Issues Paper

Evoenergy
Distribution Determination

2019 to 2024

March 2018

Inquiries about this publication should be addressed to:

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Public forum and invitation for submissions

A public forum on Evoenergy's proposal will be held on 13 April 2018 in Canberra. Interested parties are invited to register their interest in attending the forum by emailing evoenergy2019-24@aer.gov.au with their name, the business or agency they represent (if relevant) and contact details by Friday, 6 April.

Written submissions on Evoenergy's proposal are invited by 16 May 2018.

We will consider and respond to all submissions received by that date in our draft determination.

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. 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.[1]

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

Contents

Shortened forms

Shortened form	Extended form
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
augex	augmentation (capital) expenditure
capex	capital expenditure
CCP/CCP10	Consumer Challenge Panel, sub-panel 10
CESS	Capital expenditure sharing scheme
COAG EC	Council of Australian Governments - Energy Council
CPI	Consumer price index
DMIA	Demand management innovation allowance
DMIS	Demand management incentive scheme
DNSP	Distribution network service provider
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.
GSL	Guaranteed service level
HV	high voltage
ICRC	Independent Competition and Regulatory Commission (ACT)
LV	low voltage
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National electricity objective
NER	National Electricity Rules
NGL	National Gas Law
opex	operating expenditure
RAB	regulatory asset base
repex	replacement (capital) expenditure
RFM	Roll forward model
RIT (RIT-T/RIT-D)	Regulatory investment test - Transmission/Distribution
STPIS	Service target performance incentive scheme
TSS	Tariff structure statement

1 About our distribution determination process

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 networks. Our work under this framework is guided by the National Electricity Objective (NEO):[2]

> …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 (DNSP) servicing customers in the Australian Capital Territory (ACT). It was formerly known as ActewAGL Distribution. We regulate Evoenergy by making decisions on the revenue it can recover from customers for the provision of electricity network services, and the methodology it proposes to use to set its prices each year. On 31 January 2018, Evoenergy submitted its regulatory proposal for the five years commencing 1 July 2019.[3]

This issues paper highlights some of the key elements of that proposal, and how stakeholders can assist in our review. A public forum on Evoenergy's proposal will be held in Canberra on 13 April 2018. Registrations for the public forum will remain open until Friday, 6 April.

As part of this review we're also seeking written submissions from stakeholders on Evoenergy's proposal, their priorities for this review and where our assessment should focus. More information on how you can get involved in this review is provided below.

1.1 How can you get involved?

The decisions we make and the actions we take affect a wide range of individuals, businesses and organisations. Effective and meaningful engagement with stakeholders across all our functions is essential to fulfilling our role, and it provides stakeholders with an opportunity to inform and influence what we do. Engaging with those affected by our work helps us make better decisions, provides greater transparency and

[2] NEL, s. 7.

[3] Available on our website: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-determination-2019-24/proposal

predictability, and builds trust and confidence in the regulatory regime. This is reflected in our Stakeholder Engagement Framework and in the consultation process set out for our distribution determinations in the NER, which we will follow in this review.

Throughout this review we will also have the benefit of advice from our Consumer Challenge Panel (CCP10).[4] The expert members of the CCP help us to make better regulatory decisions by providing input on issues of importance to consumers and bringing consumer perspectives to our processes.

The table below sets out the key milestones and engagement opportunities in our review:

Milestone	Date
Evoenergy submitted its proposal	31 January 2018
AER issues paper published	29 March 2018
Public forum on Evoenergy's proposal	*13 April 2018*
Submissions on AER's issues paper and Evoenergy's proposal due	*16 May 2018*
AER draft decision to be published	September 2018
Public forum on draft decision	*October 2018*
Evoenergy submits its revised proposal	November 2018
Submissions on AER's draft decision and Evoenergy's revised proposal due	*January 2019*
AER final decision to be published	April 2019

[4] Members of CCP10 are Mark Henley, Louise Benjamin, Mike Swanston and Eric Groom. Member biographies are available on our website: https://www.aer.gov.au/about-us/consumer-challenge-panel.

2 What would this proposal mean for Evoenergy's customers?

Evoenergy's proposal would allow it to recover $951.8 million ($nominal, smoothed) from its customers over the five years from 1 July 2019 to 30 June 2024. Evoenergy estimates this would flow through to customers as an increase of $33 per year to the average annual electricity bill for residential electricity consumers, and $113 per year for small businesses.[5]

In the lead up to submission of its proposal, Evoenergy sought to engage consumers through a combination of consumer publications, presentations to and feedback from its Energy Consumer Reference Council, consumer workshops, written submissions, online surveys and social media promotion. The importance of predictability and certainty with respect to price changes is one of the key themes Evoenergy has identified from that engagement. Under the banner of price predictability and certainty, other key themes Evoenergy's engagement identified for its proposal (and therefore our review) include:[6]

- Maintaining safety, quality, reliability and security of supply—taking into account efficiency improvements over the current period, Evoenergy's proposed capital and operating expenditure (capex and opex) forecasts reflect the expenditure it submits is required to maintain its strong track record of quality and reliability of the ACT's electricity supply and meet the ACT Government's system security requirements.
- Striking the right cost/reliability trade-off when investing in the network—Evoenergy's proposed capex and opex forecasts are built on risk-based maintenance strategies, tested as part of its consumer engagement, that have been applied to optimise and in several cases reduce past and forecast expenditure.
- Supporting new technology—which Evoenergy notes consumers recognise as an important part of the future of the electricity network, and one with the potential to provide innovative solutions and cost reflective outcomes.
- Cost reflective pricing—noting that support for customers as they transition to more cost reflective pricing under the proposed refinements to Evoenergy's tariff structure statement (TSS) is an important part of customers' ability to modify their consumption in response to price signals.

In the sections that follow we discuss some of the key elements of Evoenergy's proposal, and how Evoenergy explains these have been guided by the key themes emerging from its engagement with consumers. We are particularly interested to hear

5 Evoenergy-Consumer overview-January 2018_Public, p. 19.

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

from stakeholders whether these themes reflect their own priorities for this determination, and how well Evoenergy's proposal has addressed them.

2.1 Estimated impact on electricity bills

Evoenergy has proposed an increase of $187.7 million ($nominal) from the revenue we approved for the current, 2014–19 regulatory control period. It estimates that this proposal would result in an average annual increase of 5.5 per cent ($nominal) to its distribution network charges during the 2019–24 regulatory control period.[7]

Network charges (excluding feed-in tariffs) make up a significant component—around 33 per cent—of the electricity bills paid by customers in the ACT.[8] Other significant components of the bill include wholesale energy purchase costs (34 per cent), allowed retail costs (12 per cent), feed-in tariffs (9 per cent), green energy and other costs (7 per cent and 6 per cent respectively).[9]

In July 2017 the Independent Competition and Regulatory Commission (ICRC) published its decision on ActewAGL Retail's standing offer prices for 2017/18 to 2019/20.[10] Based on that decision, Evoenergy estimates that its proposal would result in:

- an average annual increase of $33 per year for residential customers, and a total impact over the 2019–24 regulatory control period of $163[11]
- for small business customers, which use more electricity, an average annual increase of $113, and a total impact over the five year period of $565.[12]

This equates to an average increase of 1.7 per cent ($nominal) per year to average annual electricity bills for both residential and small business customers.[13]

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7 Evoenergy - Workbook 1 – Regulatory determination - 20180131 (Public)

8 Evoenergy-Consumer overview-January 2018_Public, p. 9.

9 Evoenergy-Consumer overview-January 2018_Public, p. 9.

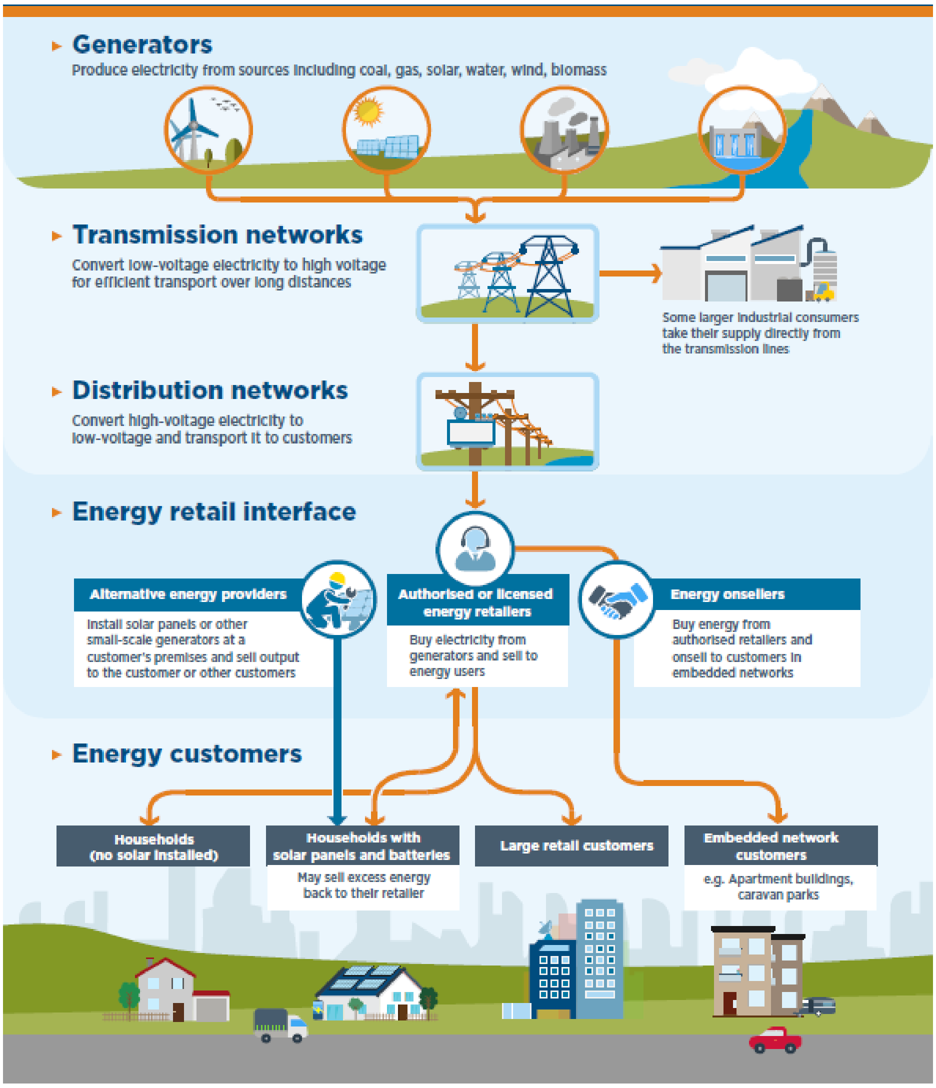
10 ICRC - *Report 6 of 2017: Final Report - Standing Offer Prices for the Supply of Electricity to Small Customers from 1 July 2017* - June 2017

11 Evoenergy - Workbook 1 – Regulatory determination - 20180131 (Public); Evoenergy-Consumer overview-January 2018_Public, p. 19. Assumes annual consumption of 8000kWh.

12 Evoenergy - Workbook 1 – Regulatory determination - 20180131 (Public); Evoenergy-Consumer overview-January 2018_Public, p. 19. Assumes annual consumption of 25000 kWh.

13 Evoenergy - Workbook 1 – Regulatory determination - 20180131 (Public)

Figure 1 Electricity supply chain



Source: AER - State of the Energy Market - May 2017, p. 18.

2.2 A note on our last decision

Our final decision on Evoenergy's (then known as ActewAGL Distribution) revenue for the current, 2014–19 regulatory control period was set aside and remitted to us by the Australian Competition Tribunal under the then Limited Merits Review regime. We are currently in the process of remaking that decision in accordance with the Tribunal's directions. These directions focus primarily on two elements of the decision: operating expenditure and the return on debt. In October and December 2017 we released consultation papers on our proposed approaches to these components of the remitted decision, and we are currently considering submissions on those papers.[14]

Until the remittal process is concluded, elements of our 2014–19 decision remain subject to change.

In this issues paper we've drawn a number of comparisons between the current (2014–19) and forthcoming (2019–24) regulatory control periods covered by Evoenergy's proposal, to highlight why revenue, and therefore prices, might need to change over time. Where we can, we've used comparisons between Evoenergy's actual expenditure in 2014–19 and its forecasts for 2019–24. In other cases—for example its forecast revenue—we have used our set-aside 2014–19 decision to provide some level of comparison and a picture of what might change in the forthcoming, 2019–24 regulatory control period.

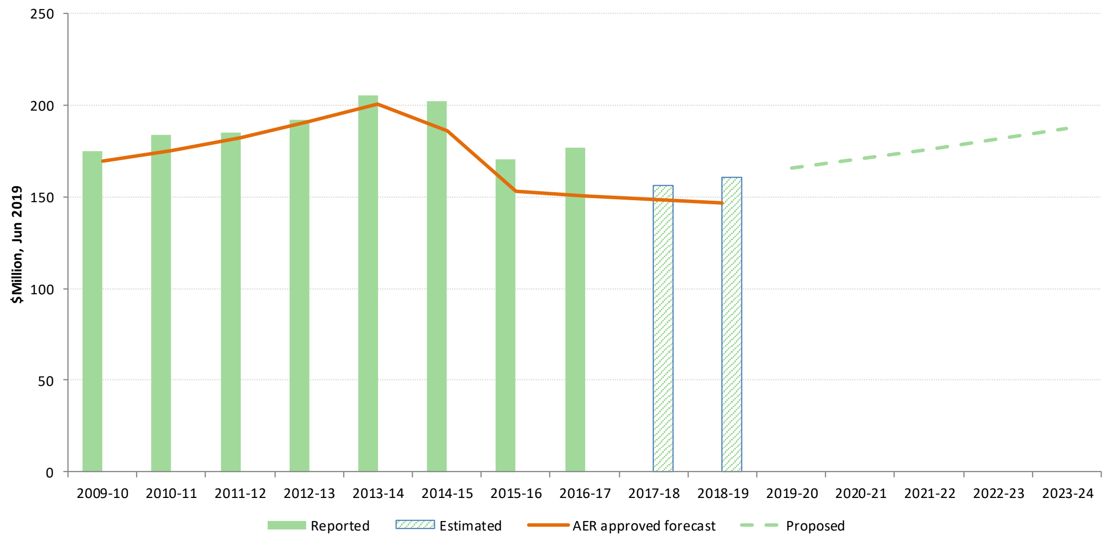
[14] AER - Issues Paper: Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations - operating expenditure - October 2017; AER - Position paper: remitted debt decisions for NSW/ACT 2014-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement - December 2017.

3 What's driving Evoenergy's revenue proposal?

In section 2 we looked at Evoenergy's proposals in nominal terms, taking into account the expected impact of inflation. 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), which have been adjusted to remove the impact of inflation.

In real terms, Evoenergy's proposal is an increase of approximately 12 per cent from the revenue our last decision allowed it to recover from customers in the 2014–19 regulatory control period.[15] As Figure 2 shows, Evoenergy proposes gradual increases of around 3 per cent per annum over the five years commencing 1 July 2019.[16]

Figure 2 Revenue over time ($million, 2018/19)



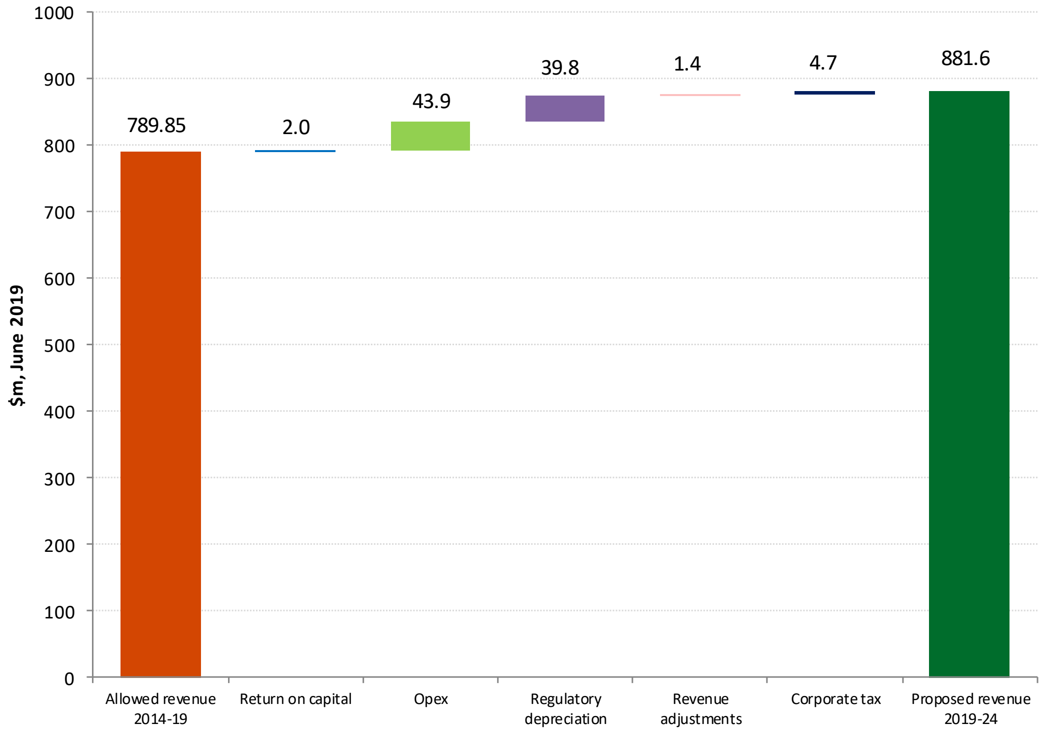
Source: AER analysis

Figure 3 below highlights the key drivers of this increase in proposed revenues, by reference to the revenue 'building blocks' that form the basis of our assessment.

15 Evoenergy-Overview of regulatory proposal-January 2018_Public, p. 26.

16 Evoenergy has proposed X factors of 3.08 per cent for distribution and 2.92 per cent for transmission: Evoenergy-Overview of regulatory proposal-January 2018_Public, p. 27.

Figure 3 Change in revenue from 2014-19 to 2019-24 ($m, 2018/19)



Source: AER analysis

Evoenergy's proposed opex forecast of $310.9 million ($2018/19)[17] is an increase of 10.2 per cent from the opex forecast included in revenue allowed in our decision for 2014–19, and one of the key contributors to Evoenergy's proposed increase in revenue. From 2009–14 to 2014–19, Evoenergy has reduced its opex by more than 20 per cent. Its forecast opex for 2019–24 reflects many of the efficiency gains achieved over the last five years, and uses its actual expenditure in 2017/18 (which is lower than we forecast) as a starting point for its proposal. However, Evoenergy's proposal outlines expected increases in the cost of labour and non-labour costs, and in the costs of operating a larger network (with more customers), and therefore suggests that its opex will need to be escalated from the base year to meet its needs over the next five years.[18] At the same time, the ACT Government has tasked Evoenergy with additional responsibilities for vegetation management relative to the current period[19], which Evoenergy expects to further increase its expenditure requirements.[20] We discuss these changes further in section 4.4.

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[17] Includes debt raising costs.

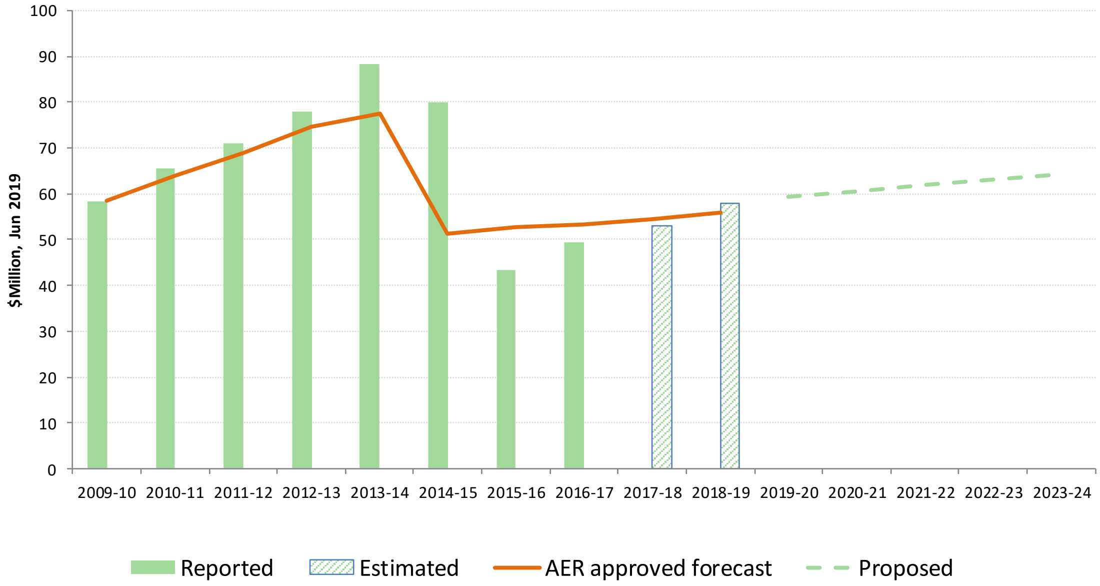
[18] Evoenergy-Attachment 6 Operating expenditure-January 2018_Public, pp. 6–14 6–15.

[19] *Utilities (Technical Regulation) Amendment Act 2017* (ACT).

[20] Evoenergy-Attachment 6 Operating expenditure-January 2018_Public, p. 6–17; Evoenergy-Appendix 6.1 Vegetation management and private pole inspection step change-January 2018_Public

Figure 4 shows trends in Evoenergy's opex over the last two control periods, and how these compare to its forecast for 2019–24.

Figure 4 Opex over time



Source: AER analysis

The other key driver of the increase in Evoenergy's forecast revenue from 2014–19 to 2019–24 (which we look at in more detail in section 4.1) is its proposed regulatory depreciation allowance. The increase in depreciation in Evoenergy's proposal flows from its increased investment in information technology and communications assets over the 2014–19 period, which Evoenergy explains:[21]

> …reflects a shift in business priorities towards increasing Evoenergy's customer centricity, and capabilities with regard to enabling a greater penetration of [distributed energy resources], while maintaining power quality. This is important as Evoenergy's customers become more informed, and as building a relationship in the face of new initiatives including demand management, is becoming more important. The completion of various [asset information system] projects… places Evoenergy among industry leaders in terms of visibility, control and management of the network to the edge of the grid. This ultimately provides improved consumer outcomes in customer service while maintaining power reliability and quality despite ongoing industry disruption.

These assets have relatively short asset lives compared to poles and wires. This means they are depreciated (removed from the regulatory asset base (RAB)) over a

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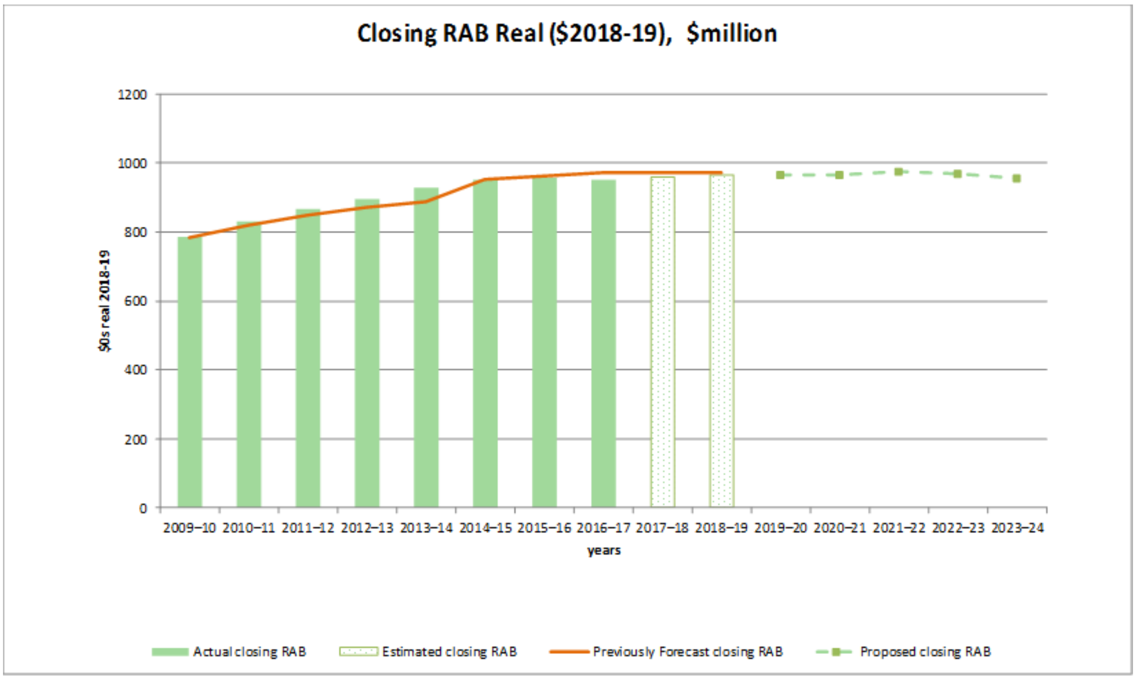
21 Evoenergy-Attachment 5 Capital expenditure-January 2018_public, p. 5–62.

shorter period of time. In 2019–24, this is driving an increase in the regulatory depreciation allowance. We discuss this further in section 4.1.

The balancing effect of this is that depreciation of the RAB (removing assets that are coming to the end of their usefulness) is helping to offset the addition of new assets to the RAB as Evoenergy's investment in other parts of its network continues. As Figure 5 shows, growth in Evoenergy's RAB—typically a key driver of regulated revenues—is stabilising in real terms. After a period of significant growth from 2009–14, when Evoenergy's RAB grew by 25.38 per cent, RAB growth in the current period fell to 4.02 per cent. Over the 2019-24 period, Evoenergy's proposal suggests that the real value of its RAB will actually fall by 1.16 per cent.

Figure 5 Projected RAB growth ($million, 2018/19)



Source: AER analysis

3.1 Price path

Evoenergy proposes to recover the increase in revenue it seeks evenly over the five years covered by our determination. It has done this by choosing to smooth its revenue requirement over the period so that its network charges increase by around 2.9 per cent per year in real terms.[22] Other components of electricity bills held constant, this would translate to an estimated real increase of 0.8 per cent per year to electricity bills for both residential and small business customers.[23]

22 Evoenergy - Workbook 1 – Regulatory determination - 20180131 (Public)

23 Evoenergy - Workbook 1 – Regulatory determination - 20180131 (Public)

This approach to the price path—which Evoenergy intends to minimise volatility between and within control periods—appears consistent with the theme of price stability, predictability and certainty emerging from Evoenergy's engagement with consumers.[24]

[24] Evoenergy-Attachment 2 Consumer engagement-January 2018_Public, pp. 2–11 - 2–12.

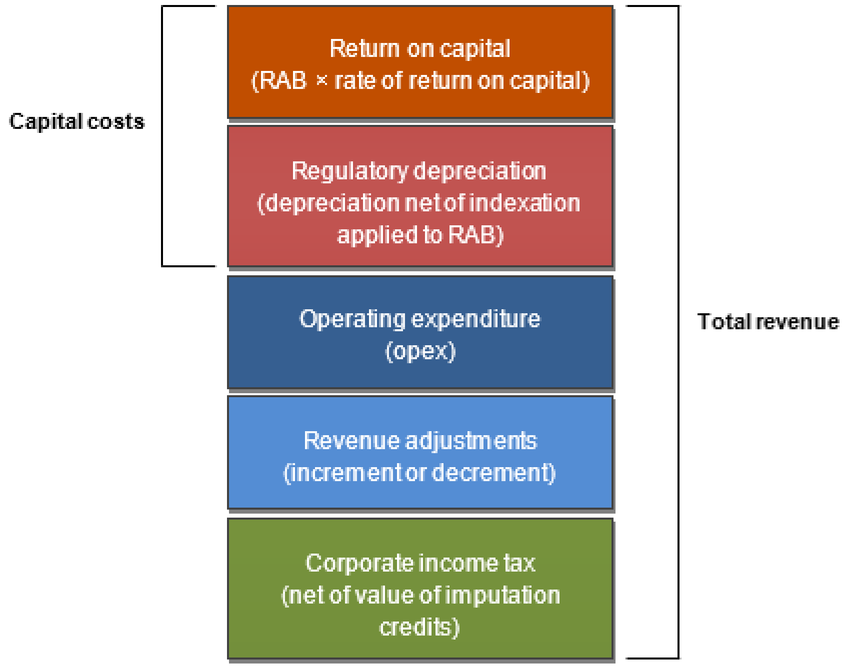
4 Key elements of Evoenergy's revenue proposal

The total revenue Evoenergy has proposed is its forecast of the efficient cost of providing its distribution and transmission network services over the 2019–24 regulatory control period. Evoenergy's network charges are derived from the total revenue approved for each year, after consideration of forecast demand for those services. Under the revenue cap form of control that will apply to Evoenergy from 1 July 2019, any difference between forecast and actual demand will impact prices: if actual demand is higher than forecast demand, prices will go down (and vice versa).

Evoenergy's revenue proposal, and our assessment of that proposal under the NER, are based on a 'building block' approach (see Figure 6) which looks at five cost components:

- a return on the regulatory asset base (RAB) (or return on capital)
- depreciation of the RAB (or return of capital)
- forecast opex
- revenue increments or decrements resulting from the application of incentive schemes
- the estimated cost of corporate income tax.

Figure 6 The building block approach for determining total revenue



Our assessment breaks these costs down further. For example, our assessment of capex directly affects the size of the capital base and therefore the revenue generated from the return on capital and depreciation building blocks.

In the sections below we highlight some of the key elements of Evoenergy's proposal in each of these areas.

4.1 RAB and depreciation

The RAB accounts for the value of Evoenergy's regulated assets over time. To set revenue for a new regulatory control period, we take the opening RAB value from the end of the last period and roll it forward year-by-year by indexing it for inflation, adding new capex, and subtracting depreciation and other possible factors (for example, disposals or customer contributions).[25] This gives us a closing value of the RAB at the end of each year of the regulatory control period. The value of the RAB is used to determine:

- the return on capital building block, which is the product of the RAB and our approved rate of return
- regulatory depreciation (or the return of capital).

As we noted in section 3, Evoenergy's proposal projects a reduction of 1.16 per cent to its RAB over the 2019–24 regulatory control period. This follows a significant reduction from 2009–14 (25.38 per cent growth) to 2014–19 (4.02 per cent growth). Evoenergy's proposal has adopted our approved Roll Forward Model (RFM) to calculate its opening RAB as at 1 July 2019, and to project its closing RAB at 30 June 2024. Its 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 determination are likely to be our related decisions on forecast capex (see section 4.3) and updates to the estimation of inflation to reflect the most recent data from the Reserve Bank of Australia at the time of our final decision.

Evoenergy's proposed approach to depreciation of the RAB is also consistent with the approach in our Framework and Approach paper issued in July 2017. The change in the depreciation allowance from 2014–19 to 2019–24 reflects the nature of capital investment Evoenergy has undertaken in recent years, which is in assets with shorter lives, and expects to undertake going forward.

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. Depreciation reflects the use of an asset each year and accounts for its loss of value due to wear and tear over its

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25 The term 'rolled forward' means the process of carrying over the value of the RAB from one regulatory year to the next.

useful life. The 'straight-line approach' used in Evoenergy's proposal recovers the value of the asset evenly over its useful life. This spreads the cost of an asset over its useful life, so that cost is shared between current and future customers who all benefit from its use. How quickly the value of the asset is recovered depends on the length of the asset's useful life.

Evoenergy's proposal outlines a reprioritisation of its business needs towards "overhauling" IT infrastructure, to prepare the business for changes in the energy industry—including Power of Choice reforms—and to drive opex savings in the current period in response to our 2015 decision. Increased penetration of distributed energy resources and a call for improved services to customers from increased automation and information have also been identified as drivers of IT and Communications expenditure.[26] These types of assets have a relatively short asset life (only 10 years, compared to 40 years for substation assets and 50-60 or more years for overhead and underground lines).[27] That means their cost is recovered over a shorter period of time. This is putting upwards pressure on the depreciation allowance over the next five years relative to previous periods.

4.2 Rate of return and value of imputation credits

The rate of return is a key determinant of the revenue allowance. It is applied to the RAB to determine Evoenergy's return on capital. In its proposal Evoenergy has applied a rate of return of 6.42 per cent, which is slightly higher than the 6.38 per cent applied in our 2015 decision for the current period. This is a placeholder, to be updated with more recent data at future key milestones throughout this review (our draft decision, Evoenergy's revised proposal and our final decision). It has also adopted a value of imputation credits (gamma) of 0.4, consistent with our guideline and recent decisions.[28]

Evoenergy has adopted some (but not all) elements of our standard approach, as set out in our 2013 rate of return guideline and subsequent determinations.[29] That guideline is now under review, with a revised 2018 guideline scheduled for release by the end of this year.

The COAG Energy Council published a bulletin on 2 March 2018 setting out their intention to implement a binding rate of return guideline.[30] The bulletin suggests that the binding guideline is intended to apply to Evoenergy’s 2019-24 final determination.[31] Consultation on proposed amendments to the NEL and NGL to give effect to this intent is still in progress, and the exact legislative outcomes, their timing and implementation,

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26 Evoenergy-Attachment 5 Capital expenditure-January 2018_public, p. 5–62.

27 Evoenergy-Attachment 7 Regulatory asset base-January 2018_Public, p. 7–8.

28 AER - Rate of Return Guideline - 2013; AER - Final decision; APA VTS access arrangement 2018-22 - November 2017.

29 AER - Rate of Return Guideline - 2013; AER - Final decision; APA VTS access arrangement 2018-22 - November 2017.

30 COAG Energy Council - Bulletin: Consultation on binding rate of return amendments - 2 March 2018.

31 COAG Energy Council - Bulletin: Consultation on binding rate of return amendments - 2 March 2018, p. 3.

are not certain. However, the COAG bulletin is the most recent public indication of the intended outcomes, and as such we think it is prudent to account for the possibility that our revised 2018 guideline will be binding on our final decision for Evoenergy.

On that basis, we plan to consider all relevant rate of return and gamma materials submitted to us in this and other concurrent determination processes as also being relevant material for our guideline review (and vice versa). We have published the rate of return materials included in Evoenergy's proposal on the guideline section of our website to bring them to the attention of stakeholders participating in the guideline review.[32]

4.3 Capital expenditure

Capital expenditure (capex) refers to the capital costs and expenditure incurred in the provision of network services. As we discussed in section 4.1, this investment 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 is a key component of the projected value of the RAB, and therefore of the return on capital and depreciation building blocks.

Drawing on the key themes from its consumer engagement, Evoenergy intends its capex proposal to:[33]

- provide for safe, reliable services in a way that reflects customer preferences—as tested through its consumer engagement—on the balance (or 'trade off') between cost and reliability
- support a gradual shift to investment in new technology, but ensure that security of supply is maintained during its adoption
- support investment in business intelligence capabilities that will continue to improve Evoenergy's ability to monitor and predict consumer needs and the impact of new technologies.
- contribute to price stability by delivering these things, with room for necessary augex and asset replacement, at total capex levels that are lower than our last decision and in line with its current period performance.

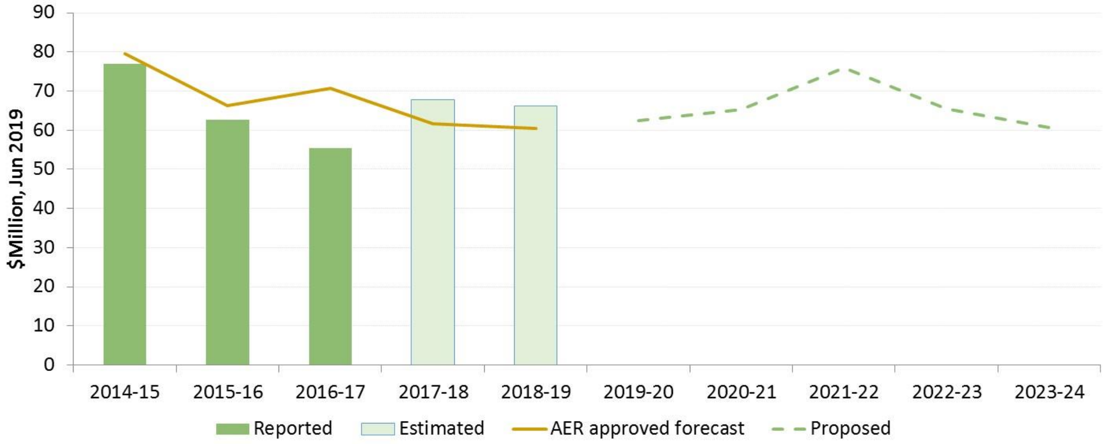
For the 2019–24 regulatory control period, Evoenergy proposes total forecast capex of $329.8 million ($2018/19): $1 million—or 0.3 per cent—higher than its actual expenditure of $328.8 million in 2014–19. This is a reduction of $8.8 million from the forecast capex approved in our decision for that period.[34] Figure 7 highlights the reduction Evoenergy's capex over the last five years, and its projection for this proposal.

32 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-rate-of-return-guideline

33 Evoenergy-Attachment 5 Capital expenditure-January 2018_public, p. 5–14

34 Evoenergy-Attachment 5 Capital expenditure-January 2018_public, p. 5–23.

Figure 7 Capex over time



Source: AER analysis

Table 1 compares the components of Evoenergy's capex forecast for 2019–24 to our 2014–19 decision and its actual expenditure in that period.[35]

Table 1 Actual and forecast capex by category

$ million ($2018/19)	2014-19 forecast	2014-19 actual	2019-24 forecast	Variance between periods (%)
Augmentation (augex)	51.7	33.4	47.2	40%
Connections	85.4	90.6	85.9	(5.2%)
Replacement (repex)	115.1	80.1	91.6	14.4%
Reliability and quality improvements	7.3	6.6	6.2	(6.1%)
Non-network (including IT and communications)	63.0	89.8	58.3	(35.1%)
Capitalised overheads	57.5	68.2	75.6	10.8%
Less capital contributions	(33.4)	(39.6)	(34.2)	(13.6)
Less disposals/material escalation adjustment	(8.2)	(0.4)	(1.1)	265%
Net capex	**338.6**	**328.8**	**329.8**	**0.3%**

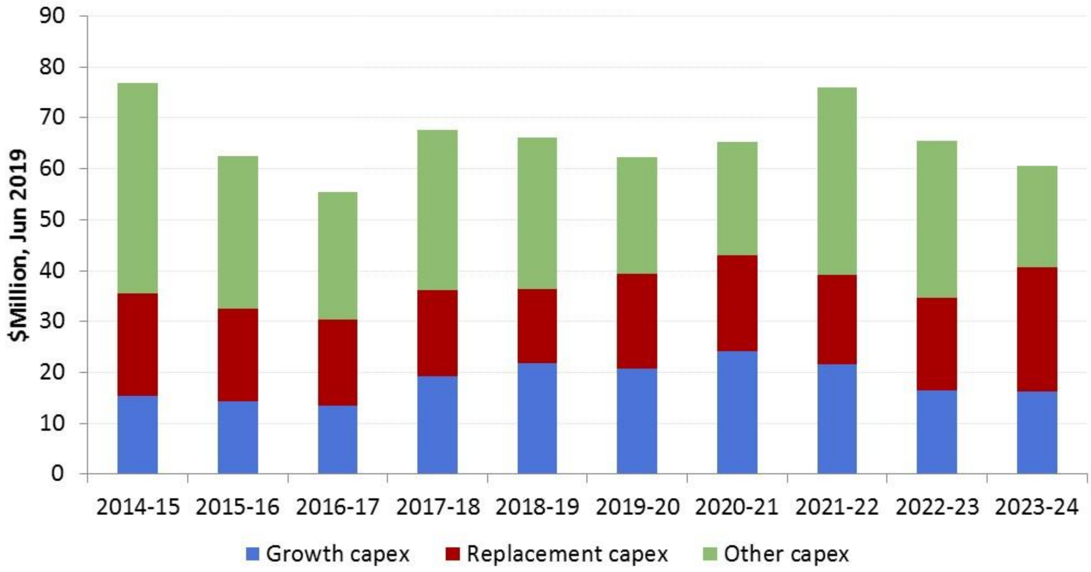
Source: AER analysis; Totals may not add due to rounding.

At a category level, forecasts of expenditure needed to fund new connections, reliability and quality improvements and non-network capex in 2019–24 are all falling

[35] Evoenergy's actual capex for 2014–19 includes its estimates of its expected capex for 2017/18 and 2018/19.

relative to Evoenergy's current period expenditure. This helps to offset Evoenergy's expected increases in augex and repex, and the increase in capitalised overheads. As a result, Evoenergy's total forecast capex for 2019–24 remains in line with its total capex in 2014–19. This change in composition of Evoenergy's capex from period to period is illustrated in Figure 8, below.

Figure 8 Changes in capex composition over time



Source: AER analysis

Note: Growth capex includes augmentation, new connections, capital contributions and asset disposals; Replacement capex includes asset replacement and reliability and quality improvements; Other capex includes non-network capex and capitalised overheads.

Capex for 2017/18 and 2018/19 is estimated; Capex for 2019/20 to 2023/24 is forecast.

While the balance of Evoenergy's expenditure between capex categories is expected to change somewhat from 2014–19, the main drivers of its 2019–24 capex forecast (before capital contributions and asset disposals) continue to be:

- Asset renewal and replacement (25 per cent)[36]—continuation of risk-based pole and underground cable replacement programs from the current period. Evoenergy proposes to replace wooden poles with concrete and fibreglass poles, and continue staking wooden poles where it is possible to extend its service life. Underground cables were previously run to failure, however Evoenergy now takes a condition-based monitoring approach to managing these assets.
- Connection of new customers (24 per cent)[37]—expenditure required to connect new customers to the network is expected to be slightly lower than in the current period, but relatively stable over time. By 2024, Evoenergy's forecasts suggest the

[36] Evoenergy-Attachment 5 Capital expenditure-January 2018_public, section 5.8.

[37] Evoenergy-Attachment 5 Capital expenditure-January 2018_public, section 5.10.

total number of customers connected to its electricity network to be around 13 per cent higher compared with 2016/17, with the greatest increases in its low voltage commercial customer class.[38] Our assessment of Evoenergy's connections capex will look at both its projected costs of connections and the forecast number of connections that have informed this element of its capex proposal.

- IT upgrades and secondary systems (10 per cent)—this is also a key factor in the increase in capitalised overheads, which make up 21 per cent of total forecast capex. The underlying cost driver for increases in non-network and capitalised overheads is reprioritisation of business needs toward overhauling IT infrastructure. This is to prepare the business for significant industry changes in the electricity market and to be a substantial driver of opex savings in response to the AER's 2015 opex allowance reductions.[39] Evoenergy's expenditure on IT and Communications assets in the current (2014–19) period is the key driver of the increase in its regulatory depreciation allowance.
- Construction of feeders and new mobile zone substation (10 per cent)—the increase in augex in the forecast period over the current period is largely attributable to the installation of new feeders to service high growth areas ($32 million). A one off deployment of a mobile substation in the Molonglo area ($6.2 million) is also proposed.[40]

Evoenergy's proposal does not include any contingent projects for 2019–24.

Our approach to the assessment of Evoenergy's forecast capex is set out in our Expenditure forecast assessment guideline.[41] In our final Framework and Approach paper last year, we confirmed our intention to apply that guideline to our assessment of Evoenergy's proposal.[42] To assist us in that assessment, we are interested in stakeholder views on the reasonableness of Evoenergy's capex proposal and how well it reflects the key themes emerging from its consumer engagement.

4.3.1 Capital expenditure sharing scheme

Our capital expenditure sharing scheme (CESS) aims to incentivise Evoenergy to undertake efficient capex throughout the regulatory control period by rewarding efficiency gains and penalising 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 accrued a reward under the CESS of $0.4 million.[43]

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[38] Evoenergy-Attachment 3 Energy customer numbers and peak demand forecasts-January 2018_Public, p. 3–7.

[39] Evoenergy-Attachment 5 Capital expenditure-January 2018_public, p. 5–25.

[40] Evoenergy-Attachment 5 Capital expenditure-January 2018_public, p. 5–53.

[41] AER - Expenditure forecast assessment guideline - November 2013.

[42] AER - Framework and Approach: ActewAGL electricity distribution 2019–24 - July 2017, p. 67.

[43] Evoenergy-Attachment 10 Incentive schemes-January 2018_public, p. 10-5.

Evoenergy's proposal that a CESS continue to apply in the 2019–24 regulatory control period is consistent with the position we took in our final Framework and Approach paper in July 2017.[44]

4.4 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses, incurred in the provision of network services.

Evoenergy's forecast opex is one of the key drivers of the increase in revenue it proposes for 2019-24. It proposes total opex of $310.9 million ($2018/19): an increase of 10.2 per cent from its estimated expenditure in the 2014–19 period.[45] However, while total opex would increase under Evoenergy's proposal, Evoenergy estimates its average annual opex per customer would remain in line with current levels at $299 per year, compared to $298 per year in the 2014–19 regulatory control period and $491 per customer in 2013–14.[46]

In considering the key themes from consumer feedback in the development of its proposal, Evoenergy submits that it has:[47]

- provided for safe, reliable distribution services with only minor increases across the period and stable opex per customer, contributing to price stability
- reflected expectations that further efficiencies will be enabled by the adoption of new technologies, building on its achievements over the current period
- ensured reliability is maintained at the lowest sustainable cost, taking into account consumer feedback on cost/reliability trade-offs – for example through less frequent inspections and maintenance of assets based on risk assessments
- ensured security of supply is maintained, including during the adoption of new technology and innovative non-network solutions.

Figure 9 provides a breakdown of Evoenergy's opex forecast into key components.

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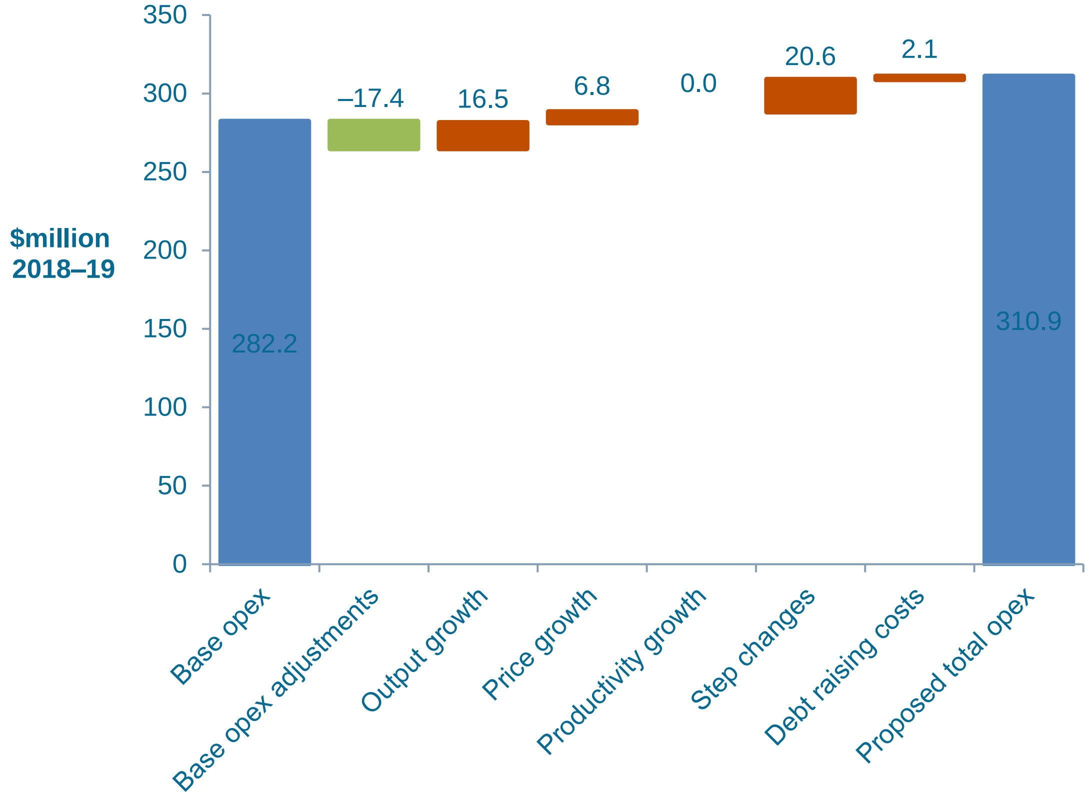
[44] AER - Framework and Approach: ActewAGL electricity distribution 2019–24 - July 2017, p. 59.

[45] Including debt raising costs.

[46] Evoenergy-Consumer overview-January 2018_Public, p. 17; Evoenergy-Attachment 6 Operating expenditure-January 2018_Public, p. 6–3.

[47] Evoenergy-Attachment 6 Operating expenditure-January 2018_Public, pp. 6–4 - 6–5.

Figure 9 Evoenergy's opex forecast breakdown



Note: Includes debt raising costs.

Source: AER analysis.

Applying our preferred revealed cost approach to forecasting opex (the 'base-step-trend' approach), Evoenergy's proposal uses its estimated opex in 2017–18[48] (its base year), to derive a base opex of $282.2 million ($2018–19). Evoenergy's base year opex reflects the significant efficiency gains Evoenergy has made within the current regulatory control period. Evoenergy has removed two non-recurrent costs from its base year opex, which it expects to incur in 2017–18 but not in future years.[49] This equates to an adjustment to the base opex of $17.4 million ($2018–19).

Evoenergy then trends forward its base opex to account for:

- Expected increases in real input prices, including forecast increases in labour costs and an increase in line with CPI for non-labour costs ($6.8 million, $2018–19).
- Forecast output growth, driven primarily by increased customer numbers, circuit line length and maximum demand, all of which can increase the cost to Evoenergy

[48] The actual opex for 2014–19 in Evoenergy's proposal includes its estimates of opex for 2017/18 and 2018/19. This will be updated later in the year when actual data becomes available.

[49] The base year adjustments are costs associated with implementation of Power of Choice reforms and the changes required by the AER's new Ring-fencing Guideline, which Evoenergy anticipates recovering as cost pass through events under the current, 2014–19 determination.

of operating its network ($16.5 million, $2018–19). Evoenergy relies on an econometric model to estimate the relationship between changes in opex and changes in measures of output, which it uses to forecast expected increases in opex over the regulatory period. Evoenergy has stated that this econometric model is the same as that we have applied in recent determinations.[50]

- Forecast zero change in opex productivity over the regulatory period, notwithstanding its recent improvement in opex productivity.[51] Evoenergy's proposal notes that this is consistent with our recent decisions for other network businesses.

Evoenergy has forecast $2.1 million ($2018–19) of debt raising costs and included two step changes in its opex forecast:

- $18.8 million ($3.8 million per annum) to meet the efficient costs of expanded vegetation management obligations following amendments to the *Utilities (Technical Regulation) Act 2014* (ACT) passed in November last year. These transfer responsibility for vegetation clearing on unleased land in urban areas of the ACT from the ACT Government to Evoenergy, and give Evoenergy responsibility for safety inspection and vegetation clearance works in relation to a small number of private poles on rural leased properties;[52] and
- $1.8 million ($0.36 million per annum) to allow deferral of capex for the construction of a new substation at Strathnairn. Instead, Evoenergy proposes to meet demand with a combination of lower initial capex and opex to support incentive payments for customers to adopt demand management technology such as battery storage to meet load growth.

Our approach to the assessment of Evoenergy's forecast opex is set out in our Expenditure forecast assessment guideline.[53] Key areas of focus in our review will be the assumptions underpinning Evoenergy's proposed rate of change, and the efficient level of opex required to meet Evoenergy's obligations under the amendments to the *Utilities (Technical Regulation) Act 2014* (ACT). To assist us in that assessment, we are interested in stakeholder views on the reasonableness of Evoenergy's opex proposal and how well it reflects the key themes emerging from its consumer engagement.

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50 Evoenergy-Attachment 6 Operating expenditure-January 2018_Public, p. 6-15. The weightings we applied to each measure of network output are the same as those estimated by the Cobb-Douglas stochastic frontier analysis model in our annual benchmarking reports. See AER, *Annual benchmarking report - Electricity distribution network service providers*, November 2017.

51 The productivity of each distribution network is reported in the AER's annual benchmarking reports. See AER, *Annual benchmarking report - Electricity distribution network service providers*, November 2017.

52 *Utilities (Technical Regulation) Amendment Bill 2017: Explanatory statement*, November 2017, pp. 3-4

53 AER - Expenditure forecast assessment guideline - November 2013.

4.4.1 Opex efficiency benefit sharing scheme

Our efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in opex, and to fairly share these between distributors and consumers. Consumers benefit from improved efficiencies through lower network prices in future regulatory control periods.

In the current, 2014–19 regulatory control period, we suspended the operation of the EBSS to Evoenergy.[54] Our final decision on Evoenergy's opex for that period was significantly lower than its past expenditure. At the time we made that decision it was unclear whether and to what extent we were likely to rely on Evoenergy's revealed costs over the 2014–19 period as a basis for forecast opex for 2019–24. Because the EBSS is designed to work with our revealed cost approach to opex forecasting, we made the decision not to apply it in the context of the reduced forecast.[55]

In the Framework and Approach paper we released last July, some of this uncertainty remained. Our position then was that we would determine whether the EBSS would apply as part of our 2019–24 determination once we'd received Evoenergy's proposal and assessed it against its revealed costs.[56]

Evoenergy's proposal for 2019–24 adopts our revealed cost approach to opex forecasting, and in that context it supports reinstatement of an EBSS going forward.

4.5 Corporate income tax

The building block approach to calculation of revenue includes an allowance for the estimated cost of corporate income tax payable by Evoenergy.

Adopting our current approach to the corporate income tax allowance, Evoenergy's proposal begins with its 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 operating expenditure) 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). Evoenergy has adopted a gamma of 0.4, consistent with our 2013 rate of return guideline and recent decisions.[57] As we noted in section 4.2, the rate of return guideline is under review. It is possible that our revised 2018

54 AER, *Electricity distribution network service providers, efficiency benefit sharing scheme*, 26 June 2008.

55 *AER, ActewAGL distribution determination 2015–19, final decision*, April 2015, Attachment 9, pp. 9-7.

56 AER - Framework and Approach: ActewAGL electricity distribution 2019–24 - July 2017, p. 56.

57 AER - Rate of Return Guideline - 2013; AER - Final decision; APA VTS access arrangement 2018-22 - November 2017.

guideline, which will include a positon on the value of imputation credits, will be binding on our final decision for Evoenergy.

Evoenergy's proposed corporate income tax allowance is an increase of $4.7 million ($2018/19) from our 2014–19 decision. This increase is a product of increases to other components of its revenue calculation (the return on capital, depreciation, opex), which we've discussed in the sections above. Under our current approach, any changes to those components as a result of our assessment would have a corresponding impact on the tax calculation.

4.6 Other incentive schemes

Evoenergy also proposes the continued application of our Service Target Performance Incentive Scheme (STPIS), and the application of our newly revised Demand Management Incentive Scheme (DMIS). These provide important balancing incentives to encourage Evoenergy to pursue expenditure efficiencies and demand side alternatives to capex and opex, while maintaining the reliability and overall performance of the network.

4.6.1 Service target performance incentive scheme

Our distribution STPIS[58] provides a financial incentive to distributors to maintain and improve service performance. The scheme aims to ensure that cost efficiencies incentivised under our expenditure schemes do not arise through the deterioration of service quality for customers. Penalties and rewards under the STPIS are calibrated with how willing customers are to pay for improved service. This aligns the distributor's incentives towards efficient price and non-price outcomes with the long-term interests of consumers.[59] We are currently undertaking a review of the STPIS. If that review is completed in time, it may be that a revised STPIS will apply to Evoenergy for the 2019–24 regulatory control period. For now, Evoenergy's proposal and this issues paper are based on the current version of the STPIS.[60]

In our final Framework and Approach paper we proposed, and CCP10 supported, the continued application of the STPIS to Evoenergy for the 2019–24 period. At that time, we also proposed to increase the amount of Evoenergy's revenue 'at risk' under the STPIS from the transitional +/- 2.5 per cent of revenue allowed in 2014–19 to the national scheme standard of +/-5 per cent. This would strengthen incentives under the scheme relative to those that have applied in the current period.

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[58] AER, *Electricity distribution network service providers - service target performance incentive scheme*, 1 November 2009.

[59] Guaranteed service levels (GSLs) and associated rebates for failure to meet minimum service standards for connection times, responses to complaints, failure to notify customers of planned interruptions and time taken to restore supply after interruptions are separately determined by the Independent Competition and Regulatory Commission in Schedule 1 of the *Utilities (Consumer Protection Code) Determination 2012* (DI2012–149), and not as part of our decision.

[60] Evoenergy-Attachment 10 Incentive schemes-January 2018_public, p. 10–7.

Evoenergy generally supports the continued application of a STPIS.[61] The key difference between its proposal and the position we took in the Framework and Approach paper is its submission that the amount of its revenue that is 'at risk' under the scheme should be held at the lower +/- 2.5 per cent that applied in the current period. In the context of feedback that most residential customers in the ACT are comfortable with Evoenergy's current strategy of maintaining (rather than investing more in improving) its current levels of reliability, it submits that its performance to date shows the current threshold provides adequate incentives to maintain its performance over the next five years.[62]

To assist us in our assessment we are interested in stakeholder views as to whether the strength of incentives under the STPIS should be raised to +/-5 per cent, consistent with the national scheme, or left at current levels as Evoenergy has proposed.

4.6.2 Demand management incentive scheme and innovation allowance

On 13 December 2017, we published a new DMIS. This rewards electricity distribution businesses for using efficient demand management projects to deliver value to consumers. We also released an improved version of our previous demand management innovation allowance (DMIA), which provides research and development funding to electricity distribution businesses so they can better use demand management to reduce long term network costs.

At this time, we requested a NER rule change to allow us to apply the DMIS before the next regulatory period for each distribution business. On 20 February 2018, the AEMC commenced consulting on this proposal as an expedited rule change. The proposed rule change, if made, will allow distribution businesses—including Evoenergy—to apply for early application of the DMIS from 3 April 2018.[63]

Our consultation on our Framework and Approach paper last year took the development of the new scheme into account. Both Evoenergy and CCP10 supported (in principle) our position to apply the new DMIS and Allowance Mechanism to Evoenergy for 2019–24.[64] That position is now supported in principle in Evoenergy's proposal.[65]

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61 Evoenergy-Attachment 10 Incentive schemes-January 2018_public, p. 10–7.

62 Evoenergy-Attachment 10 Incentive schemes-January 2018_public, p. 10–11.

63 https://www.aemc.gov.au/rule-changes/implementation-of-demand-management-incentive-sche

64 ActewAGL Distribution, *Response to AER preliminary framework and approach*, April 2017, p. 20; Consumer Challenge Panel (Sub-panel 10), *Submission on preliminary framework and approach for ActewAGL*, 21 April 2017, p. 13.

65 Evoenergy-Attachment 10 Incentive schemes-January 2018_public, p. 10–17 - 10–18.

5 Network pricing

In the Framework and Approach paper we published last year, we set out our intended classification of the services Evoenergy provides its customers:

- Standard control services are those that can only be provided by Evoenergy, and are common to most, if not all, of Evoenergy's customers. The costs of providing these services are captured in the building block revenue determination we discussed in section 4, and shared between all customers.
- Alternative control services, which are either:
  - services that can only be provided by Evoenergy, but will only be required by some of its customers, some of the time; or
  - services that can be purchased from Evoenergy, but which can also—or have the potential to be—purchased from a competing provider.

The cost of providing alternative control services is recovered from users of those services only.

Evoenergy has proposed updates to its tariff structure statement (TSS), which sets out the tariff structure through which Evoenergy will recover its regulated revenue for standard control services. It has also proposed a number of changes to prices for alternative control services. We discuss the key features of these elements of Evoenergy's proposal below.

5.1 Tariff structure statement

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 a set period of time.

Among other matters, a TSS must set out a distributor's proposed tariffs, structures and charging parameters for each proposed tariff, and the policies and procedures the distributer proposes to apply assigning customers to tariffs or reassigning customers from one tariff to another.[66] A TSS must also be accompanied by an individual pricing schedule.[67] The final prices for each tariff continue to be determined on an annual basis.

This is Evoenergy's second TSS and applies to the 2019-24 regulatory period. Its first TSS applies to the current 2017-19 period.

Evoenergy is currently the most advanced distributor in the National Electricity Market (NEM) in reforming its residential and small business customer network tariff structures.

In 2010, Evoenergy started applying a time-of-use tariff as the default network tariff for all new residential and low voltage (LV) commercial customers.[68] Since then, the number of customers 'opting-out' of these arrangements through their retailer has been low. Around 25,000 residential customers are now on the residential time-of-use tariff which represents 18 per cent of all residential customers. As part of the current 2017–19 TSS, Evoenergy has further reformed these arrangements and, from 1 December 2017, began applying a demand tariff as the default network tariff for all new residential and LV commercial customers and existing customers who receive advanced metering infrastructue (AMI, or 'smart meters'). These customers can opt-out to a time-of-use network tariff through their retailer.

Different arrangements apply to LV commercial customers with embedded generation. These customers are assigned to a capacity network tariff (with no opt-out arrangements). Other LV commercial customers can also opt-in to the capacity network tariff through their retailer.

Evoenergy’s current 2017–19 TSS focused on reforming residential and small business customer network tariffs. Evoenergy's proposed 2019–24 TSS focuses on making some refinements to its large LV and high voltage (HV) commercial customer network tariffs.

The changes in Evoenergy's proposal are intended to increase cost reflectivity and improve price signals. Changes include:[69]

- Refinements to the tariff structure for large LV and HV commercial customers, by changing the 'anytime' maximum demand charges to 'peak period' demand charges
- Refining residential and LV commercial peak demand tariffs, which are the default tariffs for customers with Type 4 meters (Type 4 meters are competitively available,

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66 NER, cl. 6.18.5.

67 NER, cl. 6.8.2(d1).

68 A new customer means a new connection the network, such as when a new premise is built. It does not refer to a customer moving into an existing premise and re-energising an existing connection.

69 Evoenergy-Overview of regulatory proposal-January 2018_Public, p. 32.

and have a range of additional functions compared to other meters, including remote communication ability)

- Closing one of its off-peak tariffs to new LV commercial connections from 1 July 2019, to remove contradictory signals about the commercial peak usage window (which under this tariff currently coincides with the off-peak window)
- Simplifying its tariff structure more generally by offering one version of each tariff from 1 July 2019, instead of different versions with and without a metering capital charge. Metering charges will instead be added to customer bills depending on their individual circumstances.

Evoenergy's proposed charges to the structure of its LV commercial tariffs are summarised in the following figure.

Figure 10 Evoenergy's proposed changes to LV commercial tariff structures

Opt out

	Tariff Components						
	Fixed	Flat energy	Inclining Block energy	TOU energy	Anytime demand	Peak demand	Capacity
General Network*	✓		✓				
General TOU	✓			✓			
LV TOU kVA Demand	✓			✓	✓	✓	
LV TOU Capacity	✓			✓	✓	✓	✓
LV KW Demand	✓	✓		✓		✓	
Streetlighting	✓	✓					
Small unmetered	✓	✓					

* Obsolete to new customers from 1 December 2017

Note: Red ticks indicate proposed change in the 2019–24 regulatory control period

Source: Evoenergy - Attachment 17 Proposed TSS - January 2018_Public, p. 17–10.

Evoenergy is more advanced than other distributors in reforming its residential network tariffs. To inform our assessment of these latest changes, and our consideration of tariff structure statements more generally, we are keen to understand customers' (and retailers') experience with Evoenergy's cost reflective network tariffs to date. For example:

- How have retailers responded to these network price signals in the retail packages offered to customers in the ACT? What has worked, what hasn't worked? What lessons have been learnt that would assist network tariff reform in other states and territories?
- Do stakeholders agree with Evoenergy's view that it has already made sufficient reforms to its residential customer network tariffs in the 2017–19 period, and therefore its focus for the 2019-24 period should be on reforming large commercial customer network tariffs?

We are also interested in Evoenergy's proposed changes to tariffs for LV and HV commercial customers, including whether stakeholders:

- Consider Evoenergy's approach of applying a different tariff assignment approach to LV commercial customers with and without embedded generation is appropriate?
- Agree with Evoenergy's approach of sharpening its peak pricing signals for LV and HV commercial customers by moving from anytime demand charges to peak period demand charges? And by moving from flat rate energy charges to time-of-use energy charges in its demand tariffs?

The following table lists our expectations for Evoenergy's next (2019-24) TSS (that we made in the previous process when assessing its 2017-19 TSS) and compares these with Evoenergy's actual 2019-24 TSS proposal. That is, how Evoenergy has responded to these comments on the future direction of tariff reform. We set out these comments in our final decisions on the first round of TSS proposals from Evoenergy and other distributors. We identified those matters to provide guidance to Evoenergy, and the industry more generally, on our views on the direction the industry should be heading, to maintain compliance with the distribution pricing principles in the future. We encourage stakeholders to look at our 2017-19 final decision regarding the future direction for network tariff reform and provide their views on how Evoenergy has responded to these.[70]

AER's expectations for 2019-24 proposal	Comparison with Evoenergy's 2019-24 proposal
Distributors to move from opt-in centred approaches to opt-out centred approaches to network tariff reform	As noted above, Evoenergy already moved to an opt-out approach in 2010.
Reconsideration of the 30 minute window to measure demand used by some distributors	Evoenergy has proposed to continue with the 30 minute window approach to measure demand.[71]
Refinement of charging windows to more closely reflect the times of congestion on a distributors' network	Evoenergy notes given the planned nature of the ACT, many areas are dominated by either residential or commercial loads that have distinctly different load profiles. Evoenergy proposes different charging windows for its residential and commercial tariffs to reflect this difference. Evoenergy proposes to align the peak, shoulder and off-peak charging windows across its commercial tariffs.[72]
Refinement of a distributors' method for estimating long run marginal cost LRMC, including the inclusion of replacement capex within marginal cost estimates	Evoenergy's proposal includes its response to our previous comments on this topic.[73]

Source: AER - Final decision - ActewAGL - Tariff Structure Statement 2017-19 - 28 February 2017

[70] See pages 14 to 15 of our 2017-19 TSS final decision which provides a guide on where to find our future direction commentary on different topics. AER, *Final decision—Tariff structure Statement—ActewAGL*, February 2017.

[71] Evoenergy, *Attachment 17: Proposed tariff structure statement*, 31 January 2018, pp.17-12.

[72] Evoenergy, *Attachment 17: Proposed tariff structure statement*, 31 January 2018, pp.17-7 to 17-8.

[73] Evoenergy, *Attachment 17: Proposed tariff structure statement*, 31 January 2018, pp.17-55 to 17-58.

5.2 Alternative control services

Alternative control services are requested, and paid for, only by customers using those services. Evoenergy's alternative control services include things like customer-specific requests for pole relocations or non-standard connection arrangements.

Under the Power of Choice reforms that took effect from 1 December 2017, Evoenergy (and other distribution network service providers) is no longer permitted to install small customer meters. This responsibility has now transferred to the local metering coordinator, most likely appointed by a retailer. All newly installed small customer meters must now be AMI (or 'smart') meters and this service is now contestable rather than a regulated monopoly. Consistent with the Framework and Approach paper we released last year, Evoenergy's proposal removes a number of metering services from its alternative control service proposal. Instead, Evoenergy has introduced a small number of new, or adjusted, services to facilitate the new metering contestability arrangements.

While metering contestability is now in practice, most customers will continue to see regulated metering charges until the financial value of the stock of older accumulation and interval meters has been fully depreciated. While some other DNSPs have proposed accelerated depreciation for the existing stock of older accumulation and interval meters in place at customer premises to remove legacy metering charges from customer bills more quickly, Evoenergy has not proposed to accelerate depreciation (which would have put upward pressure on its prices).

Evoenergy has also proposed a number of changes to its price structures (and therefore prices) for a number of other 'ancillary' services, which it submits are no longer cost reflective:[74]

- Prices for around 80 fee based services (including temporary and non-standard connections) would be adjusted to improve cost reflectivity. As some proposed price increases are large relative to existing charges, a gradual adjustment is proposed, with prices to be cost reflective by the end of the upcoming period. While some proposed price changes are reductions, others are increases of 30 to 60 per cent, with the largest price increases more than 160 per cent. As part of our assessment we will be working with Evoenergy to better understand the gap it has identified between current prices and costs.
- 65 services (miscellaneous connection charges) would be moved from quoted to fee based pricing, on the basis that these services are frequently demanded by customers. As fee based services Evoenergy will not be required to prepare separate quotes for individual jobs, which will reduce the administrative costs of providing them. While this will make costs more predictable for customers, as averaged charges some customers will presumably pay more than if these services

[74] Evoenergy-Attachment 14 Alternative Control Services-January 2018_Public.

remained as quoted services. The fee savings that flow from lower administration costs need to be weighed against the potential for reduced cost reflectivity.

As part of our assessment we will be looking at how Evoenergy's proposed approach compared to approaches taken by other distributors. Noting the recurring theme of predictability and certainty in pricing throughout Evoenergy's proposal, we are particularly interested in stakeholder views about the trade-off between the potential for reduced cost reflectivity under the simplified pricing structure proposed and the greater price certainty and administrative cost savings it could deliver.

A The regulatory framework for this determination

The NEL requires us to make our decision in a manner that contributes, or is likely to contribute, to achieving the NEO.[75] 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.[76] This is not delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision.[77]

We consider that the long-term interests of consumers are best served where consumers receive a reasonable level of safe and reliable service, which they value, at least cost in the long run.[78] 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. [79]

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.[80] 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.[81] There are also a range of outcomes that are unlikely to advance the NEO, or advance the NEO to the degree that 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.[82] 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.[83] 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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75 NEL, section 16(1).

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

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

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

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

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

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

82 NEL, s. 7A(7).

83 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.

Electricity determinations are complex decisions, made up of a number of interrelated parts. Examining any one part in isolation ignores the importance of the interrelationships between components of the overall decision, and would not contribute to the achievement of the NEO. For example:

- There are 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.
- There are direct mathematical links between different components of a decision. For example, the level of gamma has an impact on the appropriate tax allowance; the 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
- There are trade-offs between different components of revenue. For example, undertaking a particular capex project may affect the need for opex or vice versa.

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, in making our determination the NER requires us to prepare forecasts, which are predictions about unknown future circumstances. Very often, there will be more than one plausible forecast [84] 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.[85]

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.

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

85 NEL, s. 16(1)(d).

B Other AER reviews that may be of interest

Review of rate of return guideline

Our rate of return guideline sets out the approach by which we will estimate the rate of return (comprising the return on debt, the return on equity, and the value of imputation credits).

Estimation of the rate of return is complex and the rate of return is a significant driver of regulated revenue. We have sought stakeholders' views on whether our current approach to setting the allowed rate of return remains appropriate.

We expect to publish the final guideline in December 2018.

More information can be found on our website: Review of rate of return guideline.[86]

Review of the service target performance incentive scheme

We create and administer the Service Target Performance Incentive Scheme (STPIS) in accordance with the requirements of the NER. The purpose of the scheme is to provide incentives to electricity distributors to maintain the existing supply reliability performance and to make improvement to the extent to match customers' value on supply reliability.

We currently apply the scheme to distributors in the NEM. Our last review of the STPIS was in 2009 and we now consider it timely to review the scheme to account for the lessons learnt in implementing the scheme.

We also conduct this review in conjunction with the establishment of a Distribution Reliability Measures Guideline to set out common definitions of reliability measures that can be used to assess and compare the reliability performance of distributors.

We expect to finalise this review by June 2018.

More information can be found on our website: Service target performance incentive scheme - 2017 amendment.[87]

86 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-rate-of-return-guideline

87 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/service-target-performance-incentive-scheme-2017-amendment

Review of operating environment factors for distribution network service providers

We are currently reviewing our analysis of operating environment factors for the economic benchmarking of electricity distributors, in consultation with industry and other stakeholders.

In our annual benchmarking reports, we examine the relative efficiency of the distribution and transmission electricity service providers. In doing this we consider the characteristics of each network business, and how their productivity compares at the aggregate level given the outputs they deliver to consumers.

We also analyse the operating environment factors that may be unique to particular network service providers and which are not captured by our econometric benchmarking models. This helps us to identify the material factors driving apparent differences in estimated operating efficiency between the electricity distributors in the NEM.

We expect to finalise this review by May 2018.

More information can be found on our website: Review of operating environment factors for distribution network service providers.[88]

Distribution service classification guidelines and asset exemption guidelines

The AEMC has made a rule change to require the AER to prepare two new guidelines: a distribution service classification guideline and an asset exemption guideline.

Service classification determines the regulatory treatment of a service offered by a network service provider. This includes whether or not a service is subject to regulation, the approach to cost recovery, and whether or not a service will need to be ring-fenced from other services offered by a DNSP.

The AEMC's new restricted asset rule aims to aid the development of new markets for services where the participation of a DNSP could be harmful to consumers. A restricted asset is any asset owned by a DNSP located on the customer's side of a connection point to a network ('behind the meter'). A DNSP cannot add a restricted asset to its regulatory asset base unless it has obtained an exemption from us. The asset exemption guideline will set out our approach to exempting restricted assets.

Both guidelines aim to make the regulatory process more transparent and effective and will apply across the NEM. We have commenced consultation with the publication of

88 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-operating-environment-factors-for-distribution-network-service-providers

an issues paper on 16 February 2018. We will publish the guidelines by end-September 2018.

More information can be found on our website: Distribution service classification guidelines and asset exemption guidelines.[89]

Review of the application guidelines for the regulatory investment tests for transmission and distribution

We have commenced our review of the application guidelines for our regulatory investment tests (RITs). The RITs are cost–benefit analyses that network businesses must perform and consult on before making major investments in their networks. When undertaking RITs, network businesses must give due consideration to what options are out there, before identifying the best way to address needs on their networks.

We currently have separate RITs for transmission and distribution networks (the RIT-T and RIT-D). Each RIT has its own application guidelines to guide businesses on how to apply the RITs consistently and transparently.

After extensive stakeholder engagement, we expect to finalise the review in September 2018.

More information can be found on our website: Review of the application guidelines for regulatory investment tests.[90]

89 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/distribution-service-classification-guidelines-and-asset-exemption-guidelines

90 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-the-application-guidelines-for-the-regulatory-investment-tests-for-transmission-and-distribution