DRAFT DECISION

Ergon Energy
Distribution Determination
2020 to 2025

Attachment 8
Efficiency benefit sharing scheme

October 2019

AUSTRALIAN
ENERGY
REGULATOR

Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Ergon Energy for the 2020–2025 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme

Attachment 12 – Classification of services

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Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 16 – Negotiated services framework and criteria

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CPI	consumer price index
DMIAM	demand management innovation allowance (mechanism)
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
NEL	national electricity law
NER or the rules	national electricity rules
NSP	network service provider
opex	operating expenditure
RBA	Reserve Bank of Australia
RIN	regulatory information notice

8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in opex, and provide for a fair sharing of these between distributors and network users. Consumers benefit from improved efficiencies through lower regulated prices.

This attachment sets out our draft decision on the EBSS carryover amounts Ergon Energy accrued over the 2015–20 regulatory control period. It also sets out how we will apply the EBSS over the 2020–25 regulatory control period.

8.1 Draft decision

Ergon Energy elected not to claim the rewards it accrued from the operation of the EBSS during the 2015–20 regulatory control period, subject to us accepting its regulatory proposal.[1] Our draft decision is to accept Ergon Energy's proposal to not include any EBSS increments or decrements in its allowed revenues.

If, in its revised proposal, Ergon Energy elects to claim its EBSS increments, then we will add EBSS increments totalling $157.6 million ($2019–20), which it accrued in the current regulatory control period, to its total revenue for the 2020–2025 regulatory control period.

Our calculation of the EBSS increments Ergon Energy accrued is $110.9 million ($2019–20) lower than the $268.5 million ($2019–20) it calculated. This is primarily due to Ergon Energy assuming its opex in 2019–20 will be significantly lower than what it spent in 2018–19 and is likely to spend in 2019–20. This relates to the negative adjustments Ergon Energy made to its base opex, which we discuss in attachment 6. We do not consider Ergon Energy should receive EBSS rewards for efficiency gains that it does not expect to achieve.

The above amounts will need to be updated to reflect audited actual opex in 2018–19 and the latest forecast of inflation for 2019–20 from the Reserve Bank of Australia (RBA), should Ergon Energy elect to claim its EBSS increments.

Our draft decision is to continue to apply version 2 of the EBSS to Ergon Energy in the 2020–25 regulatory control period.[2] Consistent with Ergon Energy's proposal, we will exclude debt raising costs from the scheme as a pre-defined 'excluded category'. We will also make other adjustments as permitted by the EBSS, such as removing demand management innovation allowance (DMIA) costs, and movements in provisions (as outlined in section 8.4.2)

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[1] Ergon Energy, *1.004 Ergon Energy Regulatory Proposal 2020–25*, January 2019, p. 103.

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

We have set out in table 8.1 the opex forecasts we will use to calculate efficiency gains in the 2020–25 regulatory control period, including forecast debt raising costs.

Table 8.1   Forecast opex for the EBSS ($ million, 2019–20)

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Total forecast opex	388.9	396.2	376.8	371.6	367.0	362.1	357.2
Less debt raising costs	–5.7	–5.7	–5.6	–5.7	–5.7	–5.8	–5.8
Forecast opex for the EBSS	**383.2**	**390.4**	**371.2**	**365.9**	**361.3**	**356.3**	**351.4**

Source: AER, Ergon Energy draft decision—Post tax revenue model, October 2019; AER analysis.

Note: Numbers may not add up due to rounding.

We discuss the reasons for our draft decision in section 8.4.

8.2 Ergon Energy's proposal

8.2.1   Carryover amounts from the 2015–20 regulatory control period

Ergon Energy calculated EBSS carryover amounts totalling $268.5 million ($2019–20) from the application of the EBSS in the 2015–20 regulatory control period. However, it did not include these carryover amounts in its proposed revenues, subject to us accepting its regulatory proposal.[3]

8.2.2   Application in the 2020–25 regulatory control period

Ergon Energy proposed we continue to apply version 2 of the EBSS in the 2020–25 regulatory control period.[4] It also proposed that we apply the opex adjustments allowed under version 2 of EBSS, namely adjustments for:[5]

- approved pass through amounts or opex for contingent projects

- capitalisation policy changes

- categories of opex not forecast using a single year revealed cost approach, and specifically debt raising costs and DMIA opex

- inflation.

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3   Ergon Energy, *1.004 Ergon Energy Regulatory Proposal 2020–25*, January 2019, p. 103.

4   Ergon Energy, *1.004 Ergon Energy Regulatory Proposal 2020–25*, January 2019, p. 104.

5   Ergon Energy, *1.004 Ergon Energy Regulatory Proposal 2020–25*, January 2019, p. 104.

8.2.3   Stakeholder submissions

Stakeholders welcomed Ergon Energy's proposal to forgo its EBSS carryover amounts. However, some were disappointed that this came with a caveat, and stated they would be disappointed if the forgone payments were reintroduced if we reject a component of Ergon Energy's proposals. For example:

• Origin Energy commended Ergon Energy's proposal to not claim the EBSS carryover amounts it is entitled to for efficiency gains made in the 2015–20 regulatory control period[6]

• National Seniors Australia stated that it did not believe that Ergon Energy's offer to forgo incentive payments should be conditional[7]

• The Queensland Council of Social Service welcomed the fact that Ergon Energy has forgone the EBSS rewards it has accrued. However, it expressed disappointment that Ergon Energy considered it necessary to include a caveat.[8]

8.3 Assessment approach

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

• the revenue increments or decrements for each year of the 2020–25 regulatory control period arising from the application of the EBSS during the 2015–20 regulatory control period[9]

• how the EBSS will apply to Ergon Energy in the 2020–25 regulatory control period.[10]

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between Ergon Energy and network users.[11] We must also have regard to the following matters when implementing the EBSS:[12]

• the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme

• the need to provide Ergon Energy with a continuous incentive to reduce opex

• the desirability of both rewarding Ergon Energy for efficiency gains and penalising it for efficiency losses

• any incentives that Ergon Energy may have to capitalise expenditure

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[6]   Origin Energy, *QLD regulatory proposal 2020–25*, 31 May 2019, p. 2.

[7]   National Seniors Australia, *Response to AER Issues Paper: Qld electricity distribution determinations, Energex and Ergon Energy*, 2020 to 2025, 31 May 2019, p. 4.

[8]   Queensland Council of Social Service Inc., *QCOSS submission to AER Issues Paper: QLD electricity distribution determinations—Energex and Ergon 2020 to 2025*, May 2019, p. 21.

[9]   NER, cl. 6.4.3(a)(5).

[10] NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

[11] NER, cl. 6.5.8(a).

[12] NER, cl. 6.5.8(c).

- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

8.3.1   Interrelationships

The EBSS is closely linked to our revealed cost approach to forecasting opex. When we assess or develop our opex forecast, the NER require us to have regard to whether the opex forecast is consistent with any incentive schemes.[13]

Our opex forecasting method typically relies on using the 'revealed costs' of the service provider in a chosen base year to develop a total opex forecast if the chosen base year opex is not considered to be 'materially inefficient'. Under this approach, a service provider would have an incentive to spend more opex in the expected base year. Also, a service provider has less incentive to reduce opex towards the end of the regulatory control period, where the benefit of any efficiency gains is retained for less time.

The application of the EBSS serves two important functions:

1. it removes the incentive for a service provider to inflate opex in the expected base year in order to gain a higher opex forecast for the next regulatory control period

2. it provides a continuous incentive for a service provider to pursue efficiency improvements across the regulatory control period.

The EBSS does this by allowing a service provider to retain efficiency gains (or losses) for a total of six years, regardless of the year in which the service provider makes them. Where we do not propose to rely on the single year revealed costs of a service provider in forecasting opex, this has consequences for the service provider's incentives and our decision on how we apply the EBSS.

When a business makes an incremental efficiency gain, it receives a reward through the EBSS, and consumers benefit through a lower revealed cost forecast for the subsequent regulatory control period. This is how efficiency improvements are shared between consumers and the service provider. If we subject costs to the EBSS that are not forecast using a revealed cost approach, a business would in theory receive a reward for efficiency gains through the EBSS (at a cost to consumers), but consumers would not benefit through a lower revealed cost forecast in the subsequent regulatory control period.

Therefore, we typically exclude costs that we do not forecast using a single year revealed cost forecasting approach.

For these reasons, our decision on how we will apply the EBSS to Ergon Energy has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to the effect of our EBSS decision when making our opex decision, and

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[13]   NER, cl. 6.5.6(e)(8). Further, we must specify and have regard to the relationship between the constituent components of our overall decision: NEL, s 16(1)(c).

our EBSS decision is made largely in consequence of (and takes careful account of) our past and current decisions on Ergon Energy's opex.

8.4 Reasons for draft decision

8.4.1 Carryover amounts from the 2015–20 regulatory control period

Our draft decision is to not include any EBSS carryover amounts from the application of the EBSS in the 2015–20 regulatory control period.[14] This is consistent with Ergon Energy's proposal not to claim the rewards it accrued from the operation of the EBSS during this regulatory control period, subject to us accepting its regulatory proposal.

If, in its revised proposal, Ergon Energy elects to claim its EBSS increments, then we will add EBSS increments totalling $157.6 million ($2019–20), which it has accrued in the current regulatory control period, to its total revenue for the 2020–2025 regulatory control period.

While our draft decision is not to include any EBSS carryover amounts in Ergon's revenue, we may do so in our final decision, subject to Ergon Energy's revised proposal. Therefore, we set out below our reasoning determining the carryover amount that would arise from the EBSS during the 2015–20 regulatory control period.

Our calculation of the EBSS increments Ergon Energy has accrued is $110.9 million ($2019–20) lower than the $268.5 million ($2019–20) it calculated. This is primarily due to Ergon Energy assuming the negative base adjustments it proposes in 2018–19 will lead to its opex in 2019–20 being significantly lower than what it is likely to actually spend. We do not consider Ergon Energy should receive EBSS rewards for efficiency gains that it does not expect to achieve.

Other reasons for our calculation of EBSS increments being different from Ergon Energy's include that:

• we used different inflation figures to convert amounts into 2019–20 dollars

• in calculating the incremental efficiency gain for 2015–16, we did not exclude the forecast and actual opex of specific cost categories in 2013–14 and 2014–15 from total opex that Ergon Energy did. These opex categories were excluded from Ergon Energy's EBSS in the 2010–15 regulatory control period but not the 2015–20 regulatory control period

• we removed the movements in provisions Ergon Energy reported in its 2017–18 economic benchmarking regulatory information notice (RIN) from its 2017–18 opex.

• we did not exclude Ergon Energy's guaranteed service level (GSL) costs in 2015–16 from its actual opex for that year.

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[14] NER, cll. 6.12.1(9); and 6.4.3(a)(5).

We consider that the EBSS carryover amounts we have calculated would provide for a fair sharing of efficiency gains and losses between Ergon Energy and its network users. It would both reward Ergon Energy for the efficiency gains it has made and penalise it for its efficiency losses. Further, we consider that the benefit to networks users, through lower forecast opex, is sufficient to warrant the EBSS carryover amounts we have calculated.

We discuss each of these issues in more detail below.

Our calculation of the EBSS carryover amounts Ergon Energy has accrued in the 2015–20 regulatory control period is based on Ergon Energy's estimated opex for 2018–19. If Ergon Energy elect to claim its EBSS increments in its revised proposal, we will update our calculation of the carryover amounts using actual opex in 2018–19. We will also update our inflation forecast for 2019–20 in our final decision.

We have not assumed an incremental efficiency gain or loss for 2019–20

We do not currently know Ergon Energy's actual opex for 2019–20, and we will not know it when we make our final decision. We do not think it is reasonable to assume that Ergon Energy will make an incremental efficiency gain (or loss) in 2019–20 for which it should be rewarded (or penalised). Further, to treat the base opex adjustments Ergon Energy proposed in its opex forecast as an incremental efficiency gain for the purpose of EBSS is inconsistent with the requirements of the EBSS. We discuss this below.

In its proposal, Ergon Energy removed $25.4 million ($2019–20) from its base opex for the purpose of forecasting opex. It stated that this was to remove 'non-recurring' restructuring, redundancy and reform costs and merger savings from the businesses' 2018–19 base year opex (referred to as negative base adjustments).[15] This has the impact of lowering Ergon Energy's proposed opex for the 2020–25 regulatory control period by $127.0 million ($2019–20).

For the purposes of calculating its EBSS carryover amounts, Ergon Energy assumed it will make an incremental efficiency gain of $25.1 million ($2019–20) in 2019–20.[16] That is, it assumed it will achieve incremental efficiency gains in 2019–20 equal to the negative adjustments it made to its 2018–19 base year when it forecast opex. Ergon Energy carried this assumed incremental efficiency gain forward into all five years of the forecast regulatory control period, increasing its calculated EBSS rewards by $125.4 million ($2019–20).

Consequently, Ergon Energy's proposed treatment of these negative base year adjustments in effect transferred $125.4 million ($2019–20) in revenue from Ergon Energy's opex proposal to its calculated EBSS carryover amounts. However, Ergon

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[15]   These negative base year adjustments are also discussed in section 6.4.1.2 of Attachment 6.

[16]   This is different from the $25.4 million ($2019–20) Ergon Energy removed from base opex in its opex model because it used different CPI index values in the opex model than it did in its EBSS calculation.

Energy elected not to include the carryover amounts it calculated in its proposed revenues, subject to us accepting its regulatory proposal.[17]

Ergon Energy's assumed 2019–20 incremental efficiency gain is inconsistent with the EBSS

The EBSS states that we will estimate opex in the final year of the regulatory control period, which is usually not known at the time we make our final decision, as:

$$A_f^* = F_f - (F_b - A_b) + non\text{-}recurrent\ efficiency\ gain_b$$

Where:

A_f^* is estimated actual opex in the final year of the regulatory control period

F_f is forecast opex in the final year of the regulatory control period

F_b is forecast opex in the based year used to forecast opex in the following regulatory control period

A_b is actual opex in the base year used to forecast opex in the following regulatory control period

$non\text{-}recurrent\ efficiency\ gain_b$ is the adjustment made to base year opex to account for opex associated with one-off factors

The non-recurrent efficiency gain term was introduced in 2013 to add flexibility. This would allow us to address the situation where there was a significant non-recurrent efficiency gain in the base year, that is, when base year opex was abnormally low.[18] When we consulted on version 2 of the EBSS, the current version, some networks raised concerns that if we forecast opex using actual opex in a base year, and opex in that year was abnormally low, the opex forecast may understate the efficient ongoing level of opex.[19]

Notwithstanding that an opex forecast may appear too low if the base year is abnormally low, this has little effect on total revenues. In this case higher EBSS carryover amounts would offset the lower opex forecast. Total revenues would be reasonable in this scenario. However networks were concerned that comparing their subsequent actual opex against their opex allowance could make them appear inefficient. Consequently we added the non-recurrent base year efficiency gain variable to account for this.

Importantly, we stated in the EBBS explanatory statement that, in these scenarios, our preferred approach would be to use an alternative base year, if one was available. To the extent that this was not possible, accounting for a base year non-recurrent

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[17] Ergon Energy, *1.004 Ergon Energy Regulatory Proposal 2020–25*, January 2019, p. 103.

[18] AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers,* November 2013, pp. 15–16.

[19] AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers,* November 2013, pp. 15–16.

efficiency gain in the EBSS formulae would allow us to adjust base year opex for a more precise total opex forecast.[20] At the same time this approach would remove the EBSS rewards associated with gains that are not passed on to consumers through a lower opex forecast.

Ergon Energy's proposed use of the non-recurrent efficiency gain term in the EBSS carryover calculation is not consistent with the stated purpose of this term in the explanatory statement. It may be appropriate to use the non-recurrent efficiency gain term in the EBSS formulae when base year opex is abnormally high in one year (if no other appropriate base year is available), despite the EBSS explanatory statement only referring to situations where base year opex is abnormally low. Regardless, Ergon Energy's estimated opex in 2018–19 is not abnormally high. In fact, Ergon Energy's estimated opex in 2018–19 is lower than its actual opex (in real terms) in any other year in the current or previous regulatory control periods.[21] Consequently, Ergon Energy's estimated base year opex is not abnormally high due to one-off factors such that it would warrant the use of the non-recurrent efficiency gain term in the EBSS calculation. .

Ergon Energy is unlikely to achieve the 2019–20 incremental efficiency gain it has assumed

As noted above, when we calculate EBSS carryover amounts we do not usually know a distributor's actual opex for the last year of the regulatory control period. Consequently we need to make an assumption about the actual opex that the distributor will incur. We usually assume the distributor will underspend (or overspend) its opex allowance in the final year by the same amount it underspent (or overspent) opex in the base year. In this way we do not typically reward a distributor for efficiency gains it has not yet achieved.

In its EBSS calculation, Ergon Energy assumed it will make an incremental efficiency gain of $25.1 million ($2019–20) in 2019–20. Based on the evidence Ergon Energy provided, which we discuss below, we consider it is unlikely that Ergon Energy will make this assumed incremental efficiency gain in 2019–20. Given this, we consider Ergon Energy's proposed approach would be inconsistent with both the NER and the EBSS on how efficiency gains should be calculated.

The NER requires that an efficiency gain be derived from actual opex being less than forecast opex.[22] In turn, the EBSS measures efficiency gains and losses from the differences between actual and forecast opex on an incremental basis (that is, relative to the previous years under or overspend).[23]

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[20]   AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 16.

[21]   See figure 6.1 in attachment 6.

[22]   NER cl. 6.5.8(a)(1).

[23]   AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, pp. 5–7.

Ergon Energy's proposed negative base year adjustments are not an efficiency gain for which an EBSS reward should be given because we understand Ergon Energy does not expect to reduce its opex in 2019–20 by the same amount it removed from its base year opex. Ergon Energy provided information showing that, while it is not seeking to recover the 'non-recurring' restructuring, redundancy and reform costs from consumers via opex, it will continue to incur them at some level over the forecast period, including in 2019–20.[24] We discuss this further in the negative base adjustments discussion in section 6.4.1.2 of attachment 6.

Ergon Energy stated that its objective in making these negative base adjustments was to remove these costs from its proposed opex allowances and therefore network tariffs for the forthcoming regulatory control period.[25] However, we note that by treating these adjustments as an incremental efficiency gain in its EBSS calculations, it shifted these costs from its proposed opex allowance to its calculated EBSS carryover amounts. It is Ergon Energy's proposal to forgo its EBSS carryover amounts that has in effect removed these costs from its proposed network tariffs.

Ergon Energy also noted that some of its statements in relation to the negative base year adjustments have been inconsistent. It stated that it is reconsidering its positions on these adjustments and is yet to form a view on the most appropriate treatment.[26]

Consequently, we consider there is no basis to assume Ergon Energy will make an incremental efficiency gain of $25.1 million ($2019–20) in 2019–20 that we should include in our calculation of EBSS carryover amounts.

Inflation

Consistent with our standard approach, we used unlagged inflation to convert opex amounts to 2019–20 real terms. Ergon Energy, however, used lagged inflation. We questioned Ergon Energy about this and it stated that it supports us not using lagged inflation in calculating its EBSS carryover amounts.[27]

We also used different inflation forecasts for 2018–19 and 2019–20 than Ergon Energy did. For 2018–19 we used the actual CPI figures published by the Australian Bureau of Statistics, which were released after Ergon Energy submitted its proposal.[28] For 2019–20 we used the inflation forecast in the RBA's August 2019 *Statement on monetary policy*.[29] This was also published after Ergon Energy submitted its proposal.

Incremental efficiency gain in 2015–16

To calculate the incremental efficiency gain for 2015–16, we did not exclude self-insurance, insurance, superannuation and non-network alternatives opex from Ergon

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24   Ergon Energy, *Response to information request IR#056*, 17 July 2019, pp. 14–15.

25   Ergon Energy, *Response to information request IR#056*, 17 July 2019, p. 15.

26   Ergon Energy, *Response to information request IR#060*, 8 August 2019, pp. 6–7.

27   Ergon Energy, *Response to information request IR#048*, 25 June 2019, p. 2.

28   Australian Bureau of Statistics, *Catalogue number 6401.0, Consumer price index*, June 2019.

29   Reserve Bank of Australia, *Statement on monetary policy*, *Appendix: Forecasts*, August 2019.

Energy's forecast and actual opex for 2012–13 and 2013–14. Ergon Energy, however, did exclude these costs from its forecast opex and its actual opex for 2013–14 and 2014–15. These categories of opex were excluded from the operation of the EBSS for the 2010–15 regulatory control period, but not for the 2015–20 regulatory control period.

To calculate the incremental gain (loss) made in the first year of a regulatory control period we start with the opex underspend (overspend) in that year. Since the forecast for that year will reflect the level of efficiency revealed in the base year in the previous regulatory control period, this underspend will reflect all efficiency gains or losses made after the base year. So, we then subtract any incremental gains or losses made after the base year in the previous regulatory control period. When we do this, we subtract incremental efficiency gains or losses made in all categories of opex subject to the EBSS in the new regulatory control period. This includes categories of opex that we excluded from the EBSS in the previous regulatory control period. This is because we are calculating the incremental efficiency gain in 2015–16 for those categories of expenditure subject to the EBSS in the 2015–20 regulatory control period. For this reason we did not exclude self-insurance, insurance, superannuation and non-network alternatives opex from Ergon Energy's forecast and actual opex for 2012–13 and 2013–14 to calculate the incremental efficiency gain for 2015–16 (they were not excluded from the EBSS for the 2015–20 regulatory control period). By doing this, the incremental efficiency gain we have calculated for 2015–16 does not include the efficiency gains made in 2014–15 related to self-insurance, insurance, superannuation and non-network alternatives.

We outlined these reasons to Ergon Energy and it advised us that it was satisfied with our rationale for including these costs in its total opex allowance and total actual opex for 2013–14 and 2014–15 in our EBSS carryover amount calculations.[30]

GSL costs

To calculate EBSS carryover amounts, we did not exclude Ergon Energy's GSL costs in 2015–16 from its actual opex for that year because GSL costs were not listed as an excluded cost for the 2015–20 regulatory control period. Ergon Energy had excluded its GSL costs in 2015–16 from its actual opex when it calculated its EBSS carryover amounts. When we questioned Ergon Energy about this, it stated that it had erroneously excluded GSL costs from actual opex in 2015–16.[31]

Movements in provisions

To calculate EBSS carryover amounts, we removed the movements in provisions Ergon Energy reported in its 2017–18 economic benchmarking RIN from its 2017–18 opex. The movement in provisions that Ergon Energy removed from its 2017–18 opex

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[30]   Ergon Energy, *Response to information request IR#048*, 25 June 2019, p. 2.

[31]   Ergon Energy, *Response to information request IR#048*, 25 June 2019, p. 2.

did not match the amount it had reported in the economic benchmarking RIN for that year.

We questioned Ergon Energy about this and it confirmed that the amount it provided in the economic benchmarking RIN was the correct amount.[32]

8.4.2   Application in the 2020–25 regulatory control period

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

Version 2 of the EBSS specifies our approach to determining the length of the carryover period and adjusting forecast or actual opex when calculating carryover amounts.[33] We provide details on these below.

Length of carryover period

To ensure continuous incentives, the length of the carryover period for the 2020–25 regulatory control period will be the same as the length of Ergon Energy's following regulatory control period.[34] We expect Ergon Energy's next regulatory control period will be five years, starting from 1 July 2025.

Adjustments to forecast or actual opex when calculating carryover amounts

The EBSS allows us to exclude categories of costs that we do not forecast using a single year revealed cost forecasting approach. We do this to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through the EBSS and network users receive a benefit through lower forecast opex in the next regulatory control period. This is the way network users and the service provider share in the benefits of an efficiency improvement.

If we do not use a single year revealed cost forecasting approach, we may not pass the benefits of revealed efficiency gains through to network users. It follows that network users should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

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[32]   Ergon Energy, *Response to information request IR#036*, 27 May 2019, p. 3.

[33]   AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

[34]   NER, cl. 6.5.8(c)(2).

As noted in section 8.2.2, Ergon Energy proposed that we apply the opex adjustments allowed under version 2 of EBSS.[35]

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

In addition to the excluded cost categories discussed above, we will also make the following adjustments when we calculate the EBSS carryover amounts for the next regulatory control period:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass through amounts or opex for contingent projects.

- adjust actual opex to remove DMIA opex because it is not included in the opex forecast (but is typically reported by service providers as part of their standard control services opex)[36]

- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base[37]

- adjust forecast opex and actual opex for inflation[38]

- adjust actual opex to reverse any movements in provisions

- adjust opex for any services that will not be classified as standard control services in the 2025–30 regulatory control period, to the extent these costs are not forecast using a single year revealed cost approach and excluding these costs better achieves the requirements of clause 6.5.8 of the NER.[39]

[35] Ergon Energy, *1.004 Ergon Energy Regulatory Proposal 2020–25*, January 2019, p. 104.

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

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

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

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