



Determination

Power of Choice reforms cost pass through

Evoenergy

February 2019

© Commonwealth of Australia 2019

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications,
Australian Competition and Consumer Commission,
GPO Box 4141,
Canberra ACT 2601
or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au
AER Reference: **D18-96593**

Contents

Overview	1
1 Determination	3
2 Evoenergy's application.....	4
3 Relevant regulatory requirements	6
3.1. Assessment approach.....	6
3.2. Relevant factors	7
3.3. Timing matters	7
3.4. What we considered in making this determination.....	8
4 Reasons for determination	9
4.1. Occurrence of pass through event.....	9
4.1.1 Service standard event.....	10
4.1.2 Positive change event	13
4.1.3 Timing of Evoenergy's application	13
4.2. Assessment of the pass through amount	13
4.2.1 Matters and proposals set out by Evoenergy.....	14
4.2.2 The increase in costs incurred by Evoenergy	14
4.2.3 Actions to reduce the magnitude of the pass through amount	15
4.2.4 Time cost of money.....	16
4.2.5 Recovery of costs solely a consequence of the pass through event.....	16
4.2.6 Whether the costs have been factored into the annual revenue requirement	17
4.2.7 Whether the costs are the subject of a previous pass through determination.....	17
4.2.8 Any other factors we consider relevant.....	17
4.3. Calculation of the approved pass through amount	17

Overview

On 7 December 2018, the AER received a cost pass through application from Evoenergy for approval to pass through costs that it has incurred to comply with the Power of Choice (PoC) reforms to the National Electricity Rules (NER) and resultant changes to the market procedures administered by the Australian Energy Market Operator (AEMO). The PoC reforms are a package of reforms aimed at enabling participation of supply and demand side options to achieve an economically efficient demand/supply balance in the National Electricity Market (NEM). In particular, these costs arose in giving effect to the new obligations under the NER for Distribution Network Service Providers (DNSPs) to facilitate expanded contestability in metering.

The role of the AER, as the economic regulator of DNSPs in the NEM, is to assess Evoenergy's application against the cost pass through requirements in chapter 6 of the NER. Specifically, if a positive change event occurs, we must determine the required pass through amount and how much of that amount should be passed through to network users in each regulatory year. This decision addresses those requirements, which are set out in clause 6.6.1 of the NER.

We have determined that Evoenergy's pass through application satisfies the requirements of a pass through event, specifically a service standard event. The PoC reforms materially increased the costs to Evoenergy in providing direct control services. The majority of these costs related to modifying ICT systems and processes, undertaken largely in 2017-18.

Based on our assessment of the relevant factors listed in clause 6.6.1(j) of the NER, we conclude the approved pass through amount for Evoenergy is \$3.97 million (\$ 2018-19), as at 30 June 2019 and including time cost of money. Evoenergy can recover this amount from customers through higher network charges in the 2019-20 and 2020-21 regulatory years, within the next regulatory control period, as set out in Table 1.

Table 1: Approved positive pass through amounts (\$2018-19)¹

	2019-20	2020-21	2021-22	2022-23	2023-24	Total
Approved pass through amounts	1,983,057	1,983,057	0	0	0	3,966,114

Source: AER Analysis.

¹ The time cost of money will be determined at the time of the annual pricing proposal, in accordance with the WACC we determine in our final decision for Evoenergy's 2019–24 distribution determination in April 2019.

Structure of determination

This determination is structured as follows:

- Chapter 1 – sets out our determination on Evoenergy's pass through application
- Chapter 2 – sets out Evoenergy's pass through application
- Chapter 3 – sets out the relevant regulatory framework and our assessment approach
- Chapter 4 – sets out our reasons for our determination.

1 Determination

We consider that Evoenergy's pass through application of 7 December 2018² establishes that a pass through event has occurred, being a service standard event and a positive change event as defined under the NER.

The Australian Energy Market Commission's (AEMC) PoC³ reforms and associated rule change of 24 November 2016 gave rise to a service standard event, which caused Evoenergy to incur material costs of compliance. We are satisfied that the costs Evoenergy incurred in giving effect to the relevant provisions under the new NER reflect prudent and efficient amounts.

We have approved a pass through amount of \$3.97 million (\$2018-19), including the time cost of money. We determine that this amount will be recovered by Evoenergy in the 2019-20 and 2020-21 regulatory years in two equal amounts, within the 2019–24 regulatory control period. This is because it is too late for Evoenergy to recover its compliance costs within the 2014–19 regulatory control period.

We note that we have also approved two other pass through applications submitted by Evoenergy on 7 December 2018.⁴ The sum of all the approved pass through amounts is \$8.42 million (\$2018-19). If this amount is recovered in 2019-20, it is likely to result in a material increase in Evoenergy's 2019-20 revenue requirement. Given the potential volatility in Evoenergy's revenue, our preferable approach is to allow Evoenergy to recover the approved pass through amounts in two equal instalments (with adjustment for the time cost of money) for all three pass through applications over the regulatory years 2019-20 and 2020-21. We consider this approach will minimise volatility in Evoenergy's revenue requirements while still allowing it to recover its efficient costs in a timely manner.

In making this determination we have considered the factors set out in clause 6.6.1(j) of the NER.

² Evoenergy, *Power of Choice cost pass through application*, 7 December 2018.

³ On 29 March 2011, the Ministerial Council on Energy (MCE) directed the AEMC to undertake the PoC review, for which the AEMC published the final report in November 2012: AEMC 2012, *Power of choice review - giving consumers options in the way they use electricity*, Final Report, 30 November 2012.
The PoC reform of the NER is comprised of a program of interrelated, interdependent and coordinated rule changes made by the AEMC.

⁴ AER, *AER determination - Ring-fencing guideline cost pass through - Evoenergy*, February 2019; AER, *AER determination - Vegetation management cost pass through - Evoenergy*, February 2019.

2 Evoenergy's application

On 7 December 2018, the AER received a cost pass through application from Evoenergy for approval to pass through costs that it has incurred to comply with the PoC reforms to the NER and the resultant changes to the market procedures administered by the AEMO. The PoC reforms are a package of reforms aimed at enabling the participation of supply and demand side options to achieve an economically efficient demand/supply balance in the NEM. The key reforms include:

- removing networks' effective metering monopoly to enable a 'market led' rollout of smart meters and services
- introducing cost reflective network pricing
- improving customer access to information about their energy consumption
- recommendations to make it easier for consumers to switch retailers
- allowing the market operator access to better demand side participation information.⁵

Evoenergy stated that two inter-related PoC rule changes drive the costs that are the subject of this pass through application:

- The National Electricity Amendment (Expanding competition in metering and related services) Rule 2015 No. 12 (Expanding Metering Competition Rule Change), which was intended to provide for the introduction of competition in metering services and to give consumers more opportunities to access a wider range of services. This would be facilitated by changing the person who has overall responsibility for metering services under the NER from the retailer or DNSP for a connection point to a new type of Registered Participant - the Metering Coordinator - who can be any person that meets the registration requirements; and
- The National Electricity Amendment (Updating the electricity B2B framework) Rule 2016 No. 6 (B2B Rule Change), which provides for a new B2B framework to define the language, or format of communication, between parties using advanced meters. These changes were intended to enhance the benefits from the competitive metering framework introduced under the Expanding competition in metering and related services rule change. Having a shared communication method was introduced to improve interoperability, reduce barriers to entry for new participants, and reduce the costs of providing existing and new services related to small customer meters.

Evoenergy also highlighted the AEMO Market Procedure changes arising as a result of the PoC reform.⁶

Evoenergy submits that the PoC reforms constitute a positive change event that occurred on 24 November 2016 when the AEMC completed the reform package. Evoenergy submits that it incurred material costs to comply with the new regulatory obligations and requirements

⁵ <https://www.aemc.gov.au/our-work/our-current-major-projects/power-choice>

⁶ <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Power-of-Choice>

brought about by the PoC reforms. In particular, Evoenergy states that it needed to implement Information Technology (IT) systems and process changes, primarily to enable third parties to provide metering services, and that these unplanned and unforeseeable costs were not included in the AER's determination of Evoenergy's revenue allowance for the 2014–19 regulatory period.

Evoenergy is seeking approval for a positive pass through amount of \$3.97 million (\$2018-19), including the time cost of money, as calculated in Table 2 below, to be recovered in the 2019–24 regulatory period.

Table 2 - Evoenergy pass through amounts calculation (\$million, nominal)

\$million, nominal	2015-16	2016-17	2017-18	2018-19
Annual revenue requirement (ARR)	148.68	153.84	160.37	164.38
ARR+ Pass through costs	148.80	154.64	162.32	165.22
Pass through amount	0.13	0.81	1.95	0.84
Cumulative pass-through amount including time cost of money	0.13	0.94	2.95	3.97

Source: Evoenergy Power of Choice cost pass through application - Attachment 2 - PTRM

Note: Numbers may not add up due to rounding.

3 Relevant regulatory requirements

The pass through mechanism recognises that an efficient revenue allowance cannot account for certain types of matters that are uncertain and outside the control of the business, and which cannot be prevented or mitigated by prudent operational risk management. A cost pass through enables a network service provider to recover (or pass through) the costs of defined unpredictable, high cost events that are not factored into our revenue determination.

The NER includes the following prescribed pass through events for all DNSPs:

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event
- any other event specified in a determination as a pass through event (nominated pass through event).

This decision relates to a service standard event. Our discretion in assessing pass through events is limited in the NER under clause 6.6.1(j), which is outlined in section 3.2 and addressed in our assessment in section 4.2 of this decision.

3.1 Assessment approach

When assessing Evoenergy's positive pass through application, we must determine whether a 'positive change event' has occurred.

A positive change event for a DNSP is defined under chapter 10 of the NER as:

a pass through event which entails the DNSP incurring materially higher costs in providing direct control services than it would have incurred but for that event, [...]

This assessment is done with reference to the NER and the current AER determination applicable to the Evoenergy, which is our remade 2014–19 distribution determination for Evoenergy.⁷ As part of this process, we also determine the materiality of the proposed pass through amount.

Clause 6.6.1(d) of the NER provides that if the AER determines that a positive change event has occurred, the AER must determine:

- the approved pass through amount; and
- the amount that should be passed through to Distribution Network Users in the regulatory year in which, and each regulatory year after that in which, the positive change event occurred, taking into account the matters referred to in clause 6.6.1(j) of the NER.

⁷ AER, *Final decision Evoenergy 2014–19 distribution determination*, 15 November 2018.

3.2 Relevant factors

As required under clause 6.6.1(j) of the NER, in assessing Evoenergy's application and making this decision, we must take into account the following relevant factors:

- 1) The matters and proposals set out in any statement given to the AER by Evoenergy;
- 2) The increase in costs in the provision of direct control services;
- 3) The efficiency of Evoenergy's decisions and actions in relation to the risk of the positive change event, including whether Evoenergy failed to take any action that could reasonably be taken to reduce the magnitude of the eligible pass through amount and whether Evoenergy took or omitted to take any action that increased the magnitude of the amount;
- 4) The time cost of money based on the allowed rate of return;
- 5) The need to ensure that Evoenergy only recovers any actual or likely incremental costs that are solely as a consequence of the pass through event;
- 6) Whether the costs have already been or will be factored into the calculation of Evoenergy's annual revenue requirement in an existing or future distribution determination;
- 7) The extent to which costs are the subject of a previous pass through determination made by the AER; and
- 8) Any other factors the AER considers relevant.

3.3 Timing matters

Clause 6.6.1(c) of the NER stipulates that to seek the AER's approval to pass through a positive pass through amount, a DNSP must submit to the AER a written statement specifying a range of details relating to the event within 90 business days of the relevant positive change event occurring. Thus, in the normal course of events, our assessment will involve consideration of two dates, and the period of time between them, namely:

- The date on which the pass through event could be said to have occurred
- The date on which the pass through application was received
- The number of days between these events.

We must also comply with the timing limit specified under clause 6.6.1(e) of the NER in making this determination, being 40 business days from the date of Evoenergy's cost pass through application.

However, it is permissible under the NER to extend the time limits that apply to the DNSP or the AER.⁸

⁸ NER, clause 6.6.1, paragraphs (k), (k1)-(k6).

3.4 What we considered in making this determination

We have made our determination in accordance with clause 6.6.1 of the NER. In forming our determination, we have:

- considered the application and supporting information we received from Evoenergy
- consulted further with Evoenergy through meetings and information requests
- where the material Evoenergy submitted was unclear or incomplete, sought clarification from Evoenergy and had regard to its responses.
- undertaken our own analysis to verify and understand the information provided by Evoenergy
- consulted with the AER's Consumer Challenge Panel (CCP)
- applied the relevant factors set out in clause 6.6.1(j) of the NER to explain our decision
- had regard to past AER decisions, where relevant.

4 Reasons for determination

We are satisfied that Evoenergy's pass through application establishes that the relevant rule changes in relation to the PoC reforms constitute a pass through event, in the form of a positive change and service standard event. We consider that giving effect to these rules issued by AEMC on 24 November 2016 materially increased Evoenergy's costs in providing direct control services in the current regulatory control period. This section details our reasons in making this determination.

4.1 Occurrence of pass through event

The first step in our assessment is to determine whether a pass through event has occurred. A pass through event is defined in clause 6.6.1(a1) of the NER as one of the following events:

- (1) a regulatory change event;
- (2) a service standard event;
- (3) a tax change event;
- (4) a retailer insolvency event; and
- (5) any other event specified in a distribution determination as a pass through event for the determination.

Evoenergy submitted that the pass through event qualifies as a 'service standard event' or, in the alternative, a 'regulatory change event'.⁹

In relation to DNSPs, the NER defines a service standard event as:¹⁰

A legislative or administrative act or decision that:

(a) has the effect of:

(i) substantially varying, during the course of a regulatory control period, the manner in which ... a DNSP is required to provide a direct control service;

(ii) imposing, removing or varying, during the course of a regulatory control period, minimum service standards applicable to ... direct control services; or

(iii) altering, during the course of a regulatory control period, the nature or scope of the direct control services, provided by the service provider; and

(b) materially increases ...the costs to the service provider of providing ... direct control services.

The NER defines a regulatory change event as:¹¹

A change in a regulatory obligation or requirement that:

(a) falls within no other category of pass through event; and

(b) occurs during the course of a regulatory control period; and

⁹ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 11.

¹⁰ NER, Chapter 10 Glossary.

¹¹ NER, Chapter 10 Glossary.

(c) substantially affects the manner in which ... the DNSP provides direct control services ...; and

(d) materially increases or materially decreases the costs of providing those services.

4.1.1 Service standard event

To find a service standard event, we must be satisfied that there was a legislative or administrative act or decision and at least one of sub-paragraphs (a)(i), (a)(ii) or (a)(iii) of the service standard event definition is satisfied, together with sub-paragraph (b).

For the reasons set out below, we are satisfied that the pass through event meets the definition of a service standard event. Having found that the event in question is a service standard event, we have not considered further in this decision whether the pass through event also meets the definition of a regulatory change event.

Evoenergy submits that the AEMC is an administrative body authorised by statute to undertake reviews directed by the Council of Australian Governments (COAG) Energy Council (or its predecessors) and make rules at the request of any person, and the PoC reform of the NER is an act or decision of a legislative or administrative character and, therefore, 'a legislative or administrative act or decision' for the purposes of the service standard event definition.¹² We agree with Evoenergy's view.

The AEMC is a body corporate established under the Australian Energy Market Commission Establishment Act 2004 (SA).¹³ The AEMC's functions include the rule-making, market development and other functions conferred on the AEMC under the National Electricity Law and the provision of advice to the COAG Energy Council as requested by it.¹⁴

In our view, the PoC reforms of the NER is a legislative or administrative act or decision of the AEMC for the purposes of the service standard event definition.¹⁵

4.1.1.1 Sub-paragraph (a)(i) – has the effect of substantially varying the manner in which Evoenergy is required to provide a direct control service

Evoenergy considers that the PoC rule changes effected a substantial change to the manner in which Evoenergy provides direct control services. In particular, Evoenergy states that it incurred material costs in designing, building and testing IT system changes as well as updating business processes to comply with the changes to the NER and AEMO's procedures.¹⁶

One example highlighted by Evoenergy is that in order to facilitate the metering competition rule change, Evoenergy was required to change its B2B operations to be able to provide

¹² Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 12.

¹³ Australian Energy Market Commission Establishment Act 2004 (SA), section 5.

¹⁴ Australian Energy Market Commission Establishment Act 2004 (SA), section 6.

¹⁵ It is not necessary for the purpose of this pass through determination to resolve whether the reform of the NER is either a legislative act or an administrative act since the 'service standard event' is defined to include both.

¹⁶ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 13.

direct control services at the same time third parties provide metering services.¹⁷ The electricity B2B framework provides for communications between businesses on certain services related to small customer electricity meters. A shared communication method is expected to improve interoperability.

Evoenergy also highlights that compliance with the new and amended AEMO procedures required the introduction of new internal Evoenergy processes and amendment of existing processes, including:¹⁸

- field works physical procedures;
- service level procedures;
- market settlement and transfer solution procedures;
- metrology procedure;
- meter churn procedures;
- retailer of last resort procedures;
- emergency priority procedures;
- procedures relating to the minimum services specification for small customer metering installations;
- procedures relating to the installation and removal of network devices; and
- B2B procedures.

Evoenergy states that the primary impact of the PoC reforms on Evoenergy's IT systems was in relation to the meter data and billing platform, Gentrack Velocity. It submits that this platform required extensive re-work with the removal and full replacement of a module, as well as building new modules and modifying components of existing IT systems.¹⁹

We are satisfied that the activities resulting from the PoC reforms as described above constitute a substantial variation in the manner in which Evoenergy is required to provide direct control services in this current regulatory control period, and therefore satisfying the requirements of paragraph (a)(i) of the service standard event definition.

4.1.1.2 Sub-paragraph (a)(iii) altering the nature or scope of direct control services provided by Evoenergy

Evoenergy considers the PoC reforms also had the effect of altering, during the 2014-19 regulatory control period, the nature and scope of the direct control services it provides.

In particular, Evoenergy states that some functions have been removed from, and other functions added to, the services classified as direct control services for Evoenergy in the 2014–19 regulatory control period as a result of the PoC reforms. Specifically, as a

¹⁷ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 13.

¹⁸ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 13.

¹⁹ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 14.

consequence of the Expanding Metering Competition and B2B Rule Changes which took effect on 1 December 2017:²⁰

- Evoenergy is no longer permitted to install and maintain Type 1-4 meters. Contestable market providers appointed by energy retailers now have these responsibilities.
- Evoenergy must now supply end users with usage data from Type 1-4 meters.

We are satisfied that the PoC reforms have altered the nature and scope of the regulated metering services and data services that Evoenergy provides, in accordance with the requirements of sub-paragraph (a)(iii).²¹

4.1.1.3 Sub-paragraph (b) – materiality

The NER defines “materially” as follows:

For the purposes of the application of clause 6.6.1, an event results in a Distribution Network Service Provider incurring materially higher or materially lower costs if the change in costs (as opposed to the revenue impact) that the Distribution Network Service Provider has incurred and is likely to incur in any regulatory year of a regulatory control period, as a result of that event, exceeds 1% of the annual revenue requirement for the Distribution Network Service Provider for that regulatory year.²²

Evoenergy has used the AER's Post-Tax Revenue Model (PTRM) to compare the annual revenue requirement with and without the pass through costs to assess materiality. This is consistent with our approach in assessing 'costs' in our previous pass through determinations.

Evoenergy submits that the proposed pass through amount is material, on the basis that the change in Evoenergy's required revenues represents 1.21 per cent of Evoenergy's annual revenue requirement in 2017-18, which exceeds the materiality threshold of 1 per cent. This is shown in Table 3 below.

Table 3 - Materiality of Evoenergy's compliance costs (\$million, nominal)

\$million, nominal	2015-16	2016-17	2017-18	2018-19
Annual revenue requirement (ARR) (unsmoothed)	148.68	153.84	160.37	164.38
Pass through amount	0.13	0.81	1.95	0.84
Materiality threshold (1%)	0.08%	0.52%	1.21%	0.51%

Source: Evoenergy Power of Choice cost pass through application - Attachment 2 - PTRM

²⁰ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, pp. 14-15.

²¹ For the purpose of this pass through application, it is sufficient to find that at least one of sub-paragraphs (a)(i), (a)(ii) or (a)(iii) of the service standard event definition is satisfied.

²² NER, Chapter 10 Glossary.

We find that, on the basis of the costs as proposed, Evoenergy has correctly calculated the pass through amount as passing the materiality threshold.

4.1.2 Positive change event

If we are satisfied that a pass through event has occurred, we must determine whether the pass through event qualifies as a 'positive change event'. That is, whether Evoenergy incurs materially higher costs in providing direct control services than it would have incurred but for the pass through event.

As discussed in section 4.1.1 above, we consider that a pass through event has occurred, in the form of a service standard event. We agree with Evoenergy that this pass through event materially increased its costs in providing direct control services, with its costs exceeding 1% of the annual revenue requirement for Evoenergy for 2017-18. Therefore, the pass through event in question constitutes a positive change event.

4.1.3 Timing of Evoenergy's application

Clause 6.6.1(c) of the NER requires DNSPs to submit a pass through application to us within 90 business days of the positive change event occurring. Evoenergy submits the PoC reforms that constitute a positive change event occurred on 24 November 2016 when the AEMC completed the PoC reforms package.²³

On 10 April 2018, in response to Evoenergy's request, we extended the fixed time limit for Evoenergy to submit its pass through application in respect of the PoC reforms to 90 business days after publication of our remade final decision on Evoenergy's 2014–19 distribution determination.²⁴ This is because at the time of the positive change event, the AER was remaking Evoenergy's 2014–19 distribution determination which precluded Evoenergy from submitting a cost pass through application without knowing what its annual revenue requirement would be.²⁵

We published our remade final decision for Evoenergy's 2014–19 distribution determination on 15 November 2018. We received Evoenergy's pass through application 16 business days later, on 7 December 2018. Evoenergy has therefore submitted the application within the allowable timeframe.

4.2 Assessment of the pass through amount

Clause 6.6.1(c)(3) of the NER requires Evoenergy to specify the eligible pass through amount. The 'eligible pass through amount' is defined in the NER to mean 'the increase in costs in the provision of direct control services that, as a result of that positive change event, the DNSP has incurred and is likely to incur (as opposed to the revenue impact of that

²³ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 16.

²⁴ NER, cl. 6.6.1(k); AER, *Letter to Evoenergy*, dated 10 April 2018. This is the second time the AER had extended the time limit for Evoenergy to submit its pass through application with respect to obligations arising from the PoC reforms.

²⁵ Following its review of the AER's final decision made in April 2015 with respect to Evoenergy's 2015–19 distribution determination, the Australian Competition Tribunal remitted the decision to the AER to be remade in accordance with the Tribunal's directions.

event)' until the end of the regulatory control period in which the positive change event occurred. Evoenergy submits that it has incorporated only incremental costs in the eligible pass through amount consistent with the NER.²⁶ This is further discussed in section 4.2.2 below.

Clause 6.6.1(c)(4) of the NER requires Evoenergy to specify the positive pass through amount that it proposes in relation to the positive change event. The positive pass through amount is defined as an amount not exceeding the eligible pass through amount. Evoenergy proposes a positive pass through amount of \$3.97 million (\$2018-19, including the time cost of money).

In considering Evoenergy's pass through application and the proposed pass through amount, we took into account those factors set out in clause 6.6.1(j) of the NER. We discuss each of these factors below.

4.2.1 Matters and proposals set out by Evoenergy

We reviewed Evoenergy's application and supporting information, including responses to our information requests. We made our determination based on the matters and proposals set out by Evoenergy.

4.2.2 The increase in costs incurred by Evoenergy

Clause 6.6.1(j)(5) of the NER requires the AER, in determining the approved pass through amount and the amount to be passed through to users in each regulatory year, to take into account the need to ensure the DNSP only recovers any actual or likely increment in costs that is solely as a consequence of the positive change event.

Table 4 shows the additional opex and capex incurred by Evoenergy in the 2014–19 regulatory control period to comply with the PoC reforms, as submitted by Evoenergy.

Table 4: Evoenergy's compliance costs with the PoC reforms (\$, nominal)

\$, nominal	2015-16	2016-17	2017-18	Total
Opex	121,792	777,460	1,545,798	2,445,050
Capex	0	2,193,447	3,338,946	5,532,392

Source: Evoenergy Power of Choice pass through application.

Note: Numbers may not add up due to rounding.

Evoenergy had tracked the expenditure for individual tasks it undertook to comply with the PoC reforms in its accounting system, Oracle.²⁷ Evoenergy provided an extract from Oracle

²⁶ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 19.

²⁷ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 21.

on a confidential basis to substantiate its compliance costs, which we took into account in our assessment of this pass through application.

4.2.3 Actions to reduce the magnitude of the pass through amount

We consider that, as an event, the instituting of the PoC-related rule changes in November 2016 was exogenous for Evoenergy (and all other DNSPs). We are satisfied that the occurrence of the obligation to facilitate expanded metering contestability, and its attendant costs, was not a risk which Evoenergy would have been able to mitigate prior to the event.

Evoenergy submits that, once the event occurred, it took steps (actions, and the avoidance of actions) that would have mitigated the cost impact of the PoC reforms on its business. Evoenergy states that at the outset, it sought to identify minimum actions required to achieve a sufficient level of compliance, and designed its in-house project management component ("PoC Stay Compliant") to deliver activities in a coordinated, efficient manner.

Evoenergy submits that:

it determined that the least cost approach for complying with the PoC reform program included a combination of procuring external services and contract staff. Efficiencies were achieved by leveraging existing third party arrangements, which had been market tested in the recent past and had demonstrated cost effectiveness, and negotiating on the scope of external services provided.²⁸

Evoenergy's application details a range of governance and project management processes that it adopted in order to mitigate the cost impact.²⁹ For example, Evoenergy states that it decided to directly engage contract staff for system design and testing functions, and thereby took on the risk for these functions, instead of having these services provided by a vendor who would have included a risk premium in their service fees. Another example it provided was overhauling the project delivery approach from a rules-based package to a task-based project, which it considered delivered efficient management of project resources and resulted in successful negotiation with the main software vendor.

Evoenergy submits that it engaged a range of vendors using cost-effective competitive tendering and procurement processes. With respect to IT system changes, however, Evoenergy states that it engaged an incumbent service provider, Gentrack. Evoenergy considers that using third party developers for this component was not feasible and far outweighed by the intimate knowledge that Gentrack had of its own systems and Evoenergy's operations gained through previous engagements.³⁰

We have assessed efficiency primarily by consideration of the efficiency and prudence of Evoenergy's processes and actions in responding to obligations arising from the pass through event. We consider Evoenergy's actions to be consistent with those of a prudent and efficient operator who was seeking to mitigate the cost impact of the positive change event. We reached this conclusion on the basis of observing that:

²⁸ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 22.

²⁹ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 22.

³⁰ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 23.

- Evoenergy adopted processes that would have helped to ensure the scope of activities was appropriately constrained to that necessary to give effect to the relevant obligations; and
- in incurring the costs of those activities, Evoenergy adopted market tested processes when engaging external service providers and contractors, noting that these costs comprise the bulk of the costs included in this pass through application.

In assessing the efficiency of the proposed costs of the PoC reforms, we have also had regard to information available that provides a cross-check/benchmark on the appropriate quantum of the costs incurred for similar activities. In particular, we considered past AER decisions in relation to the costs incurred by DNSPs in giving effect to Power of Choice metering contestability obligations. We had assessed such costs in the context of setting the revenue allowance for the Victorian DNSPs for the 2016–20 regulatory control period.³¹ We found that Evoenergy’s compliance costs for implementing comparable obligations compare favourably to these high level benchmarks.

4.2.4 Time cost of money

Clause 6.6.1(j)(4) of the NER requires us to take into account the time cost of money based on the weighted average cost of capital (WACC) for the DNSP. Evoenergy has included the time cost of money in its proposed pass through amount.

The time cost of money included in the proposed pass through amount is \$0.25 million (\$2018-19) and it is based on the applicable WACC set out in our remade final decision for Evoenergy 2014–19 distribution determination.³² We are satisfied that Evoenergy has calculated the time cost of money consistent with our approach in previous determinations and it should be included in the approved pass through amount.

4.2.5 Recovery of costs solely a consequence of the pass through event

Evoenergy states that it recorded expenditures on the PoC Staying Compliant project in a manner consistent with its accounting framework. Evoenergy explains that it employed its existing accounting system, Oracle, to clearly record and track the costs incurred as a consequence of the positive change event by creation of a separate project code in Oracle. The costs recorded for the PoC Stay Compliant project differentiated between the expenditure incurred for activity types and business as usual (BAU) expenditure. The accounting structure allowed separation of costs into pass through and non-pass through

³¹ See AER, AusNet Services distribution determination final decision 2016-20 - Attachment 7 - Operating Expenditure, May 2016, pp.7-83–7-88; AER, CitiPower distribution determination final decision 2016-20 - Attachment 6 - Capital Expenditure, May 2016, pp.6-76–6-79; AER, Jemena distribution determination final decision 2016-20 - Attachment 7 - Operating Expenditure, May 2016, p7-92; AER, United Energy distribution determination final decision 2016-20 - Attachment 6 - Capital Expenditure, May 2016, pp. 6-105 – 6-110.

³² AER, *Final decision Evoenergy PTRM - Distribution*, November 2018; AER, *Final decision Evoenergy PTRM - Transmission*, November 2018.

costs, and into capex and opex categories. Evoenergy submits that BAU costs that were used on the project were not included in the eligible pass through amount.³³

We are satisfied that Evoenergy's proposed pass through amount only includes incremental costs that are solely attributed to the costs which it will incur in implementing the incremental obligations arising out of the PoC reforms. In particular, we note the adoption of what appears to be good practice in governance and project management, the recording of costs against a defined project cost code, and the exclusion of corporate overheads from that code. This provides confidence that the cost increment arose solely as a consequence of the pass through.

4.2.6 Whether the costs have been factored into the annual revenue requirement

In our remade final decision for Evoenergy's 2014–19 distribution determination, we determined that Evoenergy's forecast operating expenditure was \$290.82 million (\$2018-19). This forecast, and similarly the capital expenditure forecast, did not provide any allowance for the costs of compliance with the PoC reforms. Consequently, the annual revenue requirement for Evoenergy does not include any allowances for these costs.

4.2.7 Whether the costs are the subject of a previous pass through determination

Evoenergy's proposed pass through amount is not part of a previous pass through determination by us under clause 6.6.1 of the NER.

4.2.8 Any other factors we consider relevant

There are no other factors we consider relevant in making our determination on the pass through amount.

4.3 Calculation of the approved pass through amount

The approved pass through amount is \$3.97 million (\$2018-19), as at 30 June 2019. This amount means the building block revenue components resulting from the application of the capex and opex in the PTRM. This includes a straight pass through of the incremental opex, the return on and the return of capital (regulatory depreciation) associated with the incremental capex, as well as the resulting corporate income tax and the time cost of money.³⁴ The approved pass through amount has been calculated as the sum of the annual differences in the annual revenues under the PTRM with and without the costs of the pass through, including the time cost of money. The calculations are set out in the PTRM submitted by Evoenergy along with its cost pass through application, which is published on our website.³⁵

³³ Evoenergy, *Power of Choice cost pass through application*, 7 December 2018, p. 21.

³⁴ When we roll forward Evoenergy's regulatory asset base in the 2019-24 distribution determination, we will take into account Evoenergy's pass through capex incurred in 2016-17 and 2017-18.

³⁵ Evoenergy *Power of Choice cost pass through application - Attachment 2 - PTRM*, 7 December 2018.

The time cost of money included in the approved pass through amount is \$0.25 million (\$2018-19) and it is based on the applicable WACC set out in our remade final decision for Evoenergy 2014–19 distribution determination.³⁶

We determine that the approved pass through amount will be recovered by Evoenergy in the 2019-20 and 2020-21 regulatory years in two equal amounts, within the 2019–24 regulatory control period. This is because it is too late for Evoenergy to recover its compliance costs within the 2014–19 regulatory control period.

We note that we have also approved two other pass through applications submitted by Evoenergy on 7 December 2018.³⁷ The sum of all the approved pass through amounts is \$8.42 million (\$2018-19). If this amount is recovered in 2019-20, it is likely to result in a material increase in Evoenergy's 2019-20 revenue requirement. Given the potential volatility in Evoenergy's revenue, our preferable approach is to allow Evoenergy to recover the approved pass through amounts in two equal instalments (with adjustment for the time cost of money) for all three pass through applications over the regulatory years 2019-20 and 2020-21. We consider this approach will minimise volatility in Evoenergy's revenue requirements while still allowing it to recover its efficient costs in a timely manner.

³⁶ AER, *Final decision Evoenergy PTRM - Distribution*, November 2018; AER, *Final decision Evoenergy PTRM - Transmission*, November 2018.

³⁷ AER, *AER determination - Ring-fencing guideline cost pass through - Evoenergy*, February 2019; AER, *AER determination - Vegetation management cost pass through - Evoenergy*, February 2019.