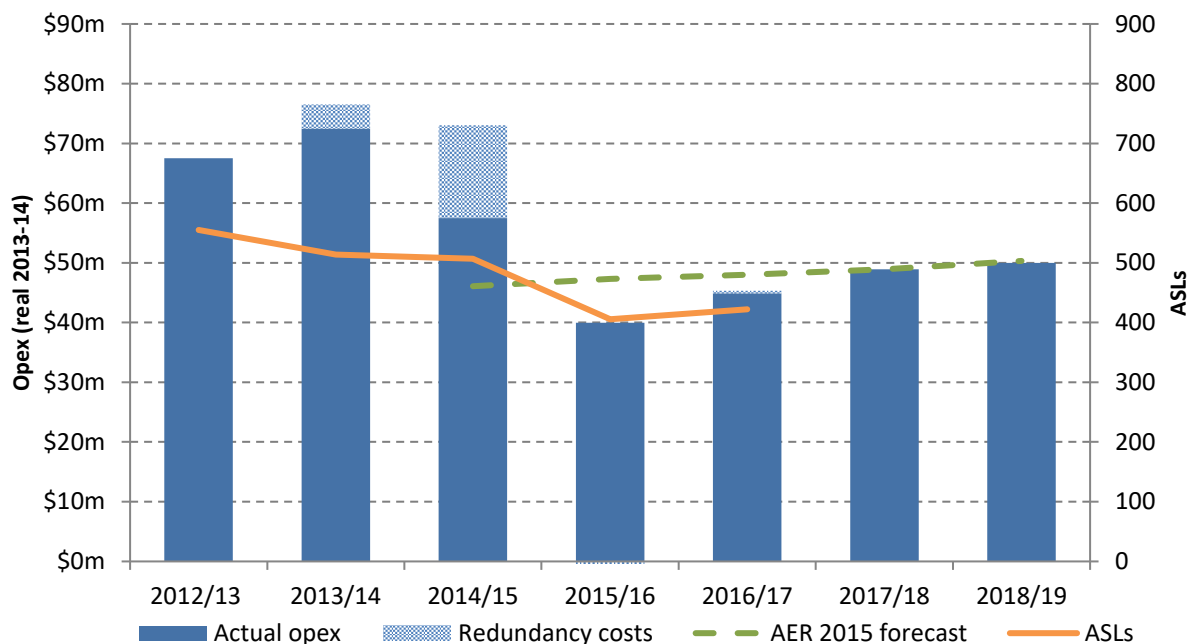
⁶⁹ Step changes provide for increases where this is not the case.

⁷⁰ AER, *Better Regulation, Expenditure Forecast Assessment Guideline for Electricity Distribution*, November 2013, p.22.

⁷¹ AER, *NSW and ACT remittal roundtable (16 August 2017) summary note*, August 2017:

<https://www.aer.gov.au/communication/aer-hosts-nsw-act-electricity-distribution-network-revenue-roundtable>

Figure 5-1 Evoenergy's opex, AER forecast opex in 2015 final decision, including movements in average staffing levels (ASLs)



Source: AER 2015 final decision; Evoenergy Annual RIN; Evoenergy 2019-24 regulatory proposal; Annual reports.

Note: Actual opex has been normalised by excluding metering and ancillary costs prior to 2014–15. Opex in 2017-18 and 2018-19 are estimates taken from Evoenergy's 2019-24 regulatory proposal opex model and regulatory RIN. Evoenergy's estimate for 2018-19 includes additional opex related to its proposed opex step-change for new vegetation management obligations within its 2019-24 proposal. For the purposes of this chart, we have removed this additional vegetation management opex because it relates to new obligations that were not in place at the time of our 2015 final decision and the AER has yet to publish a decision on Evoenergy's 2019-24 regulatory proposal.

In its proposal, Evoenergy outlines that it has achieved efficiency savings through:⁷²

- an extensive restructuring of the workforce including redundancies
- re-engineering and asset optimisation to reduce the program of works
- savings on vegetation management using new light detection and ranging (LiDAR) technology and improved contractual arrangements
- investment in systems technology to drive smarter operation of the network, including improvements in automation and asset management practices
- a reduction in overtime and staff training

While the significant reduction in opex in 2015-16 and 2016-17 (to levels below our 2015 final decision targets) has impacted reliability performance in the short term, Evoenergy states that its efficiency savings are sustainable and at a level that will not compromise safety and reliability going forward.⁷³

⁷² Evoenergy, *Proposal for remittal of Evoenergy's 2014-19 determination*, 24 July 2018, p. 2-3

⁷³ Evoenergy, *Regulatory proposal 2019-24, Attachment 6: Operating Expenditure*, January 2018, p. 6-2.

Evoenergy submits that its redundancy program was most critical to achieving the lowest possible operating expenditure for the 2014-19 period while achieving the operating expenditure objectives. It states:⁷⁴

“While Evoenergy implemented a broad program of transformation across the business, it is the workforce restructure that delivered the most significant and immediate cost savings. Without the workforce restructure, the transformation program would not have delivered the savings required to move to the significantly lower levels of operating expenditure incurred in the 2014-19 period, nor would it have guaranteed that resources were focused on the areas of the business necessary to maintain the safety and reliability of the network and therefore would not have reflected the efficient and prudent costs of achieving the opex objectives.”

This workforce restructuring is evident in Figure 5-1, which shows that Evoenergy incurred redundancy costs between 2013-14 and 2016-17. This contributed to Evoenergy reducing its average staffing levels by 24 per cent between 2012-13 and 2016-17.

These results lend support to our 2015 final decision opex forecast, which forms the basis of Evoenergy’s overall proposal, as being an efficient level of opex that reasonably reflects the opex criteria. This is further supported by statements from Evoenergy’s regulatory proposal for the 2019-24 period, which states that it will be able to sustain this lower level of opex into the 2019-24 regulatory control period:⁷⁵

“The 2019-24 regulatory control period will see Evoenergy consolidate the efficiencies achieved and continue its evolution as it adapts to the ongoing and dynamic National Electricity Market reforms and technological advancements driving industry change for all market participants. This continuous efficiency drive will be achieved while maintaining the quality, reliability and security of supply of SCS to its customers, and Evoenergy’s forecast opex reflects efficient costs.”

In the following sections, we test these findings with benchmarking and bottom-up analysis. This responds to the Tribunal’s directions to us as part of the remittal.

Benchmarking analysis

The Tribunal directed us to use a broader range of modelling, and benchmarking against Australian businesses in remaking our opex constituent decision.⁷⁶ This was in the context of the approach taken in our 2015 final decision, which relied on a specific benchmarking technique (the Cobb Douglas SFA econometric model) as a tool for determining the level of efficient base opex for our forecast.

We acknowledge the Tribunal’s directions, however under these novel circumstances it is not practical to revise our economic benchmarking analysis in time to support the remaking of our opex decision. The benchmarking techniques and data we utilised in our 2015 final decision were developed following an extensive public consultation process as part of our Better Regulation program during 2013. Any substantive revisions would therefore involve a considerable amount of re-development work and time to consult with industry, consumer groups and other interested stakeholders, further delaying resolution of all outstanding remittal-related matters for Evoenergy.

⁷⁴ Evoenergy response to AER information request, 13 July 2018, p. 3

⁷⁵ Evoenergy, *Regulatory proposal 2019-24, Attachment 6: Operating Expenditure*, January 2018, p.6-2.

⁷⁶ *Application by ActewAGL Distribution [2016] ACompT 4*, direction 1(a).

At our stakeholder roundtable meeting in August 2017, a number of stakeholders agreed there is a significant role for benchmarking in network regulation and supported its further development. At the meeting, stakeholders also expressed a clear preference for us to remake our decisions in a timely manner and recognised that revisiting our benchmarking would not be possible without further delaying the remaking of our opex decisions.⁷⁷

We now also have available to us a range of revealed and forecast cost data — Evoenergy’s actual opex for the first three years of the 2014-19 regulatory control period and its opex targets for the last two years — which we have primarily relied on in remaking our opex decision. This data was not available to us at the time of our 2015 final decision, nor the Tribunal and Federal Court decisions.

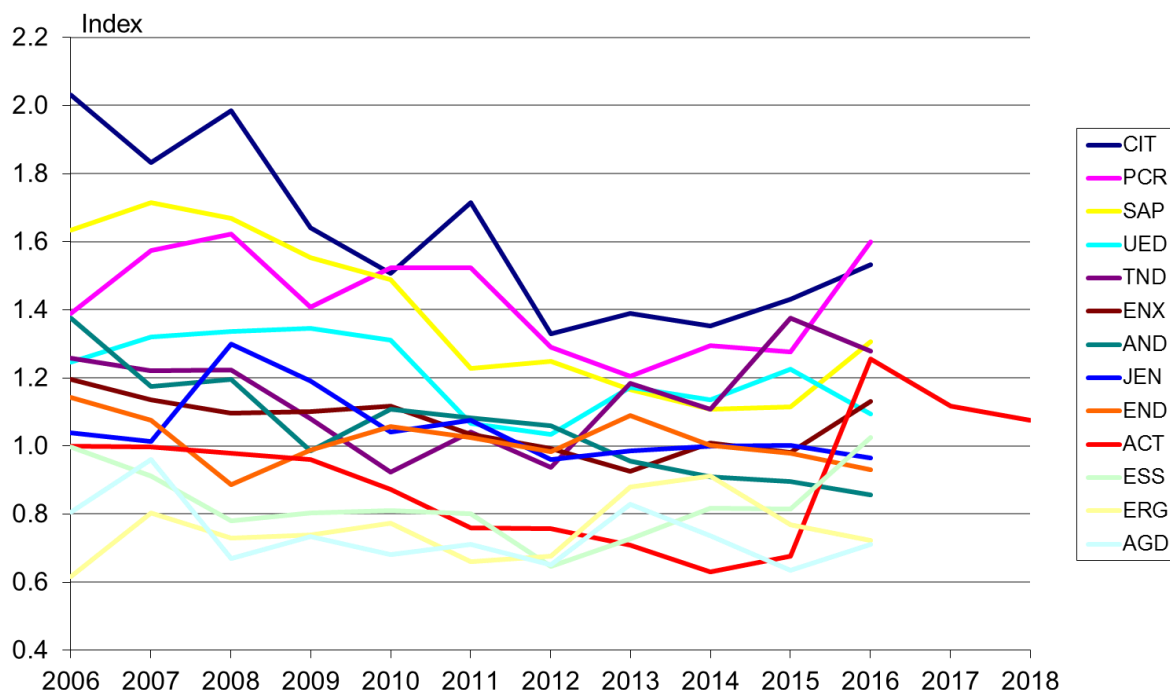
To address the Tribunal’s direction in the context of the remittal, we have used benchmarking analysis, beyond the Cobb Douglas SFA model, updated with new data and applied it to test the efficiency of Evoenergy’s revealed opex (specifically, multilateral total and partial factor productivity). More detail about these economic benchmarking techniques are set out in our annual economic benchmarking reports.⁷⁸

Figure 5-2 compares Evoenergy’s opex multi-lateral partial factor productivity (MPFP) (the red line) to its own performance and that of other networks over time. The chart uses Evoenergy’s actual opex up to 2016-17 and opex forecasts for 2017-18, and results for all other networks up until 2016 (from our most recent published benchmarking report).

⁷⁷ Consumer stakeholders have expressed support for ongoing use of benchmarking and we are committed to refining our benchmarking tools.

⁷⁸ AER, *Annual benchmarking report— Electricity distribution network service providers*, November 2017. Available at <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/annual-benchmarking-report-2017>

Figure 5-2 Distribution Network Service Provider Opex Multi-lateral Partial Productivity for FY2006-2016, with Evoenergy forecast to FY2018



Source: Economic Insights 2018

Note: Evoenergy (formerly known as ActewAGL) is denoted by "ACT" in the legend above.

This shows that Evoenergy had improved its opex productivity since the beginning of the 2014-19 regulatory control period. Between 2014-15 and 2015-16, Evoenergy improved its measured opex productivity from the second worst within the National Electricity Market (NEM) to the fifth best, in a single year. This coincides with the 45 per cent reduction in opex, as shown in Figure 5-3.

According to Evoenergy, these significant reductions caused some deterioration in network reliability which adversely impacted its reliability performance.⁷⁹ In 2016-17 and 2017-18 (as currently estimated), Evoenergy increased its opex year-on-year. This led to a corresponding change in its in opex productivity and, by 2017-18, Evoenergy is estimated to be ranked 7th amongst distribution network service providers (DNSP) in the NEM.

Notwithstanding these later reductions in Evoenergy's opex productivity, Evoenergy has significantly improved its opex productivity since 2012-13 and is now amongst the middle group of efficient networks in terms of opex efficiency. While these MPFP results do not account for some differences in operating environment factors, Evoenergy's improvement in productivity suggests that it is no longer materially inefficient.

⁷⁹ Evoenergy, submission to AER opex issues paper, p. 3

Opex category analysis

The Tribunal and the Court did not specify what form of bottom-up assessment we need to undertake in remaking our opex decision. The Court stated that the issue of what form and scope of bottom-up review is a matter for us to consider.

Generally, a bottom-up approach involves a detailed review that assesses discrete opex projects, items or categories of opex, involving reliance on engineering and managerial expertise, economic analysis, or more granular forms of benchmarking (for example, at the category analysis level). In order to assess whether the total opex forecast is consistent with the NER requirements, aggregating the relevant items is necessary.

Where, based on the available evidence, the revealed costs of a distributor are likely to reflect a prudent and efficient level of opex that meets the opex criteria, and is at a sustainable level that will maintain the safety and reliability of services in the long-term interests of consumers, any bottom-up assessment warranted may be minimal in scope and nature. In cases where the revealed costs do not reflect a prudent and efficient level of opex that meets the opex criteria, we may undertake more comprehensive and detailed bottom-up assessments.

In addition to the available revealed costs and benchmarking information, we have examined some of Evoenergy's major opex categories. This is a limited form of bottom-up analysis that examines some of the underlying drivers for its reductions in total opex since 2012-13.⁸⁰

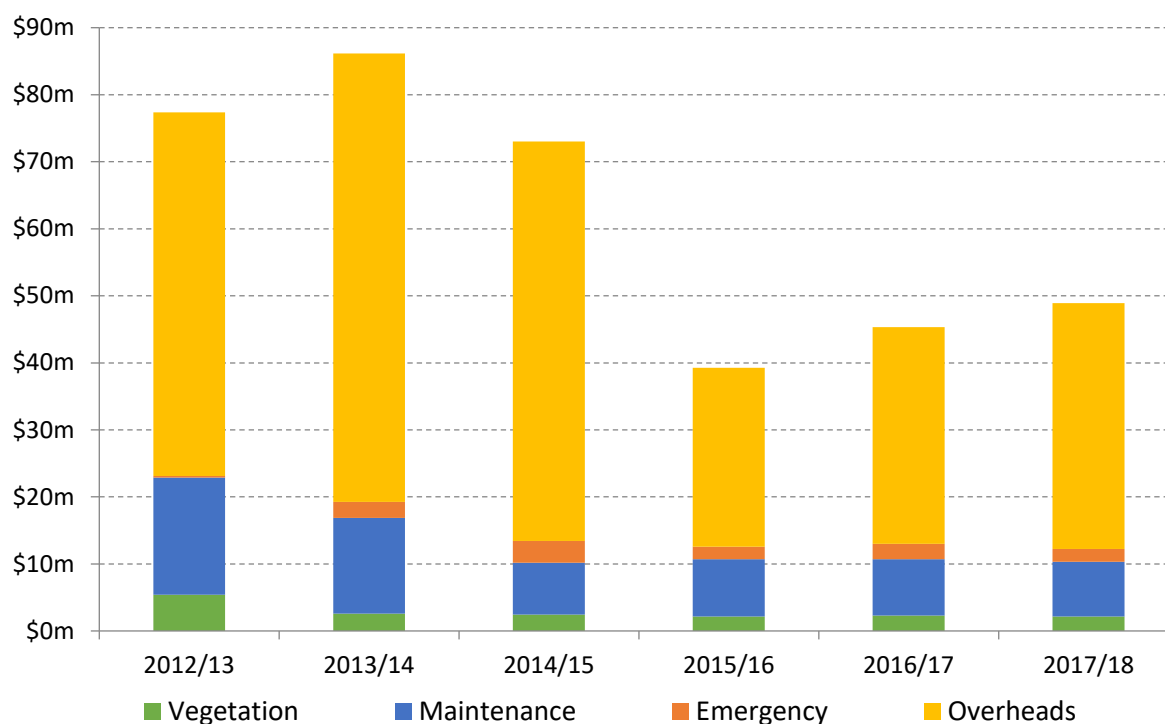
Figure 5-3 shows the breakdown of Evoenergy's major opex cost categories. Since 2012-13 (our 2015 final decision base year), there have been reductions across all of its major cost categories. Between 2012-13 and 2016-17, it has made the following opex reductions:

- vegetation management (excluding allocated overheads) reduced by 60 per cent
- maintenance costs reduced by 53 per cent
- total overheads reduced by 32 per cent

Evoenergy's emergency services opex has increased from \$0.20 million (\$2013-14) in 2012-13 to \$1.94 million (\$2013-14) in 2016-17. This is potentially driven by Evoenergy's reduction in overall maintenance costs, which may necessitate more reactive maintenance during outages and emergency situations.

⁸⁰ At our remittal stakeholder roundtable meeting in August 2017, a number of stakeholders noted there may need to be a greater emphasis on detailed reviews in key opex areas such as labour and vegetation management costs. AER, *NSW and ACT remittal roundtable (16 August 2017) summary note*, August 2017.

Figure 5-3 Evoenergy's opex cost breakdown (real \$2013-14)



Source: Evoenergy Category Analysis RIN; Reset RIN; AER analysis.

In our 2015 final decision, we found Evoenergy was not efficient in the cost categories of labour costs and vegetation management. Since that time, it has made significant reforms in these operating areas.

First, Evoenergy has improved the efficiency of its labour costs since 2012-13. In our 2015 final decision, we found Evoenergy had higher than efficient labour costs.⁸¹ In our view at the time, the primary reasons for its high labour costs were:⁸²

- Large increases in the number and cost of permanent employees leading up to and during the 2009-14 period. We found that this was influenced by Evoenergy's strategy towards using internal labour compared to outsourcing.
- Ineffective work practices, processes and systems lead to the inefficient use of labour in the office and field.

Evoenergy undertook an extensive restructuring process, reducing its average staff level from 555 to 422 between 2012-13 and 2016-17. As such, it has also incurred significant redundancy costs between 2013-14 and 2014-15, as shown in Figure 5-1. We examine Evoenergy's redundancy costs in more detail in section 5.3.1.2. Evoenergy also implemented new labour and asset management strategies to reduce operating costs (as outlined previously).

⁸¹ AER, *Final decision ActewAGL distribution determination 2015–16 to 2018–19, Attachment 7 – Operating Expenditure*, April 2015, pp. 7-54 and 7-55.

⁸² *Ibid.* pp. 7-146.

Secondly, Evoenergy has reduced its vegetation expenditure and changed its vegetation management practices. In our 2015 final decision, our review of Evoenergy's vegetation management practices indicated two primary reasons for inefficiency that might exist in 2012-13:⁸³

- primarily engaging contractors on an hourly rate basis, rather than a work volume basis
- a lack of prudent operational risk management, resulting in a largely reactive approach to maintaining vegetation

As observed in Figure 5-3, Evoenergy has reduced its vegetation management costs (excluding allocated overheads) by 58 per cent between 2012-13 and 2016-17.⁸⁴ Evoenergy states that it has improved its vegetation contract procurement procedures since 2014 when it moved from a per hour basis to a fixed price contract. This has reduced overall trimming costs by 50 per cent.⁸⁵ It also states that it has reduced its vegetation management costs through the use of new technology (LiDAR).⁸⁶

The reforms Evoenergy has made to these costs categories provide further supporting evidence, in addition to economic benchmarking, that its revealed total opex is no longer materially inefficient.

5.3.1.2 Our assessment of non-recurrent efficient costs

In remaking our opex decision, we must also consider what costs, if any, above our forecast level of underlying opex can be considered efficient and prudent costs consistent with the opex criteria. We will include these costs in our overall opex forecast.

In its proposal, Evoenergy proposes to accept our 2015 final decision on opex, with additional revenues of \$20.9 million (\$2018-19) to account for redundancy expenses.⁸⁷ Evoenergy's remittal proposal also submits:⁸⁸

"Evoenergy's understanding of the AER's issues paper is that, given the principles and remarks made by the Tribunal and the Federal Court, the AER would reconsider its approach to transition costs for the purposes of the remade determination."

Our position in this draft decision is that we are satisfied that a forecast opex allowance for the 2014-19 regulatory control period which includes Evoenergy's proposed \$20.9 million (\$2018-19) for labour redundancy costs reasonably reflects the opex criteria. In coming to this position, we have taken into account the opex factors and the RPP, the Tribunal's

⁸³ AER, *ActewAGL draft decision Attachment 7: Operating expenditure*, November 2014, p. 7-47.

⁸⁴ These vegetation management costs are based on Evoenergy's scope of responsibilities prior to it assuming responsibility of vegetation clearing on unleased land in urban areas of the ACT and the inspection of private poles on rural leased properties from 1 July 2018 under the *Utilities (Technical Regulation) Act 2014* (ACT).

⁸⁵ Evoenergy, response to AER information request 21, 7 May 2018, p.7.

⁸⁶ Evoenergy, *Regulatory Proposal 1 July 2019 to 30 June 2024– Attachment 6: Operating expenditure*, January 2018, p.6-8.

⁸⁷ Evoenergy, *Proposal for remittal of Evoenergy's 2014-19 determination*, 24 July 2018, p.5.

⁸⁸ *Ibid.*

directions and reasons, and the new information about Evoenergy's costs that are now available to us.⁸⁹

In undertaking our assessment, we have considered two things:

- First, we have considered whether these redundancy costs are of the kind that a prudent operator would incur and could be included in a forecast opex allowance. Our position is that, in the circumstances, this is the case.
- Secondly, we examined whether the quantum of redundancy costs is efficient and prudent such that they reasonably reflect the opex criteria. On the basis of the information available to us, these amounts incurred by Evoenergy appear to be efficient.

We recognise that our position in this draft decision appears to be a departure from that in our 2015 final decision. Our position in the NSW and ACT 2015 final decisions, as well as before the Tribunal and Court, was that transition costs (such as the costs of making redundancy payments to reduce labour levels and terminating contracts early) cannot be provided as part of an opex allowance that reasonably reflects the opex criteria.⁹⁰

In the 2015 final decision for Evoenergy, we stated:⁹¹

“As outlined in the [Expenditure Forecast Assessment] Guideline, if the prudent and efficient opex allowance to achieve the opex objectives is lower than a service provider's current opex, we would expect a prudent operator would take the necessary action to improve its efficiency and prudence. We would expect a service provider (including its shareholders) to bear the cost of any inefficiency or imprudent actions. To do otherwise, would mean electricity network consumers would fund some costs of a service provider's inefficiency or imprudent actions.

Accordingly, if our opex forecast is lower than a service provider's current opex we would generally not consider it open to us to provide a transition path to the efficient allowance. This approach is reflected in the NER, which provides that we must be satisfied that the opex forecast reasonably reflects the efficient costs of a prudent operator given reasonable expectations of the demand forecast and cost inputs to achieve the expenditure objectives.”

Underlying this position was our view that in identifying the outcome that best achieves the NEO, it is important to recognise that in-principle, the regulatory framework under Chapter 6 of the NER distinguishes between those operations and costs which are endogenous to, or within the control of, the regulated business from those which are not and exogenous. This recognises that the risks associated with matters that are endogenous to a regulated business are best managed and borne by the regulated business, not consumers. In general, we maintain this in-principle view of how the regulatory framework operates, and the way in which this affects how we should continue to discharge our functions and powers.

⁸⁹ NER, cl 6.5.6(c) and 6.5.6(e); NEL, ss 7A(2)(a) and 7A(3).

⁹⁰ AER, *Final decision, ActewAGL distribution determination 2015–16 to 2018–19, Attachment 7 – Operating expenditure*, April 2015, pp. 7-40–7-46.

⁹¹ *Ibid.* pp. 7-21.

The facts before us at the time of the 2015 final decision did not support a conclusion that not providing a transition would deprive a distributor of recovering at least its efficient costs or would put at risk the operation of the network and give rise to safety and reliability concerns.

However, two intervening events have since occurred which now means that this draft decision departs from our position in the 2015 final decision:

- first, the Tribunal’s direction to reconsider these costs, the subsequent Full Federal Court case and the merits and judicial review cases concerning SAPN Power
- secondly, we now have information on Evoenergy’s actual performance for the first three of the five regulatory years of the 2014-19 regulatory control period

The Tribunal did not accept our position on transition in the 2015 final decision. Specifically, the Tribunal concluded:⁹²

“Due to the Tribunal’s findings on opex, the Tribunal does not, in the circumstances, need to determine whether these contentions by Networks NSW, ActewAGL and Ergon are correct. When the AER revisits and redetermines the opex allowance, it will have to consider the costs involved in transitioning. It will do so at a time, and in relation to revenue streams, which will require it to make a fresh decision. The Tribunal is anxious not to inhibit the AER at this point in exercising its discretion in that regard.”

The Tribunal’s position, which was subsequently upheld by the Full Federal Court, and read in light of the recent merits and judicial review cases concerning SAPN Power, has identified three findings that are now relevant to remaking our opex decision and the consideration of non-recurrent transition costs.

First, whether a decision, such as agreeing to an enterprise bargaining agreement (EBA or EA), is an endogenous managerial decision of a distributor, or exogenous and not within the control of the distributor, does not itself determine whether a transition path allowance should be provided to allow a distributor to recover a particular kind of cost. It is simply one consideration that must be taken into account in light of all the available before us. This follows from the Tribunal’s position to not accept our use of the Cobb Douglas SFA model and our reasons to not provide transition costs on the basis that they were an endogenous managerial decision. To this end the Tribunal stated:⁹³

“As Networks NSW submit, Ausgrid, Essential and Endeavour are bound by the EBAs and remain bound by them and they should not be viewed as an endogenous managerial choice. At least not in circumstances where the AER has quite radically shifted from an itemised bottom-up approach to assessing opex to benchmarking total opex per se – particularly where that benchmarking has not been exposed to the rigors of the consultation the NEL and NER envisage for such a radical change.

⁹² *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1, [494].

⁹³ *Ibid.* [434] and [436].

... having regard to the regulatory prescriptions, the Tribunal does not accept that it may, by the use of the EI model, simply select the measurement of efficiency which it did in this respect without regard to the obligations under the EBAs as they presently exist. Over time, and probably during the new current regulatory period, any such inefficiencies as the AER considers to exist may progressively be reduced by the reduction in employee numbers to what the AER considers to be the efficient number, and any allowances under the EBAs (as they expire) which the AER considers to be inefficient may also by the same elapse of time be reduced to an efficient level.”

The Tribunal’s position was subsequently confirmed by the Full Federal Court and the Tribunal again in the merits review case concerning SAPN Power.⁹⁴ Specifically, the Full Federal Court stated:

“The Tribunal went on to consider the AER’s conclusion that the EBAs were endogenous and, therefore, to be ignored. The Tribunal rejected an approach that simply characterised an obligation as endogenous and to be ignored or as exogenous and to be considered, and said that a closer analysis was required. We think this was what the Tribunal was saying when it referred to the pressure placed on the NSW service providers by the Ministerial licence conditions and their response to it and, that that having happened, to the Fair Work Act being an exogenous factor. Leaving aside precisely what is meant by an endogenous matter and exogenous matter, we do not think that the Tribunal erred in finding error in this approach of the AER. The distinction might be a useful one, but it should not be used in a way which precludes an examination of all the facts and circumstances.”

Secondly, an EBA agreed to under the *Fair Work Act 2009* (Cth) is not an instrument that constitutes a “regulatory obligation or requirement” under the NEL. It follows that recovery of wage increases and redundancy payments, solely by complying with the terms of an EBA is not a sufficient reason for those costs to form part of an opex allowance. This question of whether an EBA agreed to under the *Fair Work Act 2009* (Cth) is a “regulatory obligation or requirement” was considered by the Tribunal. But as the Full Federal Court confirmed later, this was not decided by the Tribunal.⁹⁵ In any case, the recent cases of merits and judicial review cases involving SAPN Power have confirmed that an EBA, for the reason that it does not materially affect the provision of standard control services, is not a regulatory obligation or requirement under the NEL.⁹⁶

Finally, we note the finding of the Tribunal and the Full Federal Court in the merits and judicial review cases concerning SAPN Power that compliance with an EBA is not necessary to “maintain the safety of the distribution system through the supply of standard control services” in accordance with clause 6.5.6(a)(2) of the NER. The Full Federal Court stated:⁹⁷

⁹⁴ *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [370]; *Application by SA Power Networks* [2016] ACompT 11, [541] and [542].

⁹⁵ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1, [427]; see also *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [367]; and *Application by SA Power Networks* [2016] ACompT 11, [528].

⁹⁶ *Application by SA Power Networks* [2016] ACompT 11, [521]-[529]; and *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3, [385].

⁹⁷ *Application by SA Power Networks* [2016] ACompT 11, [545]; and *SA Power Networks v Australian Competition Tribunal*

“First, the provision still requires that SAPN demonstrate that the EA is necessary to ‘maintain the safety of the distribution system through the supply of standard control services’. As explained in the earlier consideration of cl 6.5.6(a)(2) and s 2D, there must be a direct connection between the EA and the delivery of standard control services. That connection is the labour employed to deliver those services, not the mechanism chosen to provide that labour.”

We must now decide the transition cost question in light of all the information available to us.⁹⁸ Since our 2015 final decision, a range of new and updated information on the actual operation of Evoenergy’s redundancy and restructuring program is available. This includes the types and quantity of transition costs incurred over the first three years of the 2014-19 regulatory control period. It also includes information on how Evoenergy has actually managed voluntary and involuntary redundancies. In addition, we have the Tribunal and Full Federal Court decisions and associated reasoning and commentary that will guide us in reconsidering and remaking our opex decision. Finally, we also have recent submissions from consumer representative groups on the issue of transition costs and redundancies.

The approach we have applied in considering transition costs and in remaking this draft decision has also been influenced by the novel circumstances that we face now. As noted earlier, these circumstances materially differ to what we faced when we made our 2015 final decision, and what we would generally face in making a distribution determination. Ultimately, whether we include transition costs remains a matter for us to determine against the opex criteria, taking into account the RPP and in a way that forms part of an overall decision that we are satisfied will, or is likely to, contribute to the achievement of the NEO to the greatest degree.⁹⁹ We have assessed Evoenergy’s proposal against the opex criteria in response to the Tribunal’s directions, including the three findings and reasoning identified above and the information now available to us.

Are redundancy costs the kind of costs a prudent operator would incur?

As we discussed above, Evoenergy’s actual opex over the 2014-19 regulatory control period has reached to a level that is consistent with the forecast opex allowance made in our 2015 final decision. We have considered whether it was necessary for Evoenergy to incur the kinds of redundancy costs it incurred to arrive at this level of opex.

Evoenergy submits that:¹⁰⁰

“In response to the AER’s 2015 final determination, Evoenergy undertook an extensive workforce restructure. Structural change occurred across all areas of the organisation, and positions were made redundant at all levels of the business, from branch managers down to junior positions. Evoenergy’s average staffing level was reduced from 507 FTE in 2014/15 to 406 FTE in 2015/16, with Evoenergy incurring in excess of \$15 million of redundancy expenses (2013/14 dollars). These redundancies occurred predominantly in 2014/15.”

(No 2) [2018] FCAFC 3, [397]-[399].

⁹⁸ NER 6.12.1(4)

⁹⁹ NER, cl 6.5.6(c) and 6.5.6(e); NEL, ss 7, 7A(2)(a), 7A(3) and 16.

¹⁰⁰ Evoenergy response to AER information request, 13 July 2018, p. 2

Evoenergy states that its redundancy program was critical to achieving the lowest possible operating expenditure for the 2014-19 regulatory control period while achieving the operating expenditure objectives. It states:¹⁰¹

“While Evoenergy implemented a broad program of transformation across the business, it is the workforce restructure that delivered the most significant and immediate cost savings. Without the workforce restructure, the transformation program would not have delivered the savings required to move to the significantly lower levels of operating expenditure incurred in the 2014-19 period, nor would it have guaranteed that resources were focused on the areas of the business necessary to maintain the safety and reliability of the network and therefore would not have reflected the efficient and prudent costs of achieving the operating expenditure objectives.”

Evoenergy also submits that the quantum of the expenses incurred in implementing its redundancy program was dictated by Evoenergy's legal obligations under its EA and the Fair Work Act. It noted:¹⁰²

“Evoenergy is required, by the Agreement itself and by section 50 of the Fair Work Act 2009 (FW Act), to comply with the ActewAGL & Combined Unions Enterprise Agreement 2014 (EA). This EA includes both voluntary and involuntary redundancy provisions which it considers to be in-step with, or in some cases less restrictive than, provisions in other DNSPs' enterprise agreements.”

Evoenergy confirms that all redundancies within Evoenergy during the 2014-19 regulatory control period were implemented in accordance with its obligations as outlined in the relevant provisions of the EA and the Fair Work Act.¹⁰³ Furthermore, it states that because its redundancy costs were incurred in compliance with these obligations, the costs should be considered prudent and efficient in the context of the Tribunal and Federal Court decisions.¹⁰⁴

“Evoenergy had no option but to operate within the constraints of the EA in existence at the time in undertaking its redundancy program and hence these costs should be considered efficient for the purpose of remaking the 2015 determination.

Evoenergy also considers the inclusion of redundancy expenses to be consistent with the Tribunal and Federal Court decisions.

The Tribunal's direction in respect of Evoenergy concerning operating expenditure, which was affirmed by the Full Court, operates to require the AER to include Evoenergy's redundancy expenses in the remade operating expenditure allowances where, as here, the decision to restructure its workforce by means of the redundancy program was efficient and prudent.”

We are satisfied with Evoenergy's proposition that it implemented its redundancy program consistent with the obligations it faced under the EA that applied at the time. We have no information in front of us that would suggest otherwise.

¹⁰¹ Ibid, p. 3.

¹⁰² Ibid, p. 3.

¹⁰³ Ibid, p. 3.

¹⁰⁴ Ibid, p. 4.

In response to our October 2017 issues paper, our CCP10 provided some support for the inclusion of redundancy costs as part of the remitted decision:¹⁰⁵

“There will be long-term benefits to consumers flowing from appropriate short-term overspend on opex, including paying for redundancies. We also note from the revealed costs, that during the period the businesses have or will reduce their costs to achieve the AER forecast opex. On this basis CCP10 believes that it would be in consumers long-term interests to bear some portion of this opex overspend.”

The CCP20 also stated:¹⁰⁶

“Our principal position is that consumers should not pay for redundancies that have not led to long term savings. This underpins our strongly held opinion that only businesses that have reached the AER’s efficient opex level at end of year 4 and have a demonstrated relationship between the cost of redundancies and opex cost reductions should be eligible to recover and of these transition costs from consumers.”

ECA also submitted that consumers stand to benefit from:¹⁰⁷

“...the significant reduction in real operating expenditure, which is reflected appropriately in Evoenergy retaining \$26 million to meet costs associated with achieving this reduction, in particular redundancy costs.”

In the context of Evoenergy’s actions since our 2015 final decision, the Tribunal’s directions to us, and submission from consumer representatives, we consider that Evoenergy’s redundancy costs are of a kind, in the circumstances, that can be characterised as costs required by a prudent operator to achieve the opex objectives.¹⁰⁸ Our reasons here do not rely on the instrument in which these costs have been incurred as being characterised as a regulatory obligation or requirement under the NEL.

At the time of our 2015 final decision, we did not have available to us information on Evoenergy’s revealed costs or details on how the redundancy program has operated. Due to the novel circumstances before us, we have available to us information on Evoenergy’s revealed costs or details on how the redundancy program has operated. The Tribunal directed us to have regard to these costs. We have formed the view that, had Evoenergy not incurred these kind of transformation costs, it is likely it would not have arrived at the level of opex that it has to date and is forecasting that it will achieve in the 2014-19 regulatory control period. It has therefore been necessary for Evoenergy to incur these costs in order for it to arrive at a level of opex consistent with the forecast opex allowance in our 2015 final decision that we were satisfied reasonably reflects the opex criteria.

¹⁰⁵ Consumer Challenge Panel, *CCP10 Response to AER Issues Paper: Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, 30 November 2017, p. 19

¹⁰⁶ *Ibid.* p. 4

¹⁰⁷ Energy Consumers Australia, Letter to AER on Evoenergy 2014-19 proposal, July 2018, p. 1

¹⁰⁸ NEL, cl 6.5.6(c)(2) and 6.5.6(c)(3).

Allowing Evoenergy to recover these kinds of costs is therefore also consistent with providing it with a reasonable opportunity to recover at least the efficient costs it incurs in providing direct control network services.

Is the quantum of proposed redundancy costs efficient?

Having determined that the kind of redundancy costs that Evoenergy has incurred have been necessary for it to achieve the opex objectives, we now consider whether the quantum of \$20.9 million (\$2018-19) is efficient and that which a prudent operator would incur for the purposes of the opex criteria. This is consistent with CCP10's submission that:¹⁰⁹

“We believe that redundancy costs be applied to a business's approved opex expenditure provided the redundancies are prudent or efficient. If there is any doubt about the efficiency of the redundancy costs then the risk of this should lie with the business rather than with consumers and the AER should impose a cap on the amount of redundancy costs to be borne by consumers.”

For the reasons set out in this section, we are satisfied that Evoenergy's actual redundancy costs are efficient and that which a prudent operator would incur for the purposes of the opex criteria, in these circumstances.

Evoenergy submits that the quantum of its redundancy program is efficient.¹¹⁰

“In Evoenergy's view, the redundancy program was efficient and prudent, as the levels of operating expenditure incurred in the 2014-19 regulatory period could not have been achieved without it. The redundancy program was critical to Evoenergy's achievement of the lowest possible operating expenditure for the period while achieving the operating expenditure objectives.”

In examining whether Evoenergy's redundancy costs are efficient, we have considered the incentives it faced in incurring these costs over the current period. In Evoenergy's circumstances over the 2014-19 regulatory control period, we consider it faced a strong incentive to minimise its redundancy costs within the confines of its legal obligations. During the 2014-19 regulatory control period so far, Evoenergy has faced uncertainty around its final revenue allowance and the final outcome of the appeals process. Faced with this uncertainty, Evoenergy implemented a reform program to reduce its own costs. This uncertainty is noted in Evoenergy's recent regulatory proposal for the 2019-24 period in which it states:¹¹¹

“Over the 2014–19 regulatory control period Evoenergy has been through significant change and reform as a business. The extent and speed of these changes was necessitated by the AER's 2015 final decision on opex and the uncertainty surrounding the outcome, following an appeal to the Australian Competition Tribunal and Federal Court on several matters, including opex, which resulted in the AER's decision being set aside. This is now in the process of being remade by the AER.”

¹⁰⁹ Consumer Challenge Panel, *CCP10 Response to AER Issues Paper: Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, 30 November 2017, p. 4

¹¹⁰ Evoenergy response to AER information request, 13 July 2018, p. 4

¹¹¹ Evoenergy, *Regulatory proposal for the ACT electricity distribution network 2019–24, Attachment 6: Operating Expenditure*, January 2018, p. 6-2

Evoenergy notes, it has been necessary to incur additional costs (i.e. redundancy costs) to minimise its total opex within the 2014-19 period. If it were to incur more redundancy costs than necessary to reduce its opex, this may have undermined an objective to minimise total costs given the uncertainty surrounding its revenue allowance and the outcome of the appeals process. All else equal, we consider that this would have placed a strong incentive on Evoenergy to minimise costs generally, including its redundancy costs.

The CCP10 also submitted that Evoenergy faced strong incentives to improve its efficiency:¹¹²

“Throughout the regulatory reset period ActewAGL had strong incentives to improve efficiency, notwithstanding uncertainty about the regulatory outcome of the appeals. Despite the uncertainty, ActewAGL benefited from any reduction in costs from the start of the regulatory period (irrespective of the final outcome). In the absence of any evidence about adverse impact to its network since it reduced its operating expenditure CCP10 believes that the revealed costs are an important piece of new information that should be given significant weight in AER’s decision-making and can be presumed to be an efficient operating level.”

To test these assumptions, we also requested information from Evoenergy about its process and strategy for implementing its redundancy program and reducing total opex. In response to our request, Evoenergy submitted:¹¹³

“Evoenergy undertook a comprehensive and fundamental review of its structure to ensure that the outcome would represent the least cost option for the business while continuing to meet its performance obligations (i.e. employee and public safety, network reliability and customer service), and comply with the terms and conditions of the Enterprise Agreement (EA).”

It also submitted details about the options it considered:¹¹⁴

“Evoenergy considered and implemented a range of options for reducing its operating expenditure, including:

- restructuring its workforce by incurring one-off redundancy costs;
- not renewing fixed term contracts;
- not back-filling vacant positions;
- implementing a hiring freeze;
- implementing a training freeze, limiting training expenditure to core and mandatory safety training and competency training;
- reducing overtime;
- process reengineering and asset management optimisation; and
- investment in systems technology.”

¹¹² Consumer Challenge Panel, *CCP10 Response to AER Issues Paper: Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, 30 November 2017, p. 34.

¹¹³ Evoenergy response to AER information request, 13 July 2018, p. 3.

¹¹⁴ *Ibid*, pp. 2-3.

In addition, Evoenergy submitted that its redundancy costs were dictated or constrained by the terms of EA and the Fair Work Act:¹¹⁵

“This EA includes both voluntary and involuntary redundancy provisions which it considers to be in-step with, or in some cases less restrictive than, provisions in other DNSPs’ enterprise agreements. Details of redundancy provisions are provided in section L of the EA. A comprehensive comparison between the key provisions of Evoenergy’s EA and the EAs of other DNSPs at the time was provided with Evoenergy’s (then ActewAGL Distribution’s) revised regulatory proposal in January 2015.”

Consistent with the statements made by the Tribunal, we have had regard to the obligations under Evoenergy’s EA that was in place at the time of its redundancy program.¹¹⁶ We have also reviewed other relevant supporting documentation that it originally provided within its revised proposal in January 2015 (some of which was provided on a confidential basis).¹¹⁷

Our review confirms that the key redundancy provisions of Evoenergy’s EA are consistent with most other DNSPs in the NEM. In particular, for voluntary redundancy payments, the amount of leave paid for each year of service and the maximum payments allowed per staff (each measured in weeks) are similar between Evoenergy and most other DNSPs. There is no evidence to suggest that costs incurred in compliance with Evoenergy’s EA would be inconsistent with that incurred by a prudent operator acting efficiently.

This is supported by the CCP10’s submission to our October 2017 issues paper:¹¹⁸

“As best as we can determine from public data, all the distributors are offering 3 weeks’ pay per year of service plus 8 weeks early severance. This is a reasonably common framework across the industry. On that basis, no business appears to be any more generous (inefficient) than another.”

The primary difference in Evoenergy’s EA is the allowance for involuntary redundancies, which were generally not present in other DNSPs EAs in 2014. Evoenergy has previously argued the benefits of having involuntary redundancies:¹¹⁹

“Unlike other DNSPs, ActewAGL Distribution can undertake organisational restructuring from both voluntary and involuntary redundancies. While the cost of this may be high in the short term, the benefit is that change can be effected in a relatively short timeframe.”

Since our 2015 final decision, Essential Energy has entered into a new EA that also contains involuntary redundancies,¹²⁰ and we understand that Ausgrid is also seeking to include involuntary redundancies to its EA from 1 July 2020. According to Essential Energy, these were part of the major reforms that enabled it to operate in line with the expenditure

¹¹⁵ Ibid, p. 3.

¹¹⁶ ActewAGL and Combined Unions Enterprise Agreement 2014, Section L

¹¹⁷ ABLA, Review of ActewAGL’s Enterprise Bargaining Provisions Against Other Electricity Network Service Providers, 31 January 2015 (Confidential)

¹¹⁸ Consumer Challenge Panel, *CCP10 Response to AER Issues Paper: Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, 30 November 2017, p.29.

¹¹⁹ ActewAGL, *Revised Regulatory Proposal 2015-19, Attachment C11 ActewAGL Distribution’s response to the AER’s detailed review of labour and vegetation management (PUBLIC)*, January 2015, p. 4

¹²⁰ Essential Energy, *Remittal of Essential Energy 2014-19 revenue determination*, 30 November 2017, pp. 2-3.

allowances we set out for it in our 2015 final decision.¹²¹ This provides some supporting evidence that Evoenergy's use of involuntary redundancies is not out of step with the approach adopted by other DNSPs in the NEM.

5.3.2 Return on debt constituent decision

The allowed rate of return provides a network service provider a return on capital that a benchmark efficient entity would require to finance (through debt and equity) investment in its network.¹²² The return on capital building block is calculated as a product of the rate of return and the value of the regulatory asset base (RAB). The rate of return is discussed in this section.

Evoenergy's revenue proposal has implicitly adopted our return on capital allowance that we set in our April 2015 final decision (with minor updates for updated return on debt data). This was based on a transition to a trailing average methodology for calculating the return on debt.

Since our 2015 final decision, having regard to the decisions of the Tribunal and Court, we have revised our general approach to determining the return on debt. We now apply a revenue neutral transition when moving from the on-the-day methodology for estimating the cost of debt to a trailing average methodology. The basis for this revenue neutral transition is discussed in more detail later.

While our approach, and the reasoning to support it, has changed since the 2015 final decision, the revenue outcome of our new approach is approximately the same as in that decision.¹²³ Evoenergy's proposal is consistent with our new approach to determining the return on debt.

The revised rate of return allowance for this draft decision is set out in Table 5-2. These numbers reflect our 2015 final decision with respect to the return on equity and the gearing ratio and a revenue neutral transition calculated using partially updated debt yield data from the Reserve Bank of Australia (RBA)¹²⁴ and fully updated data from Bloomberg. The RBA data has been updated for the pre 5 June 2018 RBA revisions only, due to the unique circumstances described in section 5.3.2.5. They also reflect the debt averaging periods we determined to use in our 2015 final decision.

¹²¹ Ibid. pp. 2-3.

¹²² The term 'network service provider' relates to service providers that provide gas and electricity transmission and distribution services.

¹²³ We note a very small change in revenue occurs due to the use of updated debt yield data (pre 5 June 2018 updates).

¹²⁴ Reserve Bank of Australia, Letter to AER, *Revisions to statistical table F3*, 4 July 2018. <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-rate-of-return-guideline/draft-decision>

Table 5-2 Evoenergy draft decision return on debt and return on capital (\$million, 2013-14) and percentage debt portfolio rate of return¹²⁵

	2014-15	2015-16	2016-17	2017-18	2018-19	Total
Draft decision debt portfolio rate of return	6.12%	5.95%	5.89%	5.78%	5.62%	
Draft decision return on debt	30.4	30.3	30.2	30.0	29.2	150.2
Draft decision return on capital	53.9	54.5	54.6	54.6	53.9	271.4

5.3.2.1 The NER requirements

We must determine a rate of return such that it achieves the allowed rate of return objective (ARORO).¹²⁶ The ARORO is that the rate of return is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of its regulated services (its standard control service in the case of electricity distributors).¹²⁷ Therefore, each remade debt decision must contribute to achieving the ARORO.

Other legislative requirements relevant to remaking our debt decision include the NEO, the RPP and any interrelationships with other related components of a distribution determination. The NEO is relevant because we are required to make a distribution determination that will, or is likely to, contribute to the achievement of the NEO to the greatest degree.¹²⁸ The RPP are relevant because we must take them into account in exercising this type of decision-making power.¹²⁹ We must also take into account any interrelationships between our remade debt decision and any other related component of a distribution determination.¹³⁰

¹²⁵ These numbers reflect the final decision including annual debt updates using data prior to the 5 June 2018 RBA update.

¹²⁶ NER ss. 6.5.2(b), 6A.6.2(b).

¹²⁷ NER ss. 6.5.2(c), 6A.6.2(c).

¹²⁸ NEL, ss. 7 and 16(1)(d).

¹²⁹ The RPP that are directly relevant to remaking our debt decision are set out at NEL, ss. 7A(2), 7A(3), 7A(5), 7A(6) and 16(2).

¹³⁰ NEL, s. 16(1)(c).

5.3.2.2 The Tribunal's decision

On 26 February 2016, the Tribunal handed down its decisions.¹³¹ The Tribunal instructed us to remake the constituent decision on the return on debt in relation to the introduction of the trailing average in accordance with the Tribunal's reasons for its decisions without giving a clear clarification of the directions for the remittal.¹³² The Tribunal found us in error in our definition of a benchmark efficient entity as a 'regulated' entity. The Tribunal also found us in error in our construction of NER rule 6.5.2(k)(4), based on the information available to the Tribunal at that time.

5.3.2.3 Judicial Review

On 24 March 2016, we applied to the Federal Court for judicial review of the Tribunal's decisions. On 24 May 2017, the Court dismissed our appeals on the return on debt and opex and upheld the Tribunal's decisions in relation to these issues. It upheld the AER's appeal in relation to the value of imputation credits (gamma).¹³³

We have carefully considered the full reasoning of the Court in considering what to do to achieve the ARORO, NEO and RPP in this decision. Of relevance, in relation to the Court's decision:

- the Court clarified that a benchmark efficient entity is not necessarily either regulated or unregulated
- the important characteristic of a benchmark efficient entity is that it has a similar degree of risk to the service provider with respect to the provision of its regulated services
- a change in debt estimation methodology does not necessarily result in any impacts for a benchmark efficient entity

In relation to both the decisions of the Tribunal and Court, we also make the following observations:

- The decisions of the Tribunal and Court were not focussed on the interpretation of 'efficient financing costs' in the ARORO. We consider this to be an important factor.
- Neither decision removes the requirement to apply a debt methodology that we consider will achieve the relevant legislative objectives for each of the respective service providers affected by the remittals.
- Neither decision requires the use of a trailing average methodology for determining the cost of debt in this remittal.

¹³¹ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1; *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 2; *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 3; *Application by ActewAGL Distribution* [2016] ACompT 4.

¹³² *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1, direction 1(b); *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 2, direction 1(b); *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 3, direction 1(b); *Application by ActewAGL Distribution* [2016] ACompT 4, direction 1(b); *Application by Jemena Gas Networks (NSW) Ltd* [2016] ACompT 5, direction 1(a).

¹³³ *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80.

In subsequent decisions involving other parties, the Tribunal and Full Federal Court have made various findings and comments which are also relevant to these matters. In particular, both the Tribunal and Federal Court have made comments about our new approach to estimating the return on debt that help to clarify how the Tribunal's decision for Evoenergy should be interpreted.¹³⁴ This is discussed in more detail below.

5.3.2.4 Other relevant legal processes

Other legal decisions that we have had regard to in our remade draft decision are:

- the decision of the Australian Competition Tribunal for SA Power Networks and the subsequent decision of the Full Federal Court on the appeal of this decision¹³⁵
- the decisions of the Australian Competition Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd¹³⁶

The decisions of the Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd are particularly important as they are directly concerned with the application of our new approach to estimating the return on debt.

After the Tribunal handed down its decisions for Evoenergy, we reconsidered our approach to debt estimation methodology. The new approach, which we adopted in our decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks, does not rely upon a conceptualisation of a benchmark efficient entity as a regulated entity. It recognises that different service providers may have a different benchmark efficient entity. The new approach also does not rely on a change in methodology impacting a benchmark efficient entity to justify our revenue neutral transition. Our new approach does not rely upon an assessment of historical financing practices. Instead, it considers the efficient financing costs (being the costs of equity and debt) in a forward looking manner. Our new approach was subject to review by the Tribunal.

The Tribunal upheld our new approach. It explained more clearly how each of the Tribunal's and Court's decisions should be read together consistently. It provided clarification for the earlier Tribunal's decision on the directions of the Tribunal for the remittal that were previously unclear to us. We consider these decisions support a revenue neutral transition when moving to a trailing average methodology based on our new approach, or the continuance of an on-the-day methodology for determining the cost of debt, to achieve the NEO.

An important aspect of the decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd is the consideration in those decisions of the interpretation of the 'allowed rate of return objective' (or ARORO) and the meaning of 'efficient financing costs'.¹³⁷ We consider these decisions support our ex ante interpretation of efficient financing costs.

¹³⁴ See, for example, *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3 at [295].

¹³⁵ *Application by SA Power Networks* [2016] ACompT 11; *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

¹³⁶ *Application by ActewAGL Distribution* [2017] ACompT 2.

¹³⁷ *Ibid.*

These decisions and our view on them are covered in further detail in our debt Position Paper on our remitted debt decisions.¹³⁸

On 18 January 2018, the Full Federal Court handed down its decision on *SA Power Networks v Australian Competition Tribunal*.¹³⁹ This was a review brought by SA Power Networks from a decision of the Tribunal.¹⁴⁰ The Full Federal Court noted that the Court had not had the benefit of hearing a number of issues in relation to Evoenergy's review that had been subsequently put to it in *SA Power Networks vs Australian Competition Tribunal*. In particular, the Court stated:

"We would add that the present proceeding has raised a number of issues that were not advanced by the parties in *AER v Australian Competition Tribunal* [i.e. the Evoenergy case]. The Full Court's observation at [572] of *AER v Australian Competition Tribunal* that there were no impacts in the form of hedging contracts that needed to be unwound was made in the context of the facts of that case and the submissions that were advanced by the parties at that time. No wider consideration of the possible "impacts" of a change in methodology to estimate the return on debt was advanced or addressed. We do not regard *AER v Australian Competition Tribunal* as in any way confining the "impacts" to which the AER might have regard when applying r 6.5.2(k)(4)."

We consider this Full Federal Court decision also supports our new revenue neutral debt transition approach which we propose to apply in this remitted debt decision.

5.3.2.5 Our approach to debt in this remitted debt decision

In remaking our debt decision, we are moving to a trailing average approach to estimating the return on debt from our previous on-the-day methodology. We will apply a revenue neutral transition in moving to this methodology. As noted by the Tribunal in its decision for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd, our revenue neutral transition is effectively a combination of the on-the-day methodology and trailing average methodology.

The only change in application we are making in comparison to our April 2015 final decision is in undertaking our calculations to use the updated Bloomberg debt series data and partially updated RBA debt data (as available prior to 5 June 2018).¹⁴¹ The RBA has made three changes to its yield curve estimates over the relevant period and Bloomberg has removed a period of data from publication. Given the timing of the third RBA update and the remittal process discussed further below, we have used data reflecting the Bloomberg update and the first two RBA updates in making this draft decision.

¹³⁸ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.

¹³⁹ *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

¹⁴⁰ *Application by SA Power Networks* [2016] ACompT 11.

¹⁴¹ We note that while our application of a revenue neutral transition to a trailing average is mathematically the same as our 2015 final decision, our reasoning has changed and is entirely based on the reasoning as set out in our APA VTS final decision.

The most recent round of RBA data updates were published on 5 June 2018, and involved a back-casting of yield curve estimates covering the 2014-19 period.¹⁴² We understand a primary driver of the update was to reflect improvements in the methodology used by the RBA to convert bonds issued in US dollars into Australian dollar-equivalent terms.

We consider that, on balance, it would not be in the long-term interests of consumers to apply the 5 June 2018 RBA debt update at this juncture, given the particular circumstances before us.

As noted in section 5.1.1, the approach we have applied in remaking this draft decision has necessarily been influenced by the novel circumstances that we face now. They are materially different from those that we faced when we made our 2015 final decision, and what we would generally face in making a distribution determination. For example, this is highlighted by the fact that we are four years into the applicable five-year 2014-19 regulatory control period. In fact, under a separate process, we have already started publically consulting on Evoenergy's 2019-24 regulatory proposal. In this respect, we also note that the recently updated RBA data has not been applied in any other decisions covering the 2014-19 regulatory period, including Essential Energy's remade final decision and Endeavour Energy's remade draft decision.

Stakeholders have told us they would like regulatory certainty and resolving the outstanding remittals in a timely manner will provide this certainty. Certainty is of benefit to both consumers and the network businesses and, therefore, will contribute to the NEO. To a large degree, this explains the concerted effort by all parties during pre-lodgement discussions – in all the remittals – to agree the key financial parameters which, in turn, could be developed into a proposal by the relevant network business – in this case, Evoenergy – and put to us for consideration and further stakeholder consultation under the regulatory determination process.

The consultation process on Evoenergy's proposal occurred in good faith, based on the best available information at the time. We note that the most recent RBA data update released on 5 June 2018 occurred after a period in which substantial pre-lodgement engagement on the key financial parameters of Evoenergy's proposal had already taken place with its key stakeholders, including consumer groups and our officers.

In summary, given the novel circumstances, the late timing of the 5 June 2018 RBA data update, the good faith in which parties have sought resolution of the remittal, and the broad stakeholder support for Evoenergy's proposal, on balance, we consider that not applying the most up to date RBA data (as updated on 5 June 2018) to this remade draft decision is the outcome that contributes to the NEO to the greatest degree. We will consider all stakeholder submissions received on this issue, and other issues more generally, before publishing our final decision later this year.

¹⁴² Reserve Bank of Australia, Letter to AER, *Revisions to statistical table F3*, 4 July 2018. <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-rate-of-return-guideline/draft-decision>

5.3.2.6 Stakeholder submissions on our cost of debt Position Paper

On 21 December 2017, we published a cost of debt Position Paper.¹⁴³ It set out our proposed approach to our remitted debt decision. On 22 January 2018, we published links to the decision of the Full Federal Court in *SA Power Networks v Australian Competition Tribunal (No 2) [2018] FCAFC 3* and invited interested parties to comment on the decision and/or our view that it supported our proposed position to the remitted debt decisions in their submissions to our debt Position Paper. All parties to the Tribunal litigation were notified of the debt Position Paper and the Full Court's decision via email on 21 December 2017 and 22 January 2018, respectively.

In response to the debt Position Paper, we received submissions from CCP10, Evoenergy, Jemena Gas Networks, PIAC and ECA. We have had regard to these submissions in making this remade draft decision.

5.3.2.7 Reasons for our draft decision

For the reasons set out in our debt Position Paper¹⁴⁴ on our remitted debt decisions and in our APA VTS final decision, we consider a revenue neutral transition to a trailing average debt estimation methodology will lead to an allowed rate of return that will achieve the ARORO and contribute to the achievement of the NEO to the greatest degree. This rate of return will both reflect ex ante efficient financing costs and result in an approximately zero NPV investment outcome which is important to achieving efficient investment incentives. A revenue neutral transition will also substantially eliminate any wealth impact on Evoenergy from changing the debt estimation methodology.

We rely on the reasoning in our APA VTS decision in making this draft decision for Evoenergy, as set out in Attachment 3 of our APA VTS determination.¹⁴⁵ This includes an explanation of how our approach has changed in response to relevant legal decisions. We also rely on our explanation and reasoning as set out in the debt Position Paper on our remitted debt decisions in making this draft decision.¹⁴⁶

In relation to the timing of the initial debt averaging period (for the commencement of the trailing average), we have used the initial averaging period set out in our 2015 final decision for the introduction of the trailing average. We also have used the debt averaging periods for the later years of the regulatory control period, as set out in our 2015 final decision, because we consider these will lead to a rate of return that achieves the ARORO and contribute to the achievement of the NEO. All averaging periods were chosen in advance of their commencement and we consider their use should result in an ex ante efficient return on debt

¹⁴³ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.

¹⁴⁴ Ibid.

¹⁴⁵ AER, *Final Decision APA VTS gas access arrangement 2018 to 2022, Attachment 3 - Rate of return*, November 2017; Available at: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/apa-victorian-transmission-system-access-arrangement-2018-22/final-decision>
This decision discusses and applies substantively identical provisions for rate of return as those applicable to electricity distribution.

¹⁴⁶ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.

allowance. We consider choosing averaging periods after the periods have finished (or post commencement) is generally inappropriate due to the potential incentive on various stakeholders to advocate for averaging periods that give particular results.

We also consider our overall approach will lead to an overall allowed rate of return that will achieve the ARORO and contribute to achieving the NEO because:

- the return on equity we determined in our 2015 final decision was upheld on appeal as was the gearing ratio and we consider these values remain appropriate
- our combination of the yield from two debt series we used to estimate the return on debt in the 2015 final decision, a simple average of yields estimated from the Bloomberg and RBA yield curves, was upheld on appeal in the Tribunal and we consider remains appropriate
- we consider the overall allowed rate of return estimated using our return on debt, return on equity and gearing estimates will result in an allowed rate of return that will achieve the ARORO and contribute to achieving the NEO

As noted earlier, we have had regard to the submissions on our debt Position Paper in making this remade draft decision.

5.3.3 Service target performance incentive scheme

The service target performance incentive scheme (STPIS) is intended to balance incentives to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to distributors to maintain and improve service performance where customers are willing to pay for these improvements.

Under clauses 6.3.2 and 6.12.1(9) of the NER, our regulatory determination must specify how any applicable STPIS is to apply in the regulatory control period.

In our 2015 final decision, we considered that our allowed expenditure reasonably reflected the sufficient amount that Evoenergy would need to maintain reliability at the current level. Therefore, in that decision, we were of the view that Evoenergy's reliability of supply performance targets should be based on its average performance over the previous five regulatory years without adjustment.¹⁴⁷

In the course of its review of our 2015 final decision, the Tribunal set aside our STPIS decision and remitted it to us to be remade.

The Tribunal stated:¹⁴⁸

“There is an interrelatedness between opex and the form of the STPIS, although not a directly linear one. However, it is sufficiently direct to require the STPIS element of the ActewAGL [Evoenergy] Final Decision to be set aside and reconsidered at the same time as the AER reconsiders and potentially resets the opex allowance for ActewAGL [Evoenergy].

¹⁴⁷ AER, *ActewAGL distribution determination 2015–16 to 2018–19*, Attachment 11, April 2015.

¹⁴⁸ Australian Competition Tribunal, *Application by ActewAGL Distribution [2016] ACompT 4*, 26 February 2016.

The AER, for its part and depending upon its revised conclusions on opex, may choose to select a different service standard for STPIS or may choose to restore the +/-5 percent exposure level which it generally imposes.”

In its proposal, Evoenergy submitted:¹⁴⁹

“Evoenergy appealed the 2015 final determination for STPIS on the basis that it was not possible to maintain historic levels of reliability with the significantly reduced opex allowance in the final determination.

...Evoenergy has been unable to meet its STPIS targets in 2015/16 and 2016/17 while reducing its opex in line with the opex allowance in the 2015 determination. In Evoenergy’s view, it is unreasonable to expect no change in historical reliability performance given a 26 per cent reduction in the opex allowance in the 2015 determination (compared with actual opex in the 2009-14 regulatory control period) with no corresponding increase in capex.”

In its proposal, Evoenergy estimated that the level of impact on the STPIS outcomes could be represented by a simplified adjustment equal to a 5 per cent change in all of the STPIS targets for 2015-16 and 2016-17, which would have a relatively minor impact on target performance levels.¹⁵⁰ This proposed change to Evoenergy’s STPIS targets results in a STPIS penalty for the current regulatory period of approximately \$1.2 million for 2015-16 and 2016-17 regulatory years.

We consider that Evoenergy’s proposal is reasonable because of the significant reduction in opex in our 2015 final decision and the fact that our remade opex draft decision is above those opex targets set out in our 2015 final decision. In addition, Evoenergy has underspent on its actual opex allowance for 2015-16 and 2016-17, which may be indicative of the impact uncertainty has had on its actual expenditure as a result of the Tribunal process.

Our draft decision is to accept Evoenergy’s proposed changes to its STPIS performance targets. That is, we have applied a 5 per cent adjustment to all of Evoenergy’s STPIS performance targets for 2015-16 and 2016-17 only, but have maintained the STPIS performance targets for 2017-18 and 2018-19 as determined in our 2015 final decision. Evoenergy’s STPIS performance targets for the reliability of supply component are at Table 5-3.

¹⁴⁹ Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018.
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/proposal>

¹⁵⁰ Ibid.

Table 5-3 Draft decision – STPIS reliability targets for Evoenergy for the 2014-19 regulatory control period

Year	2015/16	2016/17	2017/18	2018/19
Unplanned SAIDI				
Urban	31.836	31.836	30.320	30.320
Short rural	49.203	49.203	46.860	46.860
Unplanned SAIFI				
Urban	0.614	0.614	0.585	0.585
Short rural	0.940	0.940	0.895	0.895
Percentage of calls will be answered within 30 seconds	75.050	75.050	79.000	79.000

Source: AER analysis.

Due to the change in average smoothed annual revenue requirement, the incentive rates applicable to Evoenergy for the reliability of supply performance parameters of the STPIS have been recalculated in accordance with clause 3.2.2 of the STPIS and using the formulae provided in Appendix B of the national STPIS.¹⁵¹ Our draft decision of Evoenergy's incentive rates are at Table 5-4.

Table 5-4 Draft decision – STPIS incentive rates for Evoenergy for the 2014-19 regulatory control period

Year	Urban	Short rural
Unplanned SAIDI	0.0723	0.0086
Unplanned SAIFI	3.8619	0.4879

Source: AER analysis.

¹⁵¹ AER, *Service target performance incentive scheme*, November 2009, clause 3.2.2 and Appendix B.

5.4 Other aspects of the 2015 final decision to be varied

5.4.1 Control mechanism

The control mechanisms — for standard control services and alternative control services — were not a subject of Evoenergy’s appeal of our April 2015 final decision.¹⁵² We do not consider it is necessary to make any amendments to the control mechanisms as part of this remade draft decision. However, if this remade draft decision becomes our final decision, the decision has implications for the operation of the control mechanism for standard control services for the 2019–24 regulatory control period.¹⁵³

Our remade draft decision for the 2014-19 regulatory control period will result in a revenue allowance of \$26 million above the revenue we approved for standard control services in our 2015 final decision that was set aside by the Tribunal. At present, we estimate \$1 million will be returned to consumers in the next regulatory control period.¹⁵⁴

To ensure Evoenergy does not recover any additional revenue above the \$26 million, we consider a true-up will be required in the 2019–24 regulatory control period. This is because we will not know what Evoenergy’s actual standard control services revenue for the 2014-19 regulatory control period will be until after this regulatory control period expires.

A revenue cap will apply to Evoenergy’s standard control services in the 2019–24 regulatory control period.¹⁵⁵ We propose to adopt for Evoenergy the general properties of the control mechanism for the NSW distributors, including the ‘unders and overs’ accounts. With this in mind, if this remade draft decision becomes our final decision, we consider there are several options to ensure Evoenergy recovers no more than the \$26 million, as set out in this draft decision. For example, we could include an adjustment factor in the DUoS under and over account to correct for any estimates that have not be finalised by the time of the final remittal decision.

In any case, any amounts recovered above that allowed in the decision will be returned to customers in the next (2019–24) regulatory control period and determined as part of Evoenergy’s 2019–24 distribution determination.

¹⁵² The control mechanism for Evoenergy’s standard control services is the average revenue cap. The average revenue cap controls for a distributor’s revenue per unit of electricity transported (\$ per kWh), rather than the distributor’s total revenue. The average revenue cap is similar to the price cap form of control in that outturn revenue can vary with outturn sales.

¹⁵³ We do not consider this remade draft decision has implications for the form or formula of the control mechanisms for alternative control services, particularly metering. A calculation error has meant that (alternative control services) metering charges for the 2014–19 regulatory control period have not incorporated \$3.7 million of metering opex. As we discussed in section 2, we propose for this amount to be recovered through the (alternative control services) metering building block in the 2019–24 regulatory control period as given effect by our draft decision adjustment determination.

¹⁵⁴ The \$1 million that is expected to be returned to customers in the 2019-24 regulatory control period is our best estimate at this point in time as we will not know the exact amount until after the 2014-19 regulatory control period.

¹⁵⁵ AER, *Framework and approach: ActewAGL: Regulatory control period commencing 1 July 2019*, July 2017, p.33.

5.4.2 Inflation error adjustment

In the course of its review of our decisions of the Victorian electricity distributors and ActewAGL's gas decision, the Tribunal identified an error in how inflation was estimated.¹⁵⁶ The Tribunal made note of the error in its decision and left it to the AER to determine how best to address the error.¹⁵⁷ The error affected not only the decisions under that review, but the 2015 final decisions for the NSW and ACT distributors. The error had not been picked up during the review of the 2015 NSW and ACT decisions.

The error results from an incorrect geometric average calculation undertaken on the annual inflation rates; resulting in an incorrect (lower) inflation rate of 2.38 per cent instead of 2.42 per cent. Correcting the error would result in a downward revenue adjustment of approximately \$921,430 (\$2013-14, nominal) compared to our 2015 final decision.

On 15 December 2017, we notified Evoenergy (and other NSW and ACT distribution businesses) in writing, stating that we were considering whether it is appropriate to correct the affected determinations when remaking our decisions.¹⁵⁸

Evoenergy notes in its proposal:¹⁵⁹

“Evoenergy’s proposal includes the correction of...errors in the 2015 determination:

1. The correction of an error in relation to the estimation of forecast inflation, which increases forecast inflation from 2.38 per cent in the original decision to 2.42 per cent in the remade decision.”

5.4.3 Alternative control services metering opex error adjustment

There were two issues identified with respect to the AER’s 2014-19 metering determination for Evoenergy which the AER will correct in this remade draft decision. The first of these was the incorrect application of a forecast inflation rate of 2.38 per cent when an inflation rate of 2.42 per cent should have been used (as described in section 5.4.2 above). The second was that the metering opex allowance was understated by \$3.11 million (\$2013-14). The result was that Evoenergy’s metering revenue allowance was understated in the 2014-19 regulatory control period as compared to what it would have been, had these errors not occurred.

Evoenergy has proposed to recover the foregone revenue through alternative control services charges in the 2019-24 regulatory control period.¹⁶⁰ This recovered revenue would be reflected in the net present value of Evoenergy’s metering building block revenue for the 2019-24 regulatory control period being \$3.7 million (\$2018-19) higher than it would have been had this remittal determination not been made.

¹⁵⁶ File Nos: ACT 3, 4, 5, 6, 7, 8 of 2016: <http://www.competitiontribunal.gov.au/current-matters/tribunal-documents>

¹⁵⁷ For example, see ACT, Application by ActewAGL Distribution [2017] ACompT 2, 17 October 2017, p i-iii.

¹⁵⁸ AER, *Proposed correction to an inflation calculation error impacting ActewAGL distribution determination 2014-19*, 15 December 2017. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal/updates>

¹⁵⁹ Evoenergy, *Proposal for the remittal of Evoenergy’s 2014-19 determination*, 24 July 2018.

¹⁶⁰ *Ibid.* p.5-6

As noted in section 2, at the same time as releasing this remade draft decision, we have released a separate draft decision adjustment determination for Evoenergy that corrects the previously made error in the calculation of Evoenergy's metering opex allowance.¹⁶¹ In the adjustment determination, we determine that the metering variation amount is \$3.7 million (\$2018-19) which Evoenergy is to recover in the 2019-24 regulatory control period.¹⁶² We will incorporate this amount in our upcoming draft decision on the 2019-24 distribution determination for Evoenergy.¹⁶³ In particular, we will incorporate this amount as an increase to Evoenergy's metering building block revenue requirement in net present value terms.¹⁶⁴

To avoid doubt, the metering adjustment amount set out in our adjustment determination does not apply to standard control services.

5.4.4 Minor correction to our 2015 final decisions

On 20 May 2015, we published an open letter notifying our intention to correct an error in our April 2015 final decision once any appeal to that decision is resolved.¹⁶⁵ If this remade draft decision becomes our final decision, and as part of the decision for Evoenergy, we will refer and give effect to that open letter published on our website. The letter sets out our proposed correction for the following error in our 2015 final decision:

1. Inaccurate description of metering in Appendix A to the Overview
 - In April 2015, the AER made its 2014-19 distribution determination for Evoenergy. Shortly after, in May 2015, the AER agreed with Evoenergy that the distribution determination contained an inaccurate description of metering services classification in Appendix A to the Overview of that determination. This description did not align with the (accurate) description in Attachment 16 (alternative control services) of the same determination. The AER also agreed with Evoenergy that it would be inappropriate to revoke and substitute the determination to correct the error at that time, and that we would amend the error once any appeal in relation to our distribution determination was resolved.
 - In practice, throughout this regulatory period we have been applying the correct classification of metering services as reflected in Attachment 16 of the 2014-19 determination through the enforceable undertakings and annual pricing proposal processes. Accordingly, there is no residual error to correct. We consider this matter is now resolved and closed.

If this remade draft decision becomes our final decision, to ensure the relevant legal documents accurately reflect our decisions, the correction set out in the open letter shall

¹⁶¹ AER, *Draft decision Evoenergy adjustment determination*, September 2018.

¹⁶² We note that Evoenergy, in its 2014-19 remittal proposal, estimated the value of this error as approximately \$3.8 million. We have since confirmed the metering variation amount to equal \$3.7 million (\$2018–19).

¹⁶³ NER, cl 8A.15.5(c)(3) and (5).

¹⁶⁴ NER, cl 8A.15.5(c)(8).

¹⁶⁵ AER, *AER letter to ActewAGL about correcting errors in ActewAGL distribution determination 2015–16 to 2018–19*, 20 May 2015. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-determination-2014-19/final-decision>

form part of our decision for Evoenergy's remitted determination and supersede the error we had identified in our 2015 final decision.

Appendix A

Background on our remade draft decision

The AER is required to determine the revenue allowance for distributors under the National Electricity Rules (NER).

As part of the transitional arrangements for major changes to national rules for the regulation of distributors made in November 2012, the Australian Energy Market Commission (AEMC) deferred the full regulatory determination process for NSW and ACT distributors' 2014-19 regulatory control period. On 16 April 2014, as part of the transitional arrangements, we determined a placeholder revenue allowance for the 2014-15 transitional regulatory control period.

In May 2014, we received the NSW and ACT distributors' regulatory proposals for the 2014-19 regulatory control period, after which the full determination process commenced. We assessed the revenue allowances for the whole 2014-19 regulatory control period, and trued up any difference between the placeholder revenue allowance and revenue requirement for the transitional year.

2015 final decisions for the 2014-19 regulatory control period

On 30 April 2015, we published final decisions for the 2014–19 NSW and ACT electricity distribution determinations. In these decisions:

- We did not accept the distributors' proposed opex forecasts, and instead substituted our own alternative opex forecasts. We found the actual opex incurred by Ausgrid, Endeavour Energy and Evoenergy (formerly ActewAGL) in their proposed base year of 2012-13 was materially greater than what a prudent and efficient network service provider would incur in delivering safe and reliable network services to customers, and therefore these revealed costs could not be used as a basis to forecast opex for the 2014-19 regulatory control period. In the case of Endeavour Energy, we did not find any evidence of material inefficiency in the actual opex it incurred in its proposed base year, but if the proposed significant opex increase for vegetation management costs were included, then we would not be satisfied that the total forecast opex would reasonably reflect the opex criteria.
- We did not accept the distributors' proposed method for estimating allowed returns on debt. In relation to the debt transition, we did not accept the distributors' proposal to immediately use a trailing historical average. Instead, we used a transition that started from an on-the-day based estimate of the cost of debt and transitioned this to a trailing average over ten years.

Limited merits review

On 17 July 2015, the distributors sought limited merits review of our final decisions by the Australian Competition Tribunal (Tribunal). The Public Interest Advocacy Centre (PIAC) also applied for review of our NSW final decisions. Additionally, the Commonwealth Minister for

the Environment and Energy intervened. The key areas under review were opex, the cost of debt and the value of imputation credits (gamma).

On 26 February 2016, the Tribunal handed down its decisions. It remitted our decisions to us to be remade, in accordance with its orders on:¹⁶⁶

- Opex (and for Evoenergy, the implications of this for the Service Target Performance Incentive Scheme):¹⁶⁷ the Tribunal found it was open to us not to accept the distributors' opex forecasts, but had a number of concerns with how we derived our alternative opex forecasts.¹⁶⁸ In particular, the Tribunal considered that we relied too heavily on the results of a single benchmarking model to derive our alternative opex forecasts.¹⁶⁹
- Cost of debt: the Tribunal instructed us to remake the constituent decision on return on debt in relation to the introduction of the trailing average in accordance with the Tribunal's reasons for its decisions without giving a clear clarification of the directions for the remittal.¹⁷⁰

Judicial review

On 24 March 2016, we applied to the Full Federal Court (Court) for judicial review of the Tribunal's decisions on the value of imputation credits (gamma), return on debt and opex. The crux of our argument was that the Tribunal misinterpreted the scope of the reviewable errors in s 71C of the National Electricity Law (NEL).

On 24 May 2017, the Court dismissed our appeal and upheld the Tribunal's decision in relation to opex and cost of debt. It upheld the AER's appeal in relation to gamma — by consent, following the Court's decision, the parties agreed that paragraph 1(d) of the Tribunal's direction to the AER be set aside (together with consequential reference to paragraph (e)).

Undertakings provided by distributors

During the time the appeal processes were underway, all of the distributors submitted their annual pricing proposals consistent with our final decisions for the 2015–16 regulatory year, which we approved.¹⁷¹ However, following the Tribunal's decision and our subsequent

¹⁶⁶ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1; *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 2; *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 3; *Application by ActewAGL Distribution* [2016] ACompT 4.

¹⁶⁷ The Tribunal upheld the distributors' challenges to the AER's allowances for returns on debt, the value it set for gamma (which was later set aside by the Federal Court in judicial review) and Evoenergy's (formerly ActewAGL) Service Target Performance Incentive Schemes.

¹⁶⁸ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1.

¹⁶⁹ *Ibid.*

¹⁷⁰ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1, direction 1 (b); *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 2, direction 1 (b); *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT 3, direction 1 (b); *Application by ActewAGL Distribution* [2016] ACompT 4, direction 1 (b).

¹⁷¹ In May 2014, the NSW/ACT distributors had submitted to us their 2014–15 annual pricing proposals for their respective networks. We assessed these proposals for compliance with Part 1 of the NER and our 2014–15 placeholder distribution determinations. Subsequently, we approved each of the distributors' 2014–15 pricing proposals.

judicial review application, there was considerable uncertainty regarding the effect of the Tribunal's decision on pricing and non-price matters, undermining stability and transparency for consumers, retailers and the distributors.

We addressed this uncertainty in May 2016 by accepting enforceable undertakings given by the distributors under section 59A of the NEL that set out how network revenues and tariffs will be determined in 2016–17.¹⁷² Evoenergy, Ausgrid, Endeavour Energy and Essential Energy's Network Use of System (NUoS) Tariffs in 2016–17 were set as their 2015–16 approved tariffs, adjusted to include changes in the consumer price index (CPI) in 2015-16.¹⁷³

As of May 2017, the Court had not yet handed down its decision, so we accepted further undertakings given by the distributors to establish new interim arrangements to govern the setting of network tariffs in 2017–18.¹⁷⁴ Evoenergy, Ausgrid and Endeavour Energy's NUoS Tariffs in 2017–18 were also set as their 2015–16 approved tariffs, adjusted to include changes in the CPI in 2015–16 and 2016–17.¹⁷⁵ Essential Energy undertook to continue to apply the terms of, including the price path determined in, our April 2015 final decision, for 2017–18 and 2018–19, and to account for and give effect to the new tariff structure statements from 1 July 2017.

As of March 2018, as the remittal process was not yet settled, we accepted further undertakings from NSW and ACT distributors for 2018-19.¹⁷⁶

The effect of these undertakings is that the revenues recovered by the distributors during 2016–17, 2017–18 and 2018-19 are likely to differ from that which they are entitled to recover after we remake our decisions. On 1 August 2017, the AEMC made a rule that allows us to let the distributors recover such differences over both the 2014–19 and 2019-24 regulatory control periods.¹⁷⁷ The intent is to minimise the potential for significant fluctuations in retail prices that consumers may experience from one period to the next. The rule allows us to make revenue adjustments to smooth revenue across, or allocate it between, these regulatory control periods. Such adjustments are given effect through the pricing proposal and distribution determination processes.

¹⁷² Ausgrid, *Ausgrid enforceable undertaking*, May 2016. Endeavour Energy, *Endeavour Energy enforceable undertaking*, May 2016. ActewAGL, *ActewAGL enforceable undertaking*, May 2016. Endeavour Energy, *Endeavour Energy enforceable undertaking*, May 2016.

¹⁷³ Network Use of System (NUoS) Tariffs traditionally include distribution use of system tariffs and transmission use of system (TUoS) tariffs. We included TUOS tariffs in the undertakings to ensure price stability and predictability.

¹⁷⁴ Ausgrid, *Ausgrid enforceable undertaking*, May 2017. Endeavour Energy, *Endeavour Energy enforceable undertaking*, March 2017. ActewAGL, *ActewAGL enforceable undertaking*, May 2017. Endeavour Energy, *Endeavour Energy enforceable undertaking*, May 2017.

¹⁷⁵ These enforceable undertakings also obliged the ACT and NSW distributors to continue to provide network services consistent with the non-price terms and conditions of their 2015–19 electricity distribution determinations.

¹⁷⁶ *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2018*, 21 March 2018.

¹⁷⁷ AEMC, *Rule determination: National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - ACT DNSP revenue smoothing) Rule 2017 No. 7, commencing 15 August 2017*; AEMC, *Rule determination: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - NSW DNSPs Revenue Smoothing) Rule 2017 No. 6, commencing 15 August 2017*.

The remittal task – remaking our decisions for 2014-19

Following the Court’s decision, the Tribunal’s directions that we are to comply with in remaking the decision are as follows:¹⁷⁸

- “(a) the AER is to make the constituent decision on opex under r 6.12.1(4) of the National Electricity Rules in accordance with these reasons for decision including assessing whether the forecast opex proposed by the applicant reasonably reflects each of the operating expenditure criteria in r 6.5.6(c) of the National Electricity Rules including using a broader range of modelling, and benchmarking against Australian businesses, and including a ‘bottom up’ review of ActewAGL’s forecast operating expenditure;
- (b) the AER is to make the constituent decision on the service target performance incentive scheme in the light of such variations as are made to the Final Decision by reason of (a) hereof;
- (c) the AER is to make the constituent decision on return on debt in relation to the introduction of the trailing average approach in accordance with these reasons for decision;
- ...
- (d) the AER is to consider, and to the extent to which it considers appropriate to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 16(1)(d) of the National Electricity Law in the light of such variations as are made to the Final Decision by reason of (a)–(d) hereof.”

¹⁷⁸ Australian Competition Tribunal, *Application by ActewAGL Distribution [2016] ACompT 4*, 26 February 2016. Note direction (d) is omitted following the Court’s decision in relation to gamma: *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [738]-[784].