evoenergy

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Sebastian Roberts
General Manager, Network Expenditure
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email to: incentivereview@aer.gov.au

Dear Mr Roberts

Re: Review of incentive schemes for regulated networks

Evoenergy welcomes the opportunity to provide a submission to the Australian Energy Regulator's (AER) review of incentive schemes for regulated networks.

Evoenergy owns and operates the electricity distribution network in the Australian Capital Territory (ACT) and gas distribution networks in the ACT and the Queanbeyan–Palerang Regional Council and Shoalhaven City Council local government areas of New South Wales.

Incentive schemes have been designed to enhance the overall regulatory framework by ensuring networks have a strengthened and constant incentive to lower their costs and improve service performance. Overall, Evoenergy believes the current incentive schemes are fit-for-purpose and operating as intended, benefitting both consumers and networks.

Evoenergy supports the review of the incentive schemes for regulated networks and the AER's intent to optimise the regulatory framework. It is important to note that a distribution network service provider's (DNSP's) decisions on network operating and capital expenditure (capex) are made with regard to the overall regulatory framework, not just the incentive schemes.

Incentive schemes benefit consumers

Evoenergy supports the Energy Networks Australia's (ENA) submission to the review. The submission provides independent analysis quantifying the consumer benefits that have resulted from the incentive schemes. The analysis shows the schemes are working in the interests of consumers by achieving lower prices.

Over the 2006-20 period consumers have benefited by more than $13.4 billion (in 2020 dollars) as a result of the three main AER incentive schemes, namely:

- the Efficiency Benefit Sharing Scheme (EBSS),
- the Capital Expenditure Sharing Scheme (CESS), and

- the reliability component of the Service Target Performance Incentive Scheme (STPIS) for electricity distribution networks.

The analysis finds that consumers have retained 72 per cent of the total benefits ($18.6 billion). It is estimated that incentive schemes have benefitted each consumer with both an electricity and gas service by $1,466 in present value terms (2020). Consumers with only an electricity service were $1,290 better off over the same time period. As a comparison, the benefit to the networks from the schemes is estimated at $5.2 billion or $565 per customer with both an electricity and gas connection. Therefore, Evoenergy considers that reducing the level of incentives under these schemes would not be in either DNSPs' or consumers' interests.

In relation to the CESS, Evoenergy acknowledges potential concerns about the analysis relating to the counterfactual and attributing capital underspending by DNSPs to the incentive scheme as opposed to other causes. In Evoenergy's view, ambiguity in this respect is unavoidable as it is not realistic to be able to precisely quantify what capital spending would have occurred in the absence of the incentive scheme. Noting this difficulty, Evoenergy believes the consultant engaged by ENA has made a reasonable assumption in its report. This could turn out to be a generous assumption for DNSPs, but the opposite could also be true; if DNSPs would have overspent the capex allowance, but for the scheme.

The balance between the CESS and EBSS sharing ratios should be maintained

Evoenergy notes the focus of the review on the difference between the CESS sharing ratio (30/70: network to consumers) in comparison to the EBSS (18/82). The EBSS sharing ratio has fallen with the weighted average cost of capital (WACC), which is currently at a historically low level, with an industry average real WACC of 3.34 per cent in 2020. We concur with the ENA that the EBSS sharing ratio is likely at a low point in the cycle, along with the WACC.

Evoenergy also agrees with the ENA's conclusion that short term movements in markets should not guide changes to the CESS sharing ratio and that a stable regulatory regime is crucial to providing stable prices for customers and investment certainty for DNSPs. Further, we doubt that it would be suggested to increase the CESS ratio had the EBSS ratio changed in the opposite direction, i.e. to greater than a 30 per cent share for network benefits. This potential asymmetry points to an simplistic underlying conception that even when consumers are accruing the majority of gains (70 per cent), network benefits are unwarranted.

Networks are incentivised to reduce costs which benefits consumers

Evoenergy notes the stakeholder feedback communicated by the AER in the Discussion paper released in December 2021. In short, consumer stakeholders raised concerns about

expenditure over-forecasting (particularly in the context of the CESS) and questioned whether network service providers are being rewarded for genuine efficiency gains.[1]

These concerns appear to rest on an underlying assumption that if a network is benefitting from a scheme, consumers are losing (as alluded to in relation to the balance between CESS/EBSS). This does not reflect how the incentive schemes have been designed to operate. In simple terms, they are designed to be a 'win-win' for both networks and consumers. Consumers benefit from more efficient networks, and downsizing or removing incentive schemes would likely lead to worse outcomes for consumers. This is consistent with the findings of the independent analysis in the ENA's submission.

Similarly, consumer concerns that relate to over-forecasting required capex portray an adversarial relationship between consumers and networks. Networks do not want to unreasonably push up consumer costs, and work closely with the community, retailers and advocacy groups to provide affordable tariff options. Further, consumer concerns in relation to over forecasting imply, in the case of the CESS, that it is easy for a DNSP to propose inflated capex forecasts that are endorsed by the AER. This is not a reasonable assumption in our opinion as the AER acts in an independent capacity to carefully determine prudent and efficient expenditure.

In Evoenergy's case, the capex allowance for the 2019–24 regulatory control period (RCP) for the electricity network is actually around 7 per cent lower than the previous RCP (in constant 2021/22 dollars). Actual capex over the first two years of the RCP has tracked relatively closely to the regulatory allowance, with the current third year (2021/22) also likely to be the same. This does not sit consistently with the narrative of a DNSP proposing an inflated capex allowance which will be deliberately underspent, or alternatively, see expenditure accelerated towards the end of the RCP.

Evoenergy considers the incentives schemes, principally the EBSS, CESS and the reliability component of STPIS, are fit-or-purpose and operating as intended. Independent analysis indicates that they have provided benefits to both consumers and networks. Any changes to the schemes should be carefully considered as a result.

Should you wish to further discuss matters raised in this submission, please contact

Yours sincerely

Peter Billing
General Manager Evoenergy

[1] Australian Energy Regulator 2021, *Review of expenditure incentive schemes – discussion paper – December 2021*, p.38.