



DRAFT DECISION
Evoenergy
Distribution Determination

2019 to 2024

Attachment 8

**Efficiency benefit sharing
scheme**

September 2018

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Evoenergy for the 2019–2024 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

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

Attachment 13 – Control mechanisms

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

Note	8-2
Contents	8-3
Shortened forms	8-4
8 Efficiency benefit sharing scheme.....	8-5
8.1 Draft decision	8-5
8.2 Application of the EBSS in the 2019–24 regulatory control period	8-6
8.2.1 Length of carryover period	8-6
8.2.2 Adjustments to forecast or actual opex when calculating carryover amounts	8-6

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CCP10	Consumer Challenge Panel, sub-panel 10
DMIA	demand management innovation allowance
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
NEL	national electricity law
NER	national electricity rules
opex	operating expenditure

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 operating expenditure (opex), and provide for a fair sharing of these between distributors and network users. Consumers benefit from improved efficiencies through lower regulated prices.

8.1 Draft decision

Our draft decision is to apply version two of our EBSS to Evoenergy in the 2019–24 regulatory control period. This is consistent with Evoenergy’s proposal.¹

The EBSS is closely linked to our opex revealed cost forecasting approach to choosing a base year to develop a total opex forecast. Under this approach, a service provider has 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 to:

- remove 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
- provide a continuous incentive for a service provider to pursue efficiency improvements across the regulatory control period.

Where we do not propose to rely on the 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.

In our April 2015 opex decision for Evoenergy’s 2014-19 regulatory control period, we decided not to subject Evoenergy’s opex to the EBSS. This was because we forecast Evoenergy’s opex for the 2014-19 period using economic benchmarking rather than using a revealed cost approach. In this circumstance, we did not consider the EBSS was needed to incentivise efficient opex over the 2014-19 regulatory control period. We also noted that it is uncertain whether and to what extent we were likely to rely on Evoenergy’s revealed costs in the 2014–19 period in forecasting opex in the following regulatory control period.

As set out in Attachment 6, we are relying on Evoenergy’s revealed cost as the base year to forecast efficient opex over the 2019-14 regulatory control period. This is because Evoenergy has reduced its opex and we consider that its revealed costs in 2017-18 are no longer materially inefficient. We also consider it is reasonably likely that we will rely on Evoenergy’s revealed costs over the 2019-24 regulatory control period to forecast opex in the following regulatory control period.

¹ Evoenergy, *Regulatory proposal 2019-24, Attachment 10: Incentive schemes*, January 2018, p 10-3.

For these reasons, we are reinstating the EBSS to Evoenergy in the 2019–24 regulatory control period.

The Consumer Challenge Panel (CCP10) supports the application of an EBSS to Evoenergy in the 2019-24 regulatory control period.²

8.2 Application of the EBSS in the 2019–24 regulatory control period

Under the National Electricity Rules (NER) we must determine how the EBSS will apply to Evoenergy in the 2019–24 regulatory control period.³

Version two of our EBSS guideline specifies our approach to determining the length of the EBSS carryover period, and adjusting forecast or actual opex when calculating carryover amounts.⁴ We provide details on these below.

8.2.1 Length of carryover period

The EBSS operates by carrying forward a service provider’s incremental efficiency gains or losses for the length of a carryover period. These carryover amounts will be added or subtracted as an additional building block when determining Evoenergy’s revenue allowance for the 2024–29 regulatory control period.

The length of the carryover period for the 2019–24 regulatory control period should be the same length as the regulatory control period commencing on 1 July 2024. This aligns the EBSS carryover period with the total length of Evoenergy’s regulatory control period and ensures continuous incentives.⁵ We expect Evoenergy’s next regulatory control period will be five years; that is, the period starting 1 July 2024.

8.2.2 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 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 revealed efficiency gains through to network users. Network users should not pay for EBSS benefits where they do not receive the benefits of a lower opex forecast.

² CCP10 Response to Evoenergy regulatory proposal 2019–24 and AER issues paper, May 2018, p.17.

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

⁴ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

⁵ NER, cl. 6.5.8(c)(2).

Evoenergy proposed that the following categories should also be excluded from the calculations of efficiency gains or losses over the 2019-24 regulatory control period:⁶

- debt-raising costs
- costs of any approved pass through events and new regulatory obligations introduced after the final determination
- insurance and self-insurance costs
- superannuation costs for defined benefits fund members
- operating costs associated with projects funded under the DMIA mechanism
- operating costs associated with demand management (non-network) initiatives as they will not be forecast using a single-year revealed-cost approach, and
- costs for any services that will not be classified as Standard Control Services in the 2024–29 regulatory control period.

Consistent with version two of the EBSS, we will only exclude debt raising costs from the EBSS as a pre-defined 'excluded category'. This is because we have not forecast debt raising on a revealed cost basis as part of base year operating expenditure. We instead forecast these using benchmarking.

In addition to the excluded cost category, we will also make the following adjustments when we calculate the efficiency gains and losses that will be carried over into 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.
- adjust actual opex to remove demand management innovation allowance (DMIA) operating expenditure because it is not included in the opex forecast (but is typically reported by service providers as part of their standard control opex)
- adjust actual opex to add capitalised opex that has been excluded from the RAB
- costs for any services that will not be classified as Standard Control Services in the 2024–29 regulatory control period, to the extent that excluding these costs better achieves the requirements of clauses 6.5.8 and 6A.6.5 of the NER.

We have not excluded insurance and self-insurance costs, or superannuation costs for defined benefits fund members, as proposed by Evoenergy. This is because we have forecast these costs using a revealed cost approach as part of total opex, as have Evoenergy in its regulatory proposal. It would be inconsistent with the EBSS to exclude costs from the EBSS which we have forecast using a revealed cost approach.

⁶ Evoenergy, *Regulatory proposal 2019-24, Attachment 10: Incentive schemes*, January 2018, p 10-4

Similarly, we have not excluded costs associated with demand management (non-network) initiatives. It is not clear what costs Evoenergy is referring to when it proposes these costs as an excluded category. However, we note our standard control opex forecast for Evoenergy in Attachment 7 includes a step-change in opex for demand management to prudently defer investment in the construction of a new zone substation. It is not yet clear whether these costs will be required in the 2024-29 regulatory control period, and whether we would adopt a revealed cost approach to forecasting these costs. However, our explanatory statement on the EBSS outlines that we generally do not make specific exclusions for costs that may be ‘one-off’ or ‘lumpy’ in the base year opex we will use to forecast opex into the next regulator control period.⁷

⁷ AER, *Explanatory Statement – Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, pp. 14-17, 21-22