



FINAL DECISION
Evoenergy
Access Arrangement

2021 to 2026

Attachment 13
Capital expenditure sharing
scheme

April 2021

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Note

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

The final decision includes the following documents:

Overview

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 7 – Corporate income tax

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

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13 Capital expenditure sharing scheme

This attachment outlines our assessment of Evoenergy's proposal for a capital expenditure sharing scheme (CESS) for the 2021–26 access arrangement period.

As the CESS is new for Evoenergy, it will not impact revenues in the upcoming access arrangement period, but rather, future access arrangement periods. Consequently, our draft decision relates to the design of the scheme.

In its initial proposal, the design of Evoenergy's proposed CESS appeared to be based on Jemena Gas Networks (NSW) Ltd's (JGN) CESS 2020 proposal.¹ Significantly, Evoenergy's CESS would not apply to connections capital expenditure (capex) which we accepted in our draft decision.²

In its revised proposal, Evoenergy has amended its proposed CESS to also exclude renewable gas related capex and to add the performance data of 2019–20 actual to its performance measure targets.

13.1 Final decision

Our final decision approves the application of a CESS in Evoenergy's 2021–26 period. However, we require amendments to be made to its proposal that:

- remove clause 6.1(d) of the access arrangement, which provides that the CESS is a fixed principle for the 2021–26 period and for the next two access arrangement periods
- remove a clause requiring material events outside of Evoenergy's control to be adjusted when measuring actual performance
- remove clause 4.2(e)(iv) of the access arrangement, which exclude certain capex found to be conforming in the speculative capex account from the operation of the CESS
- amend drafting to ensure the correct operation of the CESS.

A full list of required amendments are provided in Table 13.2 below.

¹ JGN, *2020-25 Access Arrangement, January 2020*, pp. 26–32.

² AER, *Draft decision, Evoenergy access arrangement 2021–26, Attachment 13 – Capital Expenditure Sharing Scheme, November 2020*, p. 7.

13.2 Evoenergy's revised proposal

In its revised proposal, Evoenergy made the following amendments to its access arrangement:³

- Added the following clause in the operation of the CESS incentive mechanism in its access arrangement:⁴
 - 'exclude capital expenditure on projects to connect or progress the injection of renewable gas alternatives into the gas network.'
- Revised the following performance targets:⁵
 - Unplanned System Average Interruption Frequency Index (SAIFI) from 0.6562 to 0.675581
 - Unplanned System Average Interruption Duration Index (SAIDI) from 2.4357 to 2.566814
 - Mains and services leaks from 0.0504 to 0.049728
 - Meter leaks from 11.8062 to 11.764908.

13.3 Assessment approach

Our assessment approach is the same as for the draft decision.⁶

13.3.1 Interrelationships

Evoenergy's proposed CESS relates to various areas of the business covered by the 2021–26 access arrangement.⁷ For example, its introduction will affect the size of the capital base and may alter the balance of investment signals between operating expenditure (opex) and capex.

We aim to incentivise service providers, such as Evoenergy, to make efficient decisions on when and what type of expenditure, to incur, and to balance expenditure efficiencies with service standards.

³ Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 51.

⁴ Evoenergy, *Attachment 11.2 – Access arrangement for the ACT and Queanbeyan-Palerang gas distribution network (marked up)*, January 2021, p. 9.

⁵ *Ibid.*, pp. 89–90.

⁶ AER, *Draft decision, Evoenergy access arrangement, Attachment 13 - Capital expenditure sharing scheme*, November 2020, p. 4.

⁷ Evoenergy, *Attachment 11.2 – Access arrangement for the ACT and Queanbeyan-Palerang gas distribution network (marked up)*, January 2021, pp. 9–14.

13.3.2 Stakeholders

We received one submission which commented on CESS. The Consumer Challenge Panel (CCP24) thought the AER should exclude any capex saving by Evoenergy resulting from any NSW legislative changes re net zero emission. Otherwise CCP24 support CESS excluding capex and the further proposed exclusions.⁸

There are provisions in the access arrangement which address the potential cost pass through events, including the possibility mentioned by CCP24.

13.4 Reasons for final decision

13.4.1 Removal of fixed principle

Evoenergy proposed to apply a fixed principle to the CESS. A fixed principle extends an access arrangement clause into future access arrangement periods (up to two periods). If we accept a fixed principle, we are bound to accept that clause in the future periods.⁹

We do not consider there is a need to include the CESS as a fixed principle to facilitate the inclusion of increments or decrements in revenues in subsequent access arrangement periods. The National Gas Rules (NGR) already allow for the inclusion of increments or decrements from the application of incentive schemes in a previous access arrangement period.

Further, our decision to apply the CESS without fixed principle is consistent with our 2017 Victorian and 2020 NSW decisions for distribution gas networks. In the Victorian decisions, we noted that we would continue to consult on the operation, monitor the outcomes and address any issues that may arise at the time of the next access arrangement review. For this reason, we did not approve application of a fixed principle for 10 years in relation to the CESS. For the reasons outlined above, and as a matter of consistency with the other access arrangements, we do not accept Evoenergy's proposed fixed principle.

We raised this concern with Evoenergy on the 25 March 2021 and subsequently received a revision of its access arrangement on the 31 March 2021 for consideration in our final decision.

⁸ CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 37.

⁹ NGR, r. 99. A fixed principle can be revoked by consent with a service provider, or, if a fixed principle is inconsistent with a rule, the rule operates to the exclusion of the fixed principle.

13.4.2 Removal of and replacement of uncontrollable events

Evoenergy added a clause to its revised proposal regarding the treatment of events outside of its control.¹⁰ The clause allows Evoenergy to adjust its performance measures to account for events outside of its control. These events, once excluded, would not reduce Evoenergy's performance against its targets, and would not cause it to receive a lower CESS payment through the contingent payment mechanism.

We do not accept this proposal for the following reasons:

- when the CESS was first designed, we carried out a public consultation process and specifically ruled out exclusions of this kind¹¹
- the contingent payment mechanism provides a range within which CESS can be obtained, and is designed to account for unforeseen factors.¹²

On this basis, we do not accept Evoenergy's proposed clause relating to uncontrollable events (Schedule 9(h)). Evoenergy can seek an adjustment for unforeseen events in the next access arrangement review. We would consider the merits of this at the time of that review.

We raised this concern with Evoenergy on the 25 March 2021 and subsequently received a revision of its access arrangement on the 31 March 2021 for consideration in our final decision.

In addition, at the next access arrangement review, we will do an ex-post review to inform our assessment of:

- what capex in the last period has been prudent and efficient
- any capex that has been deferred
- the case for any adjustments that Evoenergy proposes.

¹⁰ Attachment 11.2 – Access arrangement for the ACT and Queanbeyan-Palerang gas distribution network (marked up), January 2021, p. 90.

¹¹ AER, *Better Regulation, Explanatory Statement, Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, Section 2.3.6, p. 36.

¹² The contingent payment factor allows CESS payments to be made to Evoenergy on a sliding scale. If Evoenergy achieves 100 per cent of its performance targets, it will receive a full payment. The payment will then reduce if Evoenergy does not achieve 100 per cent on a sliding scale, and Evoenergy will not receive a CESS payment if its performance is less than 80 per cent.

13.4.3 Exclusion of speculative capex from CESS targets

As a result of Evoenergy requesting the opening of a speculative capex account relating to renewable gas investment, Evoenergy has added the following clause in the operation of the CESS incentive mechanism in its access arrangement:¹³

- ‘exclude capital expenditure on projects to connect or progress the injection of renewable gas alternatives into the gas network.’

It is our understanding that the reason Evoenergy’s included this clause was to exclude from CESS any renewable gas related capex in the speculative capex account found to be conforming in the 2021–26 period.¹⁴

Since we do not accept the opening of a speculative capex account for Evoenergy in the 2021–26 period, we also do not accept the proposed clause in the revised access arrangement.¹⁵ We will reconsider this clause on a case by case basis should we accept the opening of a speculative capex account at some future time.

13.4.4 Minor drafting amendments

We also require other minor drafting amendments to the access arrangement:

- Remove the cross references in clause 4.2(d) and amend the drafting of clause 4.2(d) to:

“(d) For the purpose of calculating the annual efficiency gain (or loss), the approved capital expenditure allowance is to be adjusted to take into account a change in the scope of activities in accordance with the approach outlined below or for any Cost Pass Through Event that the Relevant Regulator has determined has an Administrative Cost Impact.”
- References in clause 4.4 on *real WACC* be changed to *real vanilla WACC*.

13.4.5 Contingent payment factor range

The CESS proposed by Evoenergy contains a mechanism to vary CESS payments based on Evoenergy’s performance against certain service targets. This is known as the contingent payment factor (CPF). The CPF is in place to balance the incentive for Evoenergy to make efficiency savings on capex and to maintain its quality of service.

The CPF allows CESS payments to be made to Evoenergy on a sliding scale. Evoenergy has proposed the range for the CPF be set from 80 to 100 per cent

¹³ Attachment 11.2 – Access arrangement for the ACT and Queanbeyan-Palerang gas distribution network (marked up), January 2021, p. 9.

¹⁴ Evoenergy, Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26, January 2021, p. 51.

¹⁵ AER, Final decision, Evoenergy access arrangement 2021–26, Attachment 5 – Capital expenditure, April 2021, p. 26.

consistent with our NSW and Victorian gas network decisions. Under this arrangement, if Evoenergy achieves 100 per cent of its performance targets, it will receive a full payment. The payment will then reduce if Evoenergy does not achieve 100 per cent on a sliding scale. Evoenergy will not receive a CESS payment if its performance is less than 80 per cent even in instances where a capex reduction occurs.

We have accepted Evoenergy’s proposal to apply the CPF range from 80–100 for the 2021–26 period. We consider the performance targets proposed and calculations used are broadly similar to those approved in NSW and Victoria.

13.4.6 Performance targets for the contingent payment factor

Evoenergy’s contingent payment factor includes a series of targets that its performance is judged against. In our draft decision, we accepted that the three years of historical data Evoenergy used to develop its performance targets were reasonable given that they were relatively stable.¹⁶

In its revised proposal, Evoenergy adjusted its performance target by including its recent 2019–20 actual performance. This resulted in a slight reduction of its performance requirement for certain targets. Table 13.1 show the changes in Evoenergy’s performance targets between our draft decision and its revised proposal.

Table 13.1 Evoenergy’s proposed performance targets

Performance targets (weighting)	2016–17	2017–18	2018–19	2019–20	Initial proposal ^a	Revised Proposal ^b
Unplanned SAIFI (30%)	0.917	0.446	0.605	0.734	0.6562	0.6756
Unplanned SAIDI (30%)	4.249	1.189	1.870	2.960	2.4357	2.5668
Mains and services leaks (20%)	0.055	0.047	0.050	0.048	0.0504	0.0497
Meter leaks (20%)	11.037	11.921	12.461	11.641	11.8062	11.7649

Source: AER analysis based on actual data provided by Evoenergy.

Notes a 2016–17 to 2018–19 three year average.

b 2016–17 to 2019–20 four year average.

We have reviewed the 2019–20 actual performance data Evoenergy used to develop its targets. While some of the targets are higher than the previous two years, we do not considered them to be outliers and they do not materially impact the overall target compared to our draft decision.

On that basis, we accept Evoenergy’s revised performance targets to be reasonable in assessing the actual performance of Evoenergy over the access arrangement period.

¹⁶ AER, *Draft decision, Evoenergy access arrangement 2021–26, Attachment 13 – Capital Expenditure Sharing Scheme*, November 2020, p. 7.

13.5 Proposed revisions

We require the following revisions to make the access arrangement proposal acceptable:

Table 13.2 Revisions

Revision 13.1	Remove clauses 6.1(d) from the Access arrangement, Evoenergy's gas distribution network, 1 July 2021 – 30 June 2026.
Revision 13.2	Delete schedule 9(h). Include new schedule 9(h) stating: "Evoenergy may seek, subject to AER approval, to exclude from the arithmetic average calculated in paragraph (b), the impact of material events that are outside of Evoenergy's control."
Revision 13.3	Remove the explicit cross references in clause 4.2(d) and change the drafting of clause 4.2(d) to : "(d) For the purpose of calculating the annual efficiency gain (or loss), the approved capital expenditure allowance is to be adjusted to take into account a change in the scope of activities in accordance with the approach outlined below or for any approved Cost Pass Through Event that the Relevant Regulator has determined has an Administrative Cost Impact."
Revision 13.4	Remove clauses 4.2(e)(iv) from the Access arrangement, Evoenergy's gas distribution network, 1 July 2021 – 30 June 2026.
Revision 13.5	Change References in clause 4 from <i>real WACC</i> to <i>real vanilla WACC</i>

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
Capex	capital expenditure
CCP/CCP24	Consumer Challenge Panel, sub-panel 24
CESS	capital expenditure sharing scheme
CPF	Contingent Payment Factor
JGN	Jemena Gas Networks (NSW) Ltd
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NSW	New South Wales
Opex	operating expenditure
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
WACC	Weighted average cost of capital