DRAFT DECISION
Evoenergy

Distribution Determination

2019 to 2024

Overview

September 2018

AUSTRALIAN ENERGY REGULATOR

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Note

This overview 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 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

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Attachment 10 – Service target performance incentive scheme

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Shortened forms

Shortened form	Extended form
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CCP/CCP10	Consumer Challenge Panel, sub-panel 10
CESS	Capital expenditure sharing scheme
CPI	Consumer price index
DMIA/DMIAM	Demand management innovation allowance (mechanism)
DMIS	Demand management incentive scheme
EBSS	Efficiency benefit sharing scheme
Evoenergy	The operating name of the energy network division of ActewAGL Distribution partnership, owned equally by Icon Water Limited and Jemena Ltd via subsidiary companies.
ICRC	Independent Competition and Regulatory Commission (ACT)
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
opex	operating expenditure
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RFM	Roll Forward Model
STPIS	Service target performance incentive scheme
TSS	tariff structure statement

About this decision

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. We regulate energy networks in all jurisdictions except Western Australia. We set the amount of revenue that network businesses can recover from customers for using these networks.

The National Electricity Law and Rules (NEL and NER) provide the regulatory framework governing electricity transmission and distribution networks. Our work under this framework is guided by the National Electricity Objective (NEO):[1]

> "…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—
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system."

Evoenergy is the electricity distribution network service provider for the Australian Capital Territory (ACT). On 31 January 2018, Evoenergy submitted its regulatory proposal for the five years commencing 1 July 2019.

The key component of our distribution determination for Evoenergy will be the total revenue it can recover from customers for the provision of common distribution services (or 'standard control services'): those used by most, if not all, of Evoenergy's customers.[2] This is our 'building block determination', and will form the basis of Evoenergy's distribution tariffs for the 2019-24 regulatory control period. Evoenergy's tariff structure statement (TSS) sets out the tariff structure through which it will recover its regulated revenue for standard control services from customers.

Evoenergy also provides 'alternative control services', the costs of which are recovered from users of those services only, through a capped price on the individual service. These costs are considered separately to our revenue determination. We discuss Evoenergy's alternative control services in attachment 15 to this draft decision. Evoenergy has not proposed to provide any services on a negotiated basis in the 2019–24 regulatory control period.[3]

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1 NEL, s. 7.

2 Evoenergy's proposal also includes revenue for its dual function (transmission) assets, which will be recovered through TransGrid as the coordinating transmission network service provider for New South Wales.

3 Our distribution determination for Evoenergy includes an approved negotiating framework and negotiated distribution service criteria, as required by the NER. Because Evoenergy has not included any negotiated services in its proposal, these elements of our determination will be 'inactive' for the 2019-24 regulatory control period.

Invitation for submissions

This is our draft decision on Evoenergy's distribution determination for the 2019–24 regulatory control period. Evoenergy will now have the opportunity to submit a revised proposal in response to this draft decision by 29 November 2018.

Submissions from interested stakeholders on both this draft decision and Evoenergy's revised proposal are invited by 11 January 2019. We will consider and respond to all submissions received by that date in our final determination, which is due to be made by 30 April 2019.

Submissions should be sent to: Evoenergy2019-24@aer.gov.au. Alternatively, submissions can be sent to:

Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

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:

(1) clearly identify the information that is the subject of the confidentiality claim

(2) provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website.[4]

[4] 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: https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information

1 Our draft decision

Our draft decision would allow Evoenergy to recover $871.5 million ($nominal) from its customers from 1 July 2019 to 30 June 2024. We estimate that this draft decision, if implemented, would mean that over that period:

- Evoenergy's average distribution network tariff would increase (in nominal terms) by 12.2 per cent[5]
- the average annual electricity bill for a residential or small business customer on Evoenergy's distribution network would increase by 3.0 per cent.[6]

Evoenergy has undertaken genuine efforts to engage with consumers on both its proposal for the 2019–24 regulatory control period and its proposed resolution to our remaking of our 2014–19 revenue determination.[7] Through this engagement, it is clear that predictability and certainty with respect to price changes is a priority for Evoenergy's customers. Energy affordability remains a key concern for many, as highlighted in submissions from the ACT Energy Consumer Policy Consortium[8] and our own Consumer Challenge Panel (CCP10) on Evoenergy's proposal. At the same time, customers have also told Evoenergy that they want it to:[9]

- maintain safety, quality, reliability and security of supply
- strike the right cost/reliability trade-off when investing in the network
- support new technology and the role it plays in the future of the electricity network, including the potential to provide innovative solutions and cost reflective outcomes
- support customers as they transition to more cost reflective pricing under the proposed refinements to Evoenergy's tariff structure statement (TSS).

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5 Evoenergy's average distribution network tariff would increase by 0.6% (nominal) in 2019-20, and then by an average of 2.8% per cent per annum for the next four years.

6 The average annual electricity bill for a residential or small business customer on Evoenergy's distribution network would increase by 0.2% (nominal) in 2019-20, and then by an average of 0.7% per annum for the next four years. We estimate the expected bill impact by varying the distribution and transmission network charges in accordance with our draft decision, while holding all other components constant. This approach isolates the effect of our draft decision on the core distribution and transmission network charges, and does not imply that other components will remain unchanged across the regulatory control period.

7 AER, Draft Decision Evoenergy 2019–24 electricity distribution determination, September 2018.

8 The Consortium is comprised of representatives of the ACT Council of Social Service (ACTCOSS), Care Financial Counselling Service, the Conservation Council ACT Region, SEE-Change and the Small Business Taskforce of the Canberra Business Chamber. ACTCOSS, the Canberra Business Chamber and SEE-Change are also members of Evoenergy's Energy Customer Reference Council.

9 Evoenergy-Attachment 2 Consumer engagement-January 2018_Public, pp. 2–11 - 2–12.

In the context of these priorities, as CCP10 has also observed,

> "the proposal from Evoenergy is largely reasonable and in general addresses the contemporary concerns of Evoenergy's customers".[10]

Over the current period we have seen Evoenergy make significant progress in improving its efficiency. Where our last decision expressed concerns that its operating expenditure (opex) in particular was materially above efficient levels, we are now in a position to accept Evoenergy's revealed opex as a starting point for its forecast expenditure for the next five years. Evoenergy has also looked closely at its capital expenditure (capex), and its proposal suggests a downward trend in its regulatory asset base (RAB) over the next five years as it works to explore and adopt more efficient capital investment strategies.

In many respects we agree with Evoenergy on the key drivers influencing its revenue requirement for 2019–24. However, a few areas remain in which we require further information before we can accept its proposed increases to capex and opex relative to the current period. In particular, as CCP10 has observed, there are elements of the expenditure proposals that suggest Evoenergy has:

> "drifted more to the reliability side of [the cost/reliability] trade-off than at least some customers would prefer"[11]

We highlight some of these areas of concern in this overview.

Evoenergy will now have the opportunity to respond to our concerns in its revised proposal. We will continue to work with Evoenergy and stakeholders to ensure that our final decision, which will determine the revenue Evoenergy can recover from its customers for the 2019–24 regulatory control period, is in the long term interests of consumers and that Evoenergy's customers are paying no more than they should for safe and reliable electricity.

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[10] Consumer Challenge Panel subpanel 10 - Response to Evoenergy regulatory proposal 2019-24 and AER issues paper - 16 May 2018, p. 2.

[11] Consumer Challenge Panel subpanel 10 - Response to Evoenergy regulatory proposal 2019-24 and AER issues paper - 16 May 2018, p. 2.

1.1 How would our draft decision affect electricity bills?

The distribution network tariffs that will be set by reference to our final decision are only one contributor to electricity bills, and make up around 25 per cent of the total retail electricity bills Evoenergy's customers pay. Other contributors to the total retail bill are:

- Wholesale costs incurred by retailers in purchasing electricity from the National Electricity Market (or of generation as relevant in the case of vertically integrated gentailers), and of managing hedging and price exposure.
- Costs charged by TransGrid as the coordinating transmission network service provider for NSW and the ACT (which we regulate under our transmission determination for TransGrid[12]). This includes the charges for Evoenergy's dual function assets, which are recovered separately from its distribution network tariffs.
- Costs of complying with environmental (green) schemes, including Commonwealth and Territory-based schemes and feed-in tariff schemes.
- The costs of running a retail electricity business, such as billing, marketing and customer assistance costs.
- A retail margin (or profit) returned to shareholders.

Each of these costs contributes to the retail prices charged to customers by their chosen electricity retailer. In the ACT, the Independent Competition and Regulatory Commission (ICRC) sets a default (standing offer) retail price for ActewAGL Retail.[13]

Table 1 shows the estimated average annual impact of our draft decision for the 2019–24 regulatory control period on electricity bills for residential and small business customers. These estimates suggest a change of less than one per cent per year.

[12] https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/transgrid-determination-2018-23.

[13] ICRC - Report 6 of 2017: Final Report - Standing Offer Prices for the Supply of Electricity to Small Customers from 1 July 2017 - June 2017.

Table 1 Estimated impact on annual electricity bills for the 2019–24 regulatory control period ($ nominal)

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24
AER draft decision						
Residential annual bill[a]	2012	2015	2033	2044	2059	2073
Annual change[c]		3 (0.2%)	18 (0.9%)	11 (0.6%)	15 (0.7%)	14 (0.7%)
Small business annual bill[b]	6993	7004	7066	7106	7156	7206
Annual change[c]		11 (0.2%)	62 (0.9%)	39 (0.6%)	51 (0.7%)	49 (0.7%)
Evoenergy's proposal						
Residential annual bill[a]	2012	2043	2075	2102	2133	2165
Annual change[c]		31 (1.5%)	33 (1.6%)	27 (1.3%)	31 (1.5%)	32 (1.5%)
Small business annual bill[b]	6993	7099	7213	7306	7415	7526
Annual change[c]		106 (1.5%)	113 (1.6%)	93 (1.3%)	109 (1.5%)	112 (1.5%)

Source: AER analysis; AER, Energy Made Easy website; AEMC 2017-Residential-Electricity-Price-Trends, ICRC final report on standing offer prices for the supply of electricity to small customers from 1 July 2017.

(a) Annual bill for 2018–19 is sourced from Energy Made Easy and reflects the average consumption of 8000 kWh for residential customers in ACT (postcode 2600).

(b) Annual bill for 2018–19 is sourced from Energy Made Easy and reflects the average consumption of 25000 kWh for small business customers in ACT (postcode 2600).

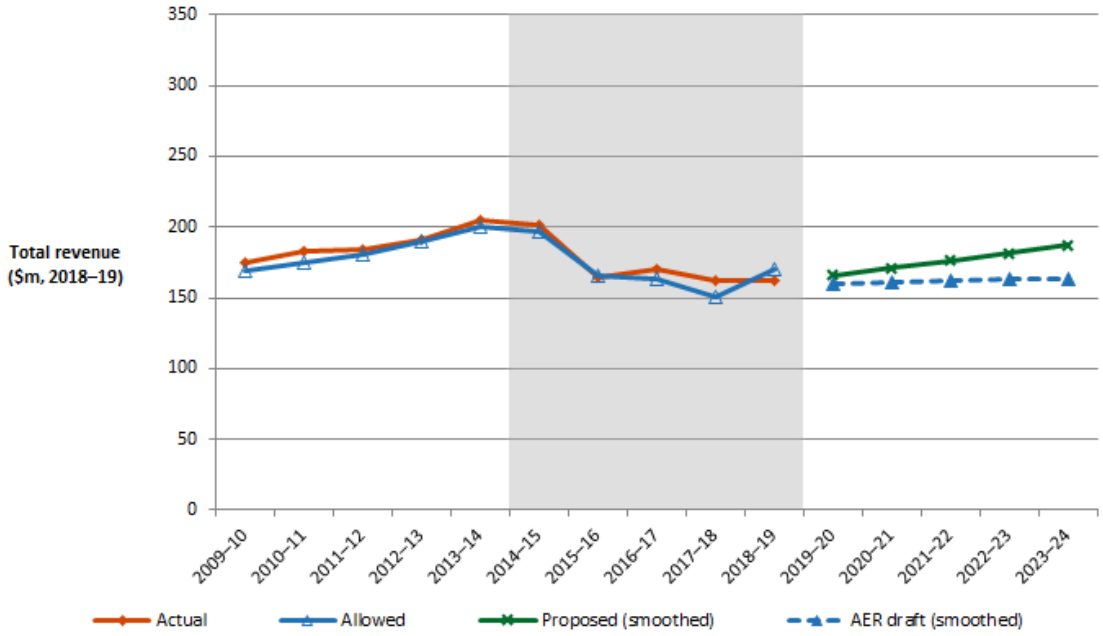
(c) Annual change amounts and percentages are indicative. They are derived by varying the network tariff contribution to the 2018–19 bill amounts in proportion to yearly expected revenue for network services, divided by AEMO's forecast energy delivered for NSW/ACT for transmission and forecast energy for distribution as proposed by Evoenergy. Actual bill impacts will vary depending on electricity consumption and tariff class.

1.2 What is driving revenue?

The changing impact of inflation over time makes it difficult to compare revenue from one period to the next on a like-for-like basis. To do this we use 'real' values based on a common year (in this case 2018/19[14]), which have been adjusted for the impact of inflation.

In real terms, the total revenue allowance in this draft decision is 4.2 per cent lower than total allowed revenue for the current, 2014–19 regulatory control period.[15] As Figure 1 shows, this would result in a real revenue decrease of 1.4 per cent from 2018–19 to 2019–20 followed by gradual increases in annual revenue of around 0.5 per cent.[16]

Figure 1 Revenue over time - distribution and transmission ($million, 2018/19)



Source: AER analysis

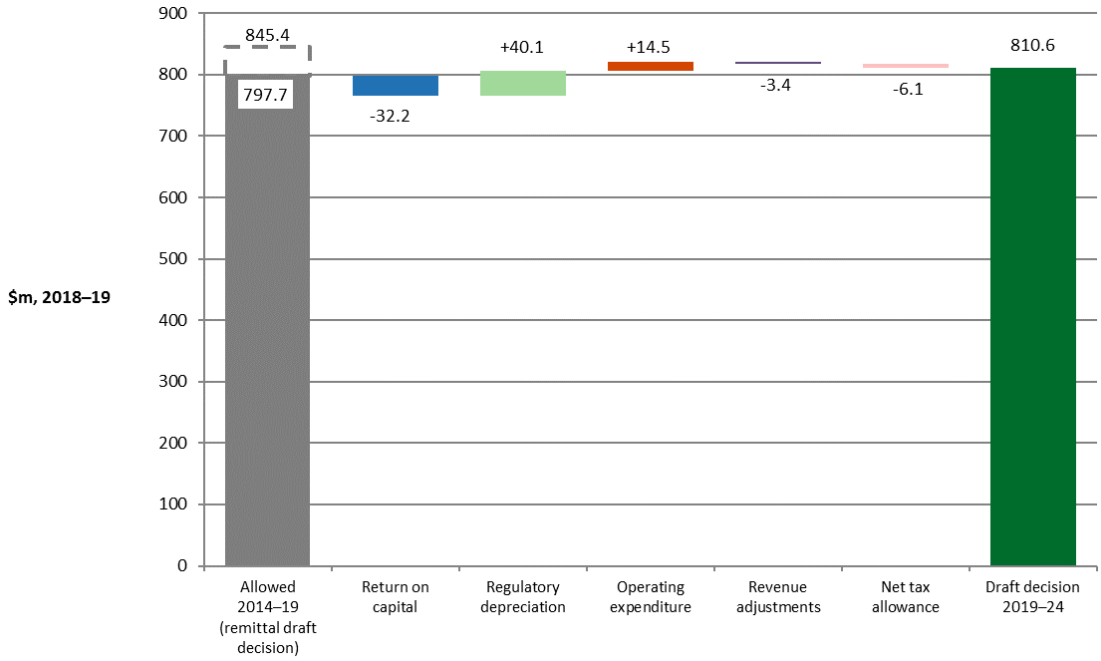
14 i.e. 30 June 2019 dollar terms.

15 This comparison is between the total revenue allowed under this draft decision and that in our draft, remade decision on Evoenergy's total revenue allowance for 2014–19 (https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal).

16 Our draft decision is for X factors of –0.60 per cent for distribution and zero per cent for transmission. We estimate that this draft decision, if implemented, would mean that Evoenergy's average network tariffs would decrease by 0.5 per cent in real terms over the 2019–24 regulatory control period (including a 1.8 per cent decrease from 2018/19 to 2019/20).

Figure 2 below highlights the key drivers of the real change in Evoenergy's revenues from period to period, by reference to the revenue 'building blocks' that form the basis of our assessment.[17]

Figure 2 Change in revenue from 2014-19 to 2019-24 - distribution and transmission ($m, 2018/19)



Note: The 'Allowed 2014–19 (remittal draft decision)' column shows an additional $47.7 million (in dashed grey outline) on top of the $797.7 million total. The $797.7 million is the sum of the revenue building blocks in the remittal PTRM, and incorporates some of the remittal changes including expected inflation, return on debt updates and opex. The additional $47.7 million represents further changes in the remittal PTRM calculations including: yield calculation (updated for actual volumes), service target performance financial incentives, negotiated cap settlement amounts and difference in CPI adjustments.[18]

'Revenue adjustments' include increments or decrements accrued under incentives schemes such as the CESS and DMIA. These are discussed in section 2.6.

Source: AER analysis.

The largest component of Evoenergy's regulated revenue is its return on capital. The return on capital is the product of the size of the RAB and the allowed rate of return (a forecast of the costs of funds Evoenergy will require to attract investment in its

[17] There is an overall period to period revenue decrease from our draft, remade decision for 2014–19 (remittal) compared to this draft decision for 2019–24. The sum of the period to period changes in individual building blocks is positive, but adjustments for yield calculation (updated for actual volumes), service target performance financial incentives, negotiated cap settlement amounts and difference in CPI adjustments offset these to result in an overall decrease.

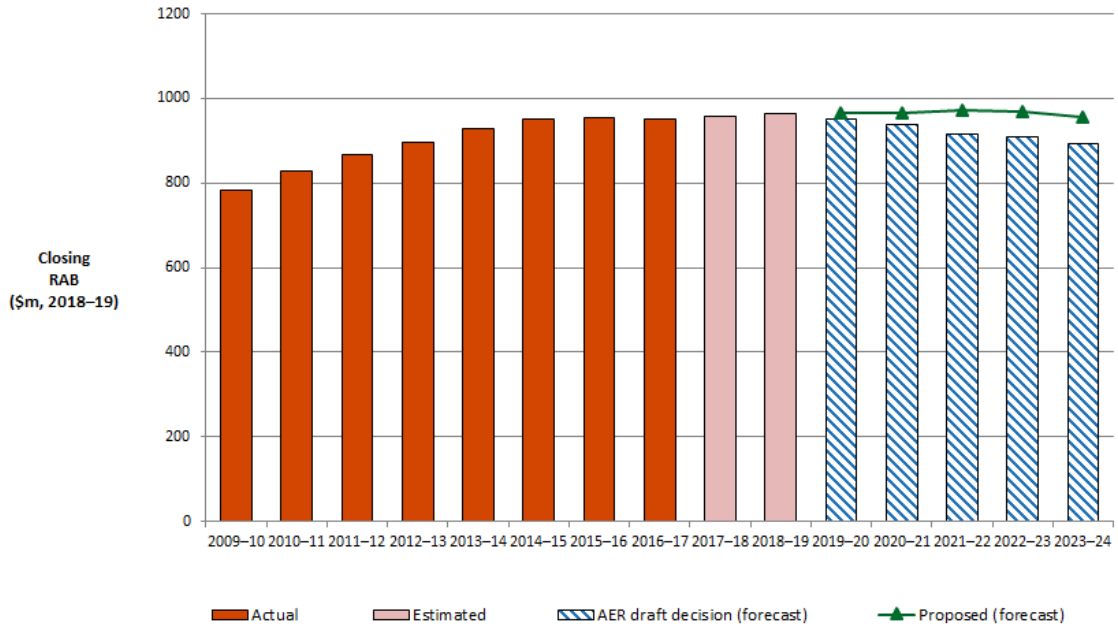
[18] Building block revenues are converted from nominal to real $2018-19 using both forecast and actual CPI, the 'Allowed 2014-19 (remittal draft decision)' amount is converted from nominal to real $2018-19 only using actual CPI.

network). The return on capital under this draft decision is significantly lower than that for the current period.

Our draft decision revenue adopts a placeholder rate of return on Evoenergy's RAB of 5.80 per cent.[19] This is consistent with the approach set out in our draft 2018 rate of return guideline, consultation on which is ongoing. This compares to the 6.48 per cent we previously set for the current period.[20]

In addition to the lower rate of return on the RAB, the size of Evoenergy's RAB is also reducing in real terms. After significant growth in the 2009-14 regulatory control period, Evoenergy's RAB is now expected to reduce in size by a projected 7.6 per cent (in real terms) under this draft decision. This is illustrated in Figure 3.

Figure 3 Projected RAB - distribution and transmission ($million, 2018/19)



Source: AER analysis.

Note: Includes distribution and dual function (transmission) assets.

This lower return on capital is helping to offset the impact of an increase in the regulatory depreciation allowance (or return of capital) component of our draft decision on revenue. One of the key reasons Evoenergy's regulatory depreciation allowance is increasing is the nature of Evoenergy's capex in the current period. Evoenergy's proposal noted the shift in its business priorities over the current period, with an increased focus on customer service outcomes and network capabilities to open the way for greater penetration of distributed energy resources. This is one of the priorities identified in its discussions with consumers.

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19 Nominal, vanilla weighted average cost of capital.

20 Based on the first year of the 2014–19 regulatory control period.

The information and communications technology (ICT) assets that Evoenergy invested in to deliver on these priorities have relatively short asset lives. That means they are depreciated (removed from the RAB as assets come to the end of their usefulness) over a shorter period of time than poles and wires (which have asset lives of 50 years or more). In 2019–24, this is driving an increase in the regulatory depreciation allowance. The balancing effect of this is that depreciation of the RAB is helping to offset the addition of new assets to the RAB as Evoenergy's investment in other parts of its network continues. As noted above, the size of Evoenergy's RAB is expected to reduce (in real terms) from 1 July 2019 to 30 June 2024.

The other element of Evoenergy's revenue that is expected to increase in 2019–24 is its opex. The significant opex efficiencies in labour and workforce practices Evoenergy achieved in 2014–19—one of the benefits of its ICT investment in the current period—are expected to be maintained, and have been passed through to customers in this decision in the form of a lower opex base year. However, total opex is increasing. This is to allow for additional efficient and prudent expenditure to meet Evoenergy's expanded responsibilities for vegetation management under the *Utilities (Technical Regulation) Amendment Act 2017* (ACT), which took effect from 1 July 2018. It also reflects expected increases in input costs, including the cost of labour, and in the costs of operating a larger network with more customers connected.

The combined effect of the lower return on capital and higher depreciation and opex allowances means that our draft decision on Evoenergy's total revenue for 2019–24 is 3.1 per cent lower in real terms than in the current period.

1.3 Key differences between our draft decision and Evoenergy's proposal

Our draft decision does not reflect the total revenue proposed by Evoenergy. The total revenue in this draft decision is 8.4 per cent lower than in Evoenergy's proposal.

The biggest contributor to the difference between our draft decision and Evoenergy's proposal is our proposed change to the rate of return (and therefore the return on capital). Where Evoenergy's proposal was for a higher rate of return than in the current period, this draft decision applies a lower one. Our draft decision adopts the approach proposed in our draft 2018 rate of return guideline to calculate this lower rate of return (5.80 per cent compared to Evoenergy's proposed 6.42 per cent).

Also reflecting our draft 2018 rate of return guideline, our draft decision adopts a value of imputation credits (gamma) of 0.5 compared to Evoenergy's proposed 0.4, which has contributed to the reduction in the corporate income tax allowance relative to Evoenergy's proposal.

Consultation on our draft 2018 guideline is ongoing, and is expected to conclude in December 2018. Legislation currently before the South Australian House of Assembly will (if passed) make our final 2018 rate of return guideline binding on this and other decisions.

While the total revenue in this draft decision shares many of the same drivers that informed Evoenergy's proposal, our current assessment of its expenditure forecasts is also contributing to the difference between the two:

- Evoenergy's total forecast capex includes provision for a level of capital investment that we consider goes beyond what is efficient and prudent for the maintenance and operation of its network and given expected demand. The lower capex forecast we have substituted for the purposes of this draft decision has resulted in a greater projected reduction in Evoenergy's RAB over the 2019–24 period, and also a smaller increase in the regulatory depreciation allowance.
- On the information before us, we consider Evoenergy's total forecast opex overestimates the likely changes in the costs of labour and network growth, and the prudent and efficient costs of meeting its expanded responsibilities for vegetation management. Between now and our final decision in April 2019, we will also be giving further consideration to our approach to forecasting productivity. This review may change our approach going forward, which in turn may impact our final decision on Evoenergy's opex.

We expand on these elements of our draft decision below and in attachments 5 and 6 to this draft decision.

1.4 Evoenergy's consumer engagement

The NEO puts the long term interests of consumers at the centre of our decisions as a regulator and the way Evoenergy operates its network. An important part of this is ensuring the regulatory proposal Evoenergy puts to us for approval reflects the NEO, and that Evoenergy has engaged with its consumers to determine how best to provide services that align with their long term interests.

Consumer engagement in this context is about Evoenergy working openly and collaboratively with consumers and providing opportunities for their views and preferences to be heard and to influence Evoenergy’s decisions. In the regulatory process, stronger consumer engagement can help us test service providers' expenditure proposals, and can raise alternative views on matters such as service priorities, capex and opex proposals and tariff structures.

Our impression is that Evoenergy's consumer engagement processes, including its increased efforts to engage with consumers prior to submission of its regulatory proposal in January this year, have improved significantly in recent years. Evoenergy's engagement program for the proposal currently under consideration was developed in 2016, and "has guided activities that provided stakeholders from a range of consumer groups input to Evoenergy’s electricity network five-year plan".[21] This engagement was instrumental in identifying the key themes that have informed Evoenergy's proposal.

[21] Evoenergy-Attachment 2 Consumer engagement-January 2018_Public, pp. 2–1.

Summary tables throughout its proposal set out how, in each element of that proposal, Evoenergy has sought to work with and respond to the key themes identified through its engagement.

We received two submissions on Evoenergy's proposal that provided feedback on its consumer engagement program, from CCP10 and the ACT Energy Consumer Policy Consortium. Both were on the whole complimentary of Evoenergy's engagement efforts.

With the caveat that it had limited capacity to observe the range of Evoenergy's consumer engagement activities[22], CCP10 observed that:

> "Evoenergy has made significant effort to improve consumer engagement since its last regulatory proposal" and "is making significant steps, as are other network businesses across Australia, to improve the quality of their consumer engagement and to apply continuous improvement approaches".[23]

The subpanel concluded that:[24]

> CCP10 is confident that Evoenergy is taking consumer engagement seriously and is taking a continuous improvement approach by learning as they go. They have also played useful role in helping to build relationships and a knowledge base with a small but significant number of consumer groups. Building on this through refining the regulatory proposal for a revised proposal is likely to be very constructive.

The ACT Energy Consumer Policy Consortium, which shares a number of members with Evoenergy's Energy Customer Reference Council[25], identified resources and funding as a challenge for those looking to engage in regulatory processes. In its submission, the Consortium highlighted support from Evoenergy in the form of funding for ACTCOSS's work on improved customer understanding of energy distribution price-setting and costing issues, and for the targeted survey with low income household customers that informed preparation of its proposal.[26]

In August 2018 Evoenergy commenced a series of targeted 'deep dives', to continue the discussion of its proposal in areas that had attracted particular interest in stakeholder submissions on its proposal and our issues paper. These are the

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22 Consumer Challenge Panel subpanel 10 - Response to Evoenergy regulatory proposal 2019-24 and AER issues paper - 16 May 2018, p. 27.

23 Consumer Challenge Panel subpanel 10 - Response to Evoenergy regulatory proposal 2019-24 and AER issues paper - 16 May 2018, p. 2.

24 Consumer Challenge Panel subpanel 10 - Response to Evoenergy regulatory proposal 2019-24 and AER issues paper - 16 May 2018, p. 31.

25 The Consortium is comprised of representatives of the ACT Council of Social Service (ACTCOSS), Care Financial Counselling Service, the Conservation Council ACT Region, SEE-Change and the Small Business Taskforce of the Canberra Business Chamber. ACTCOSS, the Canberra Business Chamber and SEE-Change are also members of Evoenergy's Energy Customer Reference Council.

26 ACT Energy Consumer Policy Consortium - AER issues paper on Evoenergy distribution determination 2019 to 2024 - 16 May 2018, p. 8.

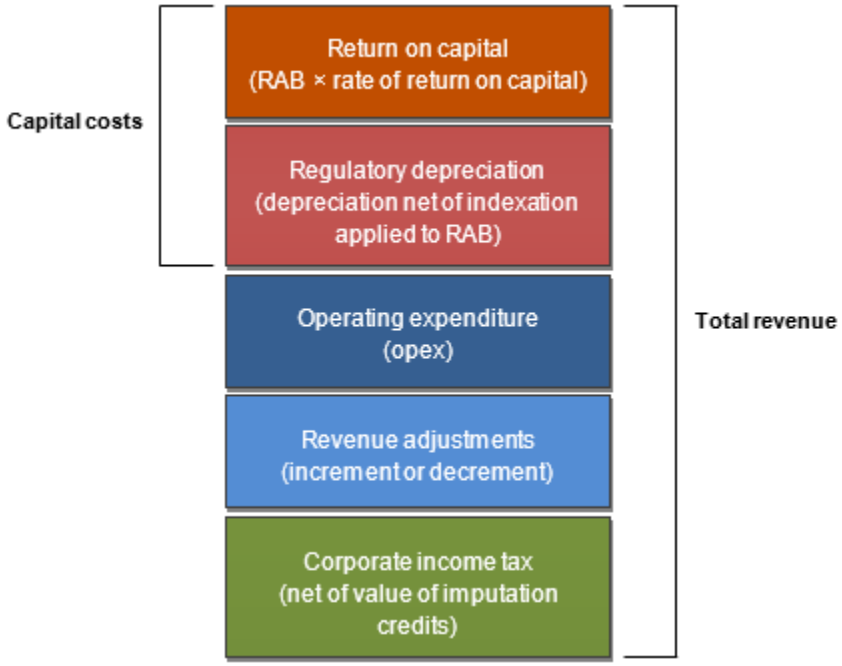
beginning of the next phase of Evoenergy's planned consumer engagement, which will continue as it considers its response to this draft decision and its discussions with us and other stakeholders as we progress towards our final decision in April 2019.

2 Key components of our draft decision on revenue

The total revenue Evoenergy has proposed reflects its forecast of the efficient cost of providing network services over the 2019–24 regulatory control period. Evoenergy's proposal, and our assessment of it under the NEL and NER, are based on a 'building block' approach to determining a total revenue allowance (see Figure 4) which looks at five cost components:

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business)
- depreciation of the RAB (or return of capital, to return the initial investment to investors over time)
    - capex—the capital costs and expenditure incurred in the provision of network services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. The forecast capex approved in our decisions affects the projected size of the RAB and therefore the revenue generated from the return on capital and depreciation building blocks.
- forecast opex—the operating, maintenance and other non-capital expenses incurred in the provision of network services
- revenue adjustments, including revenue increments or decrements resulting from the application of incentive schemes, such as the Capital Expenditure Sharing Scheme (CESS) that applied to Evoenergy for the 2014–19 regulatory control period and the Demand Management Innovation Allowance Mechanism (DMIAM) allowance for 2019–24.
- the estimated cost of corporate income tax.

Figure 4 The building block approach for determining total revenue



We use an incentive approach where, once regulated revenues are set for a five year period, networks who keep actual costs below the regulatory forecast of costs retain part of the benefit. This benchmark incentive framework is a foundation of our regulatory approach and promotes the delivery of the NEO. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

In the sections below we discuss each component of our draft decision on Evoenergy's revenue for 2019–24 in turn.

2.1 Regulatory asset base

The RAB is the value of assets used by Evoenergy to provide regulated distribution and transmission network services. The value of the RAB substantially impacts Evoenergy's revenue requirement, and the price consumers ultimately pay. This makes it a key issue for many stakeholders. Other things being equal, a higher RAB would increase both the return on capital and depreciation (return of capital) components of the revenue determination.

As part of our decision on Evoenergy's revenue for 2019–24, we make a decision on Evoenergy's opening RAB as at 1 July 2019 for its distribution and transmission (dual

function assets) networks.[27] We use the RAB at the start of each regulatory year to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

For our draft decision, we have determined:

- opening RAB values of $790.9 million and $174.1 million ($ nominal) as at 1 July 2019 for Evoenergy for its distribution and transmission networks respectively.
- forecast closing RAB values of $847.1 million and $159.8 million ($ nominal) as at 30 June 2024 for Evoenergy's distribution and transmission networks respectively.

Both our draft decision and Evoenergy's proposal adopt our approved Roll Forward Model (RFM) to calculate Evoenergy's opening RAB as at 1 July 2019, and to project its closing RAB at 30 June 2024. This approach is consistent with that applied for the current period, and that we have used in other, subsequent decisions. The key determinants of RAB outcomes in this draft decision—and of the differences between our draft decision and this element of Evoenergy's proposal—are our related decisions on:

- the forecast of capex to be added to the RAB over the 2019–24 period, which as we discuss in section 2.4 below is lower than Evoenergy proposed.
- updates to the estimation of inflation to reflect the most recent data from the Reserve Bank of Australia (RBA). Our draft decision applies a lower inflation rate of 2.45 per cent, compared to 2.50 per cent in Evoenergy's proposal.

2.2 Rate of return and value of imputation credits

The return (the 'return on capital') each business will receive on its RAB continues to be a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB.

We estimate the rate of return by combining the returns of the two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest on its loans and give a return on equity to investors.

A good estimate of the rate of return is necessary to promote efficient prices in the long term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and reliability may decline. Alternatively, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

[27] NER, cl. 6.12.1(6). Evoenergy's dual function assets are high voltage assets which support the broader NSW transmission network owned and operated by TransGrid. We apply transmission pricing to these assets.

Our draft decision is for an allowed rate of return of 5.80 per cent (nominal vanilla, indicative) for the first year of the 2019–24 regulatory control period. We will annually update the return on debt and overall rate of return for the remaining regulatory years. Our draft decision is to not accept Evoenergy's rate of return proposal of 6.42 per cent.[28]

We estimated our draft decision allowed rate of return using the approach set out in our draft 2018 rate of return guidelines. This reflects a departure from the current (2013) Guidelines. After considering all the material submitted to us, we consider that this departure will, for the reasons set out in the draft 2018 Guidelines,[29] contribute to the achievement of the NEO and allowed rate of return objective to the greatest degree.

Table 2 Draft decision on Evoenergy's rate of return (% nominal)

	ActewAGL/Evoenergy final decision (2014–19)	Evoenergy's proposal (2019–24)	AER draft decision (2019–24)	Allowed return over regulatory control period
Nominal risk free rate	2.55%	2.78%[a]	2.66%[b]	
Market risk premium	6.5%	7%	6%	
Equity beta	0.7	0.7	0.6	
Return on equity (nominal post–tax)	7.1%	7.7%	6.3%	Constant (%)
Return on debt (nominal pre–tax)	6.07%[c]	5.57%	5.46%[d]	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	6.48%	6.42%	5.80%	Updated annually for return on debt
Forecast inflation	2.42%[30]	2.5% c	2.45%	Constant (%)

Source: AER analysis.

a Evoenergy's proxy averaging period of 20 business days ending 31 October 2017.

b AER placeholder averaging period of 20 business days ending 31 July 2018.

c AER return on debt for 2014–15 (the first year of the 2014-19 period).

d AER placeholder trailing average return on debt for 2019-20 (the first year of the 2019-24 period).

[28] Evoenergy, Regulatory proposal for the ACT electricity distribution network 2019–24 Attachment 8: rate of return, imputation credits and forecast inflation, January 2018.

[29] AER, Draft rate of return guidelines explanatory statement, July 2018, p. 17.

[30] We have corrected for an inflation estimation error for Evoenergy/ActewAGL that was identified in the merits review of Victorian Electricity and ACT Gas decisions. For example, see: AER, Proposed revocation and substitution of TransGrid transmission determination 2014–2018, 15 December 2017. The corrected forecast inflation is 2.42 per cent.

Our rate of return of 5.80 per cent represents a reduction from the 6.48[31] per cent we previously set. This is driven by lower returns on equity and debt.

We continue to apply the foundation model approach for estimating the return on equity and estimate a (placeholder) return on equity of 6.3 per cent. This is based on an equity beta estimate of 0.6 and a market risk premium estimate of 6 per cent, which reflect the current market conditions and recent analysis outlined in the draft 2018 Guidelines.[32]

Our draft decision is to maintain the current transition path for Evoenergy and estimate a return on debt of 5.46 per cent. We have maintained our benchmark credit rating and term of debt from the 2013 Guidelines. However, for reasons outlined in the draft 2018 Guidelines, we have updated the implementation of our approach:

- The implementation of the benchmark credit rating has been updated to more accurately reflect the BBB+ benchmark credit rating for reasons outlined in the draft 2018 Guidelines.[33]
- We include an additional debt data series, the Thomson Reuters debt curve, to be evenly averaged with the RBA and Bloomberg debt curves.[34]

Evoenergy proposed a value of 0.4 for imputation credits (gamma). Our draft decision is to apply a gamma of 0.5 for reasons outlined in the draft 2018 Guidelines. These reasons include analysis of data provided to us by the Australian Tax Office and Australian Bureau of Statistics, and observing the distribution rate of the top 20 ASX-listed firms.[35]

Consultation on our draft 2018 Guidelines is ongoing, and is expected to conclude in December 2018. Legislation currently before the South Australian House of Assembly will (if passed) make our final 2018 rate of return guidelines binding on this and other decisions.

2.3 Regulatory depreciation (return of capital)

Regulatory depreciation is the allowance provided so capital investors recover their investment over the economic life of the asset (return of capital). Evoenergy invests capital in large assets to provide electricity network services to its customers. The costs of these assets are recovered over the asset's useful life, many of which can be 50 or more years. This means only a small part of the cost of such assets are recovered from customers upfront or in any year. The greater proportion is recovered over time through the depreciation allowance. The regulatory depreciation allowance is

31 Based on first year of the 2014–19 regulatory period.
32 AER, Draft rate of return guidelines explanatory statement, July 2018.
33 AER, Draft rate of return guidelines explanatory statement, July 2018.
34 AER, Draft rate of return guidelines explanatory statement, July 2018.
35 AER, Draft rate of return guidelines explanatory statement, July 2018.

the net total of the straight-line depreciation less the inflation indexation adjustment of the RAB.

Our draft decision on Evoenergy's revenue for 2019-24 includes a regulatory depreciation allowance of $244.6 million ($nominal).[36] This is $3.2 million (1.3 per cent) lower than Evoenergy's proposal. We have adopted the same approach to depreciation as Evoenergy, including its proposed asset lives which determine how quickly an asset class is depreciated (removed from the RAB). The difference between our draft decision depreciation allowance and that proposed by Evoenergy reflects other, related parts of our draft revenue decision including our draft decisions on:

- the opening RAB at 1 July 2019, which as we mentioned above is lower than Evoenergy's proposal
- the expected inflation rate, which is lower than the rate used in Evoenergy's proposal
- forecast capex, which as we discuss below is lower than Evoenergy's proposal and results in a lower projected RAB value over the 2019–24 regulatory control period.[37]

The combined effect of these changes to the opening RAB and forecast capex is to reduce the depreciation allowance relative to Evoenergy's proposal, but there is still a period to period increase in forecast regulatory depreciation. One reason for this increase is the continued depreciation (over the 2019–24 period) of short-lived assets invested in during the current period. The depreciation allowance included in our draft decision on Evoenergy's revenue is still 21.5 per cent higher (in real terms) than the allowance for the current period.[38]

2.4 Capital expenditure

Capex is added to Evoenergy's RAB, which is used to determine the return on capital and return of capital (regulatory depreciation) building block allowances. All else being equal, higher forecast capex will lead to a higher projected RAB value and higher return on capital and regulatory depreciation allowances.

Our draft decision on Evoenergy's revenue includes total forecast capex of $261.4 million ($2018–19) for 2019–24. This is 20.5 per cent lower than Evoenergy's actual capex over the current period. This is illustrated in Figure 5.

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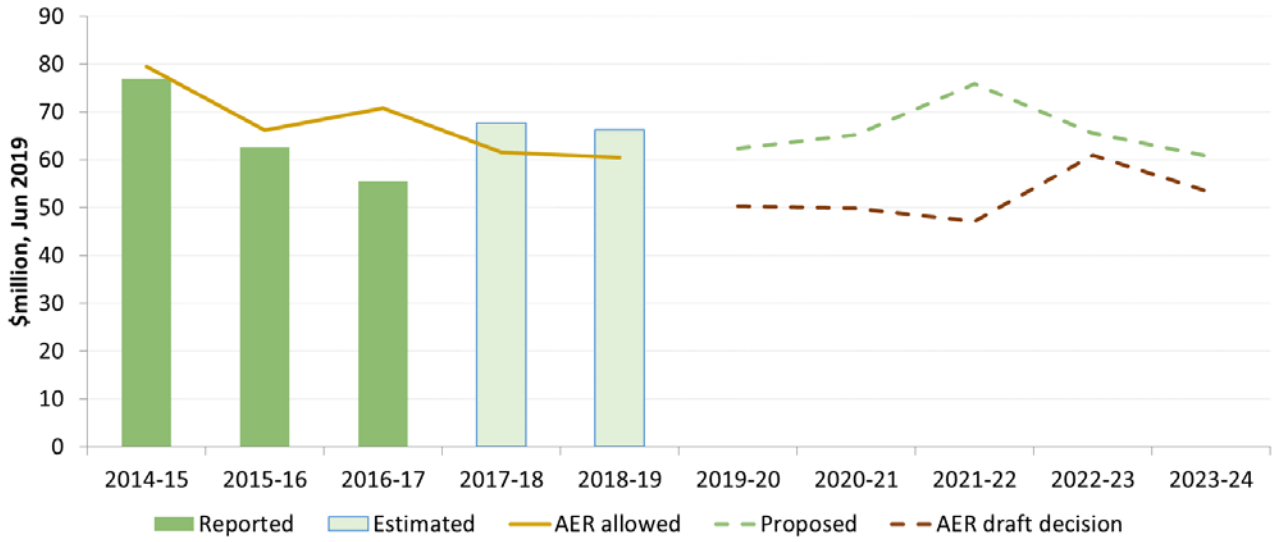
[36] This comprises $206.1 million for distribution assets and $38.5 million for dual function (transmission) assets.

[37] Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB also reflects our updates to the WACC for the 2019–24 regulatory control period.

[38] https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-distribution-determination-2014-19-remittal

Figure 5 Capex over time



Source: AER analysis

Our draft decision substitutes a capex forecast that is 20.7 per cent lower than that in Evoenergy's proposal. The alternative capex forecast for 2019-24 we have adopted for our draft decision includes Evoenergy's forecast connections capex, which will be one of the key drivers of capex in that period. However, other elements of our alternative forecast are lower than in Evoenergy's proposal. There are a number of factors contributing to this:

- While we accept that some of Evoenergy's replacement capex forecast reasonably reflects the required expenditure for this driver, we are not satisfied on the information before us that its forecast for the underground cable asset category is prudent and efficient.
- While we consider Evoenergy's projections of demand and asset utilisation are likely to be reasonable, Evoenergy's continued use of deterministic standards in augmentation planning—an approach we raised concerns with in our original 2014–19 decision—has resulted in an overly conservative approach to managing risk, and therefore overestimates the capex required to meet its expected demand and the relevant reliability targets. On the information before us, a more balanced probabilistic approach (as required under the Regulatory Investment Test) suggests a lower forecast of augmentation and reliability capex could achieve the same objectives.
- Our draft decision includes a lower allowance for non-network capex than Evoenergy's proposal, and particularly for ICT capex. Our review of Evoenergy's proposal suggests that the need for certain components of its forecast in the 2019–24 period has not been substantiated. We are also concerned that the benefits cited in support of the proposed expenditure have not been quantified, and that Evoenergy has not adequately demonstrated how these benefits have been reflected in its regulatory proposal.

- The lower allowance for capitalised overheads we have adopted for this draft decision reflects a decrease in support requirements for our alternative capex estimate compared with Evoenergy's proposal.

The differences between the total capex forecast proposed by Evoenergy and the forecast we have substituted in this draft decision are summarised in Table 3.

Table 3 Assessment of required capex by driver 2019–24 ($2019, million)

Category	Evoenergy	Our alternative estimate	Difference
Augmentation and reliability	$47.2	$24.8	(47.5%)
Reliability	$6.2	-	(100%)
Connections	$85.9	$85.7	(0.2%)
Replacement	$91.6	$83.6	(8.7%)
Non-Network	$58.3	$46.0	(21.1%)
Capitalised overheads	$75.6	$58.0	(23.2 %)
Gross Capex (includes capital contributions)	**$365.0**	**$298.0**	**(18.4%)**
Less Capital Contributions	$34.2	$35.6	0.4%
Less Disposals	$1.1	$1.1	-
Net Capex (excluding capital contributions)	**$329.8**	**$261.4**	**(20.7%)**

Source: AER analysis.

Notes: Capital contributions in this table include an overheads component.
Changes to connections due to revised data from Evoenergy (submitted 5 April 2018).
Numbers may not add up due to rounding.

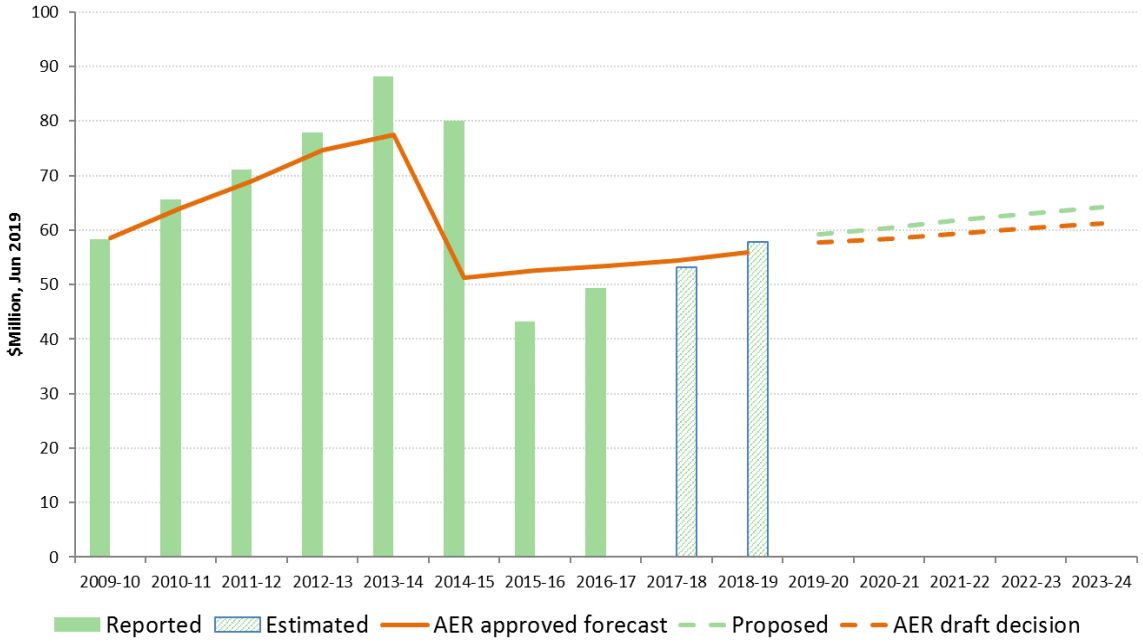
2.5 Operating expenditure

Our draft decision is to include total forecast opex of $297.1 million ($2018/19) in Evoenergy's revenue for the 2019-24 regulatory control period. This is an increase of 12 per cent from Evoenergy's actual opex in the current period, which allows for:

- efficient and prudent expenditure required to meet Evoenergy's expanded responsibilities for vegetation management under the *Utilities (Technical Regulation) Amendment Act 2017* (ACT), which took effect from 1 July 2018
- additional expenditure for demand management, which will support deferral of augmentation to Evoenergy's network
- expected increases in input costs (including the cost of labour), and in the costs of operating a larger network with more customers.

Figure 6 shows trends in Evoenergy's opex over the last two regulatory control periods, and how these compare to its forecast for 2019–24.

Figure 6 Opex over time



Source: AER analysis

The total opex forecast we have adopted in this draft decision starts with the same base year expenditure as Evoenergy's, which reflects the significant opex efficiency gains Evoenergy has made from the 2009–14 regulatory control period to the current, 2014–19 period. However, the following factors have contributed to a 4.6 per cent difference between our draft decision forecast and Evoenergy's proposal:

- The step change for Evoenergy's expanded vegetation management responsibilities that we have included in our total forecast opex is lower than proposed by Evoenergy. This reflects our view—based on the information before us—that the prudent and efficient level of expenditure required to meet these new responsibilities is less than Evoenergy has put to us.
- Our forecast of expected increase in real labour prices in the ACT ('labour price growth) is lower than proposed by Evoenergy. We have applied our standard approach by averaging growth in the wage price index for the ACT utilities industry forecast by Deloitte Access Economics and Evoenergy's consultant, BIS Oxford Economics. In contrast, Evoenergy only applied BIS Oxford Economics' forecasts.
- Our forecast of expected increases in the costs of operating a larger network ('output growth) is lower than Evoenergy:
    - We have derived output weights from the results of four of the models we presented in our 2017 annual benchmarking report. This is a refinement of

our previous approach (and that adopted in Evoenergy's proposal) which used the weights from a single econometric model.[39]

- While we accept that Evoenergy's forecasts of maximum demand are reasonable, we have adopted a different measure of maximum demand than Evoenergy's proposal.

The differences between Evoenergy's total proposed opex and the forecast we have substituted for the purposes of this draft decision are summarised in Table 4.

Table 4 Our alternative estimate compared to Evoenergy's proposal ($ million, 2018–19)

	Evoenergy	Our alternative estimate	Difference
Base opex	282.2	283.0	0.8
Base opex adjustment	-17.4	-17.6	-0.3
Price growth	16.5	12.0	-4.5
Output growth	6.8	3.5	-3.4
Productivity growth	0.0	0.0	0.0
Step changes	20.6	13.8	-6.8
Category specific forecasts	0.0	0.0	0.0
Debt raising costs	2.5	2.4	-0.1
Total opex	**311.4**	**297.1**	**-14.3**

Source: Evoenergy, Revenue proposal - forecast SCS opex model, 31 January 2018; AER analysis.

Note: Numbers may not add up to total due to rounding.

For the purpose of this draft decision, our rate of change applies a zero productivity growth forecast. This is consistent with Evoenergy's proposal, and has been our standard approach to forecasting the productivity component of our opex the rate of change in past decisions.

CCP10 is of the view that a zero productivity improvement over five years is not in the best interests of customers. CCP10 contends that:[40]

[39] We have derived weights from the results four economic benchmarking models — Cobb-Douglas stochastic frontier analysis, Cobb-Douglas least squares econometrics, translog least squares econometrics and opex multi-lateral partial factor productivity. We had previously relied solely on the results of our Cobb-Douglas stochastic frontier analysis model, which is the basis of Evoenergy's proposal.

[40] Consumer Challenge Panel (Subpanel 10), *CCP10 Response to Evoenergy regulatory proposal 2019–24 and AER issues paper*, May 2018, p.15.

> "… meeting the national energy objective (NEO) means that network businesses, including Evoenergy, need to be looking for positive productivity improvements each year, though not necessarily at the recent rate of opex productivity growth."

We are currently reviewing our approach to forecasting productivity. This review may change our approach going forward. As part of this review we will consult with all distributors and any other interested stakeholders. We will take the outcome of this review into consideration in our final decision.

2.6 Revenue adjustments

Our draft decision on Evoenergy's total revenue also includes a number of adjustments, for:

- Rewards accrued under the capital expenditure sharing scheme (CESS), which we applied in the current regulatory control period to incentivise Evoenergy to undertake efficient capex throughout the regulatory control period. The CESS rewards efficiency gains and penalises efficiency losses, each measured by reference to the difference between forecast and actual capex. In the current period Evoenergy out-performed our capex forecast, and our draft decision is to approve a CESS revenue increment amount of $0.2 million ($2018–19) from the application of the CESS in the 2014–19 regulatory control period.[41]
- A demand management innovation allowance mechanism (DMIAM) allowance of $1.7 million ($2018–19) over the 2019–24 regulatory control period.[42] The DMIAM aims to encourage distribution businesses to find investments that are lower cost alternatives to investing in network solutions.

Any difference between our remade decision on Evoenergy's revenue for the current period and the revenue recovered by Evoenergy under the interim price undertakings that have applied over that period will be included as a further adjustment in our final decision on Evoenergy's revenue for 2019–24.[43]

2.7 Corporate income tax

The building block approach to the calculation of revenue includes an allowance for the estimated cost of corporate income tax payable by Evoenergy. Our draft decision is to include a corporate income tax allowance of $26.6 million ($ nominal) in Evoenergy's revenue for 2019–24.[44]

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41 Our draft decision is slightly lower than Evoenergy's proposal of $0.40 million, for the reasons we explain in attachment 9 to this draft decision.

42 As a result of corrections to the DMIAM calculation, this is slightly higher than in Evoenergy's proposal.

43 NER, cl. 8A.15.

44 This comprises $23.2 million for Evoenergy's distribution network revenue and $3.4 million for its dual function asset (transmission) revenue.

Adopting our current approach to the corporate income tax allowance, this allowance begins with an estimate of the taxable income that would be earned by a benchmark efficient company operating its network. This estimate takes into account estimated tax expenses such as interest (using our benchmark 60 per cent gearing) and depreciation. Tax expenses (including other expenses such as opex) are then offset against Evoenergy's forecast revenue to estimate the taxable income. The statutory income tax rate of 30 per cent is then applied to the estimated taxable income to arrive at a notional amount of tax payable. Finally, a discount is applied to the notional amount of tax payable to account for the value of imputation credits (gamma).

The corporate income tax allowance we have included in our draft decision on Evoenergy's revenue for 2019–24 is 31.5 per cent lower than that in Evoenergy's proposal. The adjustments we have made in this draft decision to Evoenergy's proposed return on capital and regulatory depreciation building blocks affect our draft decision on revenues, which in turn impacts the tax calculation for this draft decision. We have also made amendments for the purposes of this draft decision, to:

- reduce the opening tax asset base to reflect updates 2014–19 equity raising costs in our draft remade decision on Evoenergy's 2014–19 revenue
- correct the tax treatment of revenue adjustments associated with the capital expenditure sharing scheme (CESS)
- apply a value of imputation credits (gamma) of 0.5, consistent with our draft 2018 rate of return guideline.

We are still consulting on our draft 2018 rate of return guideline and expect our final revised guideline, which will include a position on the value of imputation credits, will be binding on our final decision for Evoenergy's 2019-24 revenue allowance.

We are also currently consulting on our approach to the corporate income tax allowance. It is possible that, as a result of that consultation, changes to our approach to the tax allowance could be decided before our final decision on Evoenergy's revenue for 2019-24 is made. If this is the case, our final decision on Evoenergy's corporate income tax allowance for 2019–24 may change from this draft decision.

3 Incentive schemes to apply for 2019-24

Incentive schemes are a component of incentive based regulation and complement our approach to assessing efficient costs. These schemes provide important balancing incentives under the revenue determination we've discussed in section 2, to encourage Evoenergy to pursue expenditure efficiencies and demand side alternatives to capex and opex, while maintaining the reliability and overall performance of its network.

The incentive schemes that might apply to an electricity distribution network as part of our decision are:

- the opex efficiency benefit sharing scheme (EBSS)
- the capital expenditure sharing scheme (CESS)
- the service target performance incentive scheme (STPIS)
- the demand management incentive scheme (DMIS) and demand management innovation allowance mechanism (DMIAM).

Once we make our decision on Evoenergy's revenue cap, it has an incentive to provide services at the lowest possible cost, because its returns are determined by its actual costs of providing services. Our incentive schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. If networks reduce their costs to below our forecast of efficient costs, the savings are shared with their customers in future regulatory periods through the EBSS and CESS.

The DMIS and DMIAM encourage businesses to pursue demand side alternatives to opex and capex. The STPIS ensures that the network business is not simply cutting costs at the expense of service quality. Incentives for opex and capex are balanced with the incentives under the STPIS to maintain or improve service quality. The incentive schemes encourage businesses to make efficient decisions on when and what type of expenditure to incur, and meet service reliability targets.

Our draft decision is that each of the EBSS, CESS, STPIS, DMIS and DMIAM should apply to Evoenergy for the 2019–24 regulatory control period.

We discuss our draft decisions on each incentive scheme further in attachments 8 to 11.

4 Tariff structure statement

Evoenergy's 2019–24 proposal includes the second iteration of its tariff structure statement (TSS). Its current TSS applies to 30 June 2019.

The requirement on distributors to prepare a TSS arises from a significant process of reform to the NER governing distribution network pricing. The purpose of the reforms is to empower customers to make informed choices by:

- providing better price signals—tariffs that reflect what it costs to use electricity at different times so that customers can make informed decisions to better manage their bills
- transitioning to greater cost reflectivity—requiring distributors to explicitly consider the impacts of tariff changes on customers, and engaging with customers, customer representatives and retailers in developing network tariff proposals over time
- managing future expectations—providing guidance for retailers, customers and suppliers of services such as local generation, batteries and demand management by setting out the distributor's tariff approaches for the entire duration of the regulatory control period.

Among other matters, Evoenergy's TSS must set out its proposed tariffs, structures and charging parameters for each proposed tariff, and the policies and procedures it will use to assigning customers to tariffs, or reassigning customers from one tariff to another.[45]

Our decision in this determination is on the structure of tariffs that will form the basis of tariff proposals throughout the regulatory control period. While an indicative pricing schedule must accompany the TSS, Evoenergy's tariffs for the entire 2019–24 regulatory control period are not set as part of this determination.[46]

Rather, and as per past practice, tariffs for the financial year commencing 1 July 2019 will be subject to a separate approval process that takes place in May 2019, after we have made our final revenue determination in April 2019. In turn, tariffs for the following four years will also be approved on an annual basis.

We see Evoenergy as the most advanced distributor in the National Electricity Market (NEM) in respect of reforming its residential and small business customer network tariff structures. Its proposal has a stated aim to increase cost reflectivity and improve price signals while concurrently managing customer impacts. To meet this objective Evoenergy proposed to:

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45 NER, cl. 6.18.5.

46 NER, cl. 6.8.2(d)(1).

- maintain its current tariff design and assignment policies for residential customers (i.e. to assign all new customer connections to a demand tariff but with those customers having the option to opt-in to a Time of Use energy tariff instead)
- refine the tariff structure for large low voltage and high voltage commercial customers, by changing the 'anytime' maximum demand charges to include 'peak period' demand charges.
- change its default demand tariff structure from flat to time of use energy charges for residential and low voltage commercial customers.

Our draft decision broadly supports the direction of these changes, but we have a number of concerns with the way they have been reflected in the TSS itself. In attachment 18 we have therefore set out a series of changes that we consider necessary for us to approve the TSS. These include amendments to provide more certainty as to how customers are assigned to particular tariffs, and of the structure of particular tariffs.

A The National Electricity Objective

The NEL requires us to make our decision in a manner that contributes, or is likely to contribute, to achieving the NEO.[47] The focus of the NEO is on promoting efficient investment in, and operation and use of, electricity services (rather than assets) in the long term interests of consumers.[48] This is not delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision.[49]

In general, we consider that the long-term interests of consumers are best served where consumers receive a reasonable level of safe and reliable service that they value at least cost in the long run.[50] A decision that places too much emphasis on short term considerations may not lead to the best overall outcomes for consumers once the longer term implications of that decision are taken into account. [51]

There may be a range of economically efficient decisions that we could make in a revenue determination, each with different implications for the long term interests of consumers.[52] A particular economically efficient outcome may nevertheless not be in the long term interests of consumers, depending on how prices are structured and risks allocated within the market.[53] There are also a range of outcomes that are unlikely to advance the NEO, or advance the NEO to the degree than others would. For example, we consider that:

- the long term interests of consumers would not be advanced if we encourage overinvestment which results in prices so high that consumers are unwilling or unable to efficiently use the network.[54] This could have significant longer term pricing implications for those consumers who continue to use network services.
- equally, the long-term interests of consumers would not be advanced if allowed revenues result in prices so low that investors do not invest to sufficiently maintain the appropriate quality and level of service, and where customers are making more use of the network than is sustainable.[55] This could create longer term problems in the network, and could have adverse consequences for safety, security and reliability of the network.

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47 NEL, section 16(1).

48 This is also the view of the Australian Energy Market Commission (AEMC). See, for example, AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

49 Hansard, SA House of Assembly, 26 September 2013, p. 7173. See also AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 7–8.

50 Hansard, SA House of Assembly, 9 February 2005, p. 1452.

51 See, for example, AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 6–7.

52 Re Michael: Ex parte Epic Energy [2002] WASCA 231 at [143].

53 See, for example, AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

54 NEL, s. 7A(7).

55 NEL, s. 7A(6).

The legislative framework recognises the complexity of this task by providing us with significant discretion in many aspects of the decision-making process to make judgements on these matters.

A.1 Achieving the NEO to the greatest degree

Electricity determinations are complex decisions. In most cases, the provisions of the NER do not point to a single answer, either for our decision as a whole or in respect of particular components. They require us to exercise our regulatory judgement. For example, chapter 6A of the NER requires us to prepare forecasts, which are predictions about unknown future circumstances. Very often, there will be more than one plausible forecast,[56] and much debate amongst stakeholders about relevant costs. For certain components of our decision there may therefore be several plausible answers or several plausible point estimates.

When the constituent components of our decision are considered together, this means there will almost always be several potential, overall decisions. More than one of these may contribute to the achievement of the NEO. In these cases, our role is to make an overall decision that we are satisfied contributes to the achievement of the NEO to the greatest degree.[57]

We approach this from a practical perspective, accepting that it is not possible to consider every permutation specifically. Where there are choices to be made among several plausible alternatives, we have selected what we are satisfied would result in an overall decision that contributes to the achievement of the NEO to the greatest degree.

A.2 Interrelationships between constituent components

Examining constituent components in isolation ignores the importance of the interrelationships between components of the overall decision, and would not contribute to the achievement of the NEO. We have considered these interrelationships in our analysis of the constituent components of our draft decision in the relevant attachments. Examples include:

- Underlying drivers and context which are likely to affect many constituent components of our decision. For example, forecast demand affects the efficient levels of capex and opex in the regulatory control period.
- Direct mathematical links between different components of a decision. For example, the level of gamma has an impact on the appropriate tax allowance; the

[56] AEMC, *Rule Determination: National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*, 16 November 2006, p. 52.

[57] NEL, s. 16(1)(d).

benchmark efficient entity's debt to equity ratio has a direct effect on the cost of equity, the cost of debt, and the overall vanilla rate of return.

- Trade-offs between different components of revenue. For example, undertaking a particular capex project may affect the need for opex or vice versa.

B Constituent components

This overview and the accompanying attachments set out our draft decision on Evoenergy's distribution determination for the 2019–24 regulatory control period. Our draft decision includes the following constituent components:[58]

Constituent component
In accordance with clause 6.12.1(1) of the NER, the AER's draft decision is that the classification of services set out in Attachment 12 will apply to Evoenergy for the 2019–24 regulatory control period.
In accordance with clause 6.12.1(2)(i) of the NER, the AER's draft decision is not to approve the annual revenue requirement set out in Evoenergy's building block proposal. Our draft decision on Evoenergy's annual revenue requirement for each year of the 2019–24 regulatory control period is set out in attachment 1 of the draft decision.
In accordance with clause 6.12.1(2)(ii) of the NER, the AER's draft decision is to approve Evoenergy's proposal that the regulatory control period will commence on 1 July 2019. Also in accordance with clause 6.12.1(2)(ii) of the NER, the AER's draft decision is to approve Evoenergy's proposal that the length of the regulatory control period will be 5 years from 1 July 2019 to 30 June 2024.
In accordance with clause 6.12.1(3)(ii) and acting in accordance with clause 6.5.7(c), the AER's draft decision is not to accept Evoenergy's proposed total net forecast capital expenditure of $329.8 million ($2018–19). Our draft decision therefore includes a substitute estimate of Evoenergy's total net forecast capex for the 2019–24 regulatory control period of $261.4 million ($2017–18). This is discussed in attachment 5 of the draft decision.
In accordance with clause 6.12.1(4)(ii) and acting in accordance with clause 6.5.6(c), the AER's draft decision is not to accept Evoenergy's proposed total forecast operating expenditure inclusive of debt raising costs and exclusive of DMIAM of $311.4 million ($2018-19). Our draft decision therefore includes a substitute estimate of Evoenergy's total forecast opex for the 2019–24 regulatory control period of $297.1million ($2018–19) including debt raising costs and exclusive of DMIAM. This is discussed in attachment 6 of the draft decision.
In accordance with clause 6.12.1(5), the AER's draft decision is that the allowed rate or return for the 2019–20 regulatory year is 5.80 per cent (nominal vanilla), as set out in Attachment 3 of this draft decision, and that the rate of return for the remaining regulatory years 2020–24 will be updated annually because our decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.
In accordance with clause 6.12.1(5A) the AER's draft decision is that the return on debt is to be estimated using a methodology referred to in clause 6.5.2(i)(2) and using the formula to be applied in accordance with clause 6.5.2(l). The methodology and formula are set out in

[58] NEL, s. 16(1)(c).

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Attachment 3 of this draft decision.
In accordance with clause 6.12.1(5B) the AER's draft decision on the value of imputation credits as referred to in clause 6.5.3 is to adopt a value of 0.5.
In accordance with clause 6.12.1(6) the AER's draft decision on Evoenergy's regulatory asset base as at 1 July 2019 in accordance with clause 6.5.1 and schedule 6.2 is $790.9 million and $174.1 million ($ nominal) for its distribution and transmission networks respectively. This is discussed in attachment 2 of the draft decision.
In accordance with clause 6.12.1(7) the AER's draft decision is not to accept Evoenergy's proposed corporate income tax of $38.8 million ($ nominal). Our draft decision on Evoenergy's corporate income tax is $26.6 million ($ nominal). This is set out in attachment 7 of the draft decision.
In accordance with clause 6.12.1(8) the AER's draft decision is to not approve the depreciation schedules submitted by Evoenergy. Our draft decision substitutes alternative depreciation schedules in accordance with clause 6.5.5(b) and this is set out in attachment 4 of the draft decision.
In accordance with clause 6.12.1(9) the AER makes the following draft decisions on how any applicable efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme, demand management incentive scheme or small-scale incentive scheme is to apply: • We will apply version two of the EBSS to Evoenergy in the 2019–24 regulatory control period. This is set out in attachment 8 of the draft decision. • We will apply the CESS as set out in version 1 of the Capital Expenditure Incentives Guideline to Evoenergy in the 2019–24 regulatory control period. CESS is discussed in attachment 9 of the draft decision. • We will apply our Service Target Performance Incentive Scheme (STPIS) to Evoenergy for the 2019–24 regulatory control period, as set out in attachment 10 of the draft decision. • We will apply the DMIS and DMIAM to Evoenergy for the 2019–24 regulatory control period, as set out in attachment 11 of the draft decision.
In accordance with clause 6.12.1(10) the AER's draft decision is that all appropriate amounts, values and inputs are as set out in this determination including attachments.
In accordance with clause 6.12.1(11) the AER's draft decision on the form of control mechanisms (including the X factor) for standard control services is a revenue cap. The revenue cap for Evoenergy for any given regulatory year is the total annual revenue calculated using the formula in attachment 13 plus any adjustment required to move the DUoS unders and overs account to zero. This is discussed at attachment 13 of the draft decision.
In accordance with clause 6.12.1(12) the AER's draft decision on the form of the control mechanism for alternative control services is to apply price caps for all services. This is discussed in attachment 13 of the draft decision.
In accordance with clause 6.12.1(13), to demonstrate compliance with its distribution

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determination, the AER's draft decision is Evoenergy must maintain a DUoS unders and overs account. It must provide information on this account to us in its annual pricing proposal. This is discussed in attachment 13 of the draft decision.

In accordance with clause 6.12.1(14) the AER's draft decision is to apply the following nominated pass through events for the 2019–24 regulatory control period in accordance with clause 6.6.1(a1)(5):

- Terrorism event
- Natural Disaster event
- Insurance Cap event
- Insurer Credit Risk event

These events have the definitions set out in Attachment 14 of the draft decision.

In accordance with clause 6.12.1(14A) the AER's draft decision is to not approve the tariff structure statement proposed by Evoenergy. This is discussed in attachment 18 of the draft decision.

In accordance with clause 6.12.1(15) the AER's draft decision is to approve Evoenergy's proposed negotiating framework. This decision is set out in attachment 16 of the draft decision.

In accordance with clause 6.12.1(16) the AER's draft decision is to apply the negotiated distribution services criteria published in February 2018 to Evoenergy. This decision is set out in attachment 16 of the draft decision.

In accordance with clause 6.12.1(17) the AER's draft decision on the procedures for assigning retail customers to tariff classes for Evoenergy is set out in attachment 13 of the draft decision.

In accordance with clause 6.12.1(18) the AER's draft decision is that the depreciation approach based on forecast capex (forecast depreciation) is to be used to establish the RAB at the commencement of Evoenergy's regulatory control period as at 1 July 2024. This is discussed in attachment 2 of the draft decision.

In accordance with clause 6.12.1(19) the AER's draft decision on how Evoenergy is to report to the AER on its recovery of designated pricing proposal charges is to set this out in its annual pricing proposal. The method to account for the under and over recovery of designated pricing proposal charges is discussed in attachment 13 of the draft decision.

In accordance with clause 6.12.1(20) the AER's draft decision is to require Evoenergy to maintain a jurisdictional scheme unders and overs account. It must provide information on this account to us in its annual pricing proposal as set out in attachment 13 of the draft decision.

In accordance with clause 6.12.1(21) the AER's draft decision is to not approve the connection policy proposed by Evoenergy. Our draft decision is to amend Evoenergy's proposed connection policy as set out in attachment 17 of the draft decision.