FINAL DECISION

Energex
Distribution Determination
2020 to 2025

Attachment 8
Efficiency benefit sharing scheme

June 2020

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Energex for the 2020–25 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

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8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for distributors to pursue efficiency improvements in operating expenditure (opex), and provide for a fair sharing of these between distributors and network users. Consumers benefit from improved efficiencies through lower opex allowances in subsequent regulatory control periods.

This attachment sets out our final decision on the EBSS carryover amounts Energex accrued over the 2015–20 regulatory control period, and how we will apply the EBSS over the 2020–25 regulatory control period.

8.1 Final decision

Our final decision is to approve EBSS carryover amounts totalling $68.1 million ($2019–20) from the application of the EBSS in the 2015–20 regulatory control period.[1] This is $0.1 million ($2019–20) lower than Energex's revised proposal. The difference is due to updating forecast inflation for the year to June 2020 using the inflation forecast in the Reserve Bank of Australia's (RBA) latest *Statement on Monetary Policy*.[2]

We set out our final decision on Energex's EBSS carryover amounts in Table 8.1.

Table 8.1 Final decision on carryover amounts ($ million, 2019–20)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Energex's revised proposal	–34.8	36.7	34.6	31.6	–	68.2
AER final decision	**–34.7**	**36.7**	**34.6**	**31.6**	**–**	**68.1**

Source: Energex Revised Proposal, EBSS Model, December 2019; AER analysis.

Note: Numbers may not add up due to rounding.

Our final decision is to apply version two of the EBSS to Energex for the 2020–25 regulatory control period.[3] This is consistent with our draft decision and Energex's revised proposal.[4] Consistent with Energex's proposal, and our draft decision, we will

1 NER, cl. 6.4.3(a)(5).

2 Reserve Bank of Australia, *Statement on Monetary Policy – May 2020*, Forecast Table, May 2020, available at https://www.rba.gov.au/publications/smp/2020/may/forecasts.html. We have used the trimmed mean inflation series for conversion into $2019–20. Our usual implementation is to use the (headline) CPI forecast for the year ending June 2020. In the current COVID circumstances, we consider the trimmed mean forecast better reflects core expectations of inflation as set out in the RBA's *Statement on Monetary Policy*. Further, the trimmed mean smooths the transient volatility in the CPI forecasts in the May *Statement on Monetary Policy*.

3 NER, cl. 6.12.1(9); AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

4 Energex, *Energex revised regulatory proposal 2020–25*, December 2019, p. 46.

exclude debt raising costs from the scheme as a pre-defined 'excluded category'. We will also make other adjustments as permitted by the EBSS, such as removing demand management innovation allowance costs, and movements in provisions (as outlined in section 8.4).

We have set out in table 8.2 the opex forecasts we will use to calculate efficiency gains in the 2020–25 regulatory control period, including forecast debt raising costs.

Table 8.2 Forecast opex for the EBSS ($ million, $2019–20)

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Total forecast opex	384.8	387.2	365.1	362.9	361.0	359.4	357.4
Less debt raising costs	–7.6	–7.8	–6.2	–6.2	–6.2	–6.2	–6.2
Forecast opex for the EBSS	**377.2**	**379.4**	**358.9**	**356.6**	**354.8**	**353.2**	**351.2**

Source: AER, *Energex final decision - EBSS model*, May 2020; AER, *Energex final decision - Post tax revenue model*, May 2020; AER analysis.

Note: Numbers may not add up due to rounding.

8.2 Energex's revised proposal

8.2.1 Carryover amounts from the 2015–20 regulatory control period

Energex calculated EBSS carryover amounts totalling $68.2 million ($2019–20) from the application of the EBSS in the 2015–20 regulatory control period.[5] In its revised proposal, it elected to include these carryover amounts in its proposed revenues. This is a change from its initial proposal, where it did not include carryover amounts in proposed revenues, subject to our accepting its regulatory proposal.[6]

Energex adopted our draft decision methodology to calculate its EBSS carryovers in its revised regulatory proposal. It updated the calculation to include actual opex for 2018–19, rather than the estimate we used in our draft decision. Actual opex in 2018–19 was lower than the estimate we used in our draft decision. This increased the calculated EBSS carryover compared to the total of $24.3 million ($2019–20) we calculated in our draft decision.[7]

5 Energex, *Energex revised regulatory proposal 2020–25*, December 2019, pp. 45–46.

6 Energex, *1.003 Energex Regulatory proposal 2020–25*, January 2019, p. 106.

7 AER, *Energex 2020–25 - Draft decision - EBSS model*, October 2019.

8.2.2 Application in the 2020–25 regulatory control period

Energex accepted our draft decision as it relates to the application of the EBSS in the 2020–25 regulatory control period.[8]

8.2.3 Stakeholder submissions

The EBSS was not a particularly strong focus of stakeholder submissions. Several submissions (Consumer Challenge Panel, sub-panel 14, Energy Consumers Australia (ECA), Dynamic Analysis, the Chamber of Commerce and Industry Queensland (CCIQ) and Origin Energy) noted that Energex reversed, in its revised proposal, its initial proposal to forego carryover amounts.[9] The ECA noted that this retraction came late in the process and was not well socialised with advocates.[10] The CCIQ stated that it strongly opposes Energex's proposal to retain its EBSS carryovers, after having previously elected to forego them.[11]

8.3 Assessment approach

Under the National Electricity Rules (NER) we must determine:

- the revenue increments or decrements for each year of the 2020–25 regulatory control period arising from the application of the EBSS during the 2015–20 regulatory control period[12]
- how the EBSS will apply to Energex in the 2020–25 regulatory control period.[13]

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between service providers and network users.[14] We must also have regard to the following matters when implementing the EBSS:[15]

- the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme
- the need to provide Energex with a continuous incentive to reduce opex

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8 Energex, *Revised regulatory proposal 2020–25*, December 2019, p. 46.

9 CCP14, *Advice to the AER on the Energex and Ergon Energy 2020–25 Revised Regulatory Proposals*, March 2020, p. 13; ECA, *ECA submission on Energy Queensland revised proposals*, January 2020, p. 4; Dynamic Analysis, *Technical report on Ergon revised proposal*, January 2020, pp. 10–11; CCIQ, *CCIQ submission to the AER, 2020–25 Energy Queensland Price Determination*, January 2020, pp. 4–5; Origin Energy, *Origin Response EQ Revised Proposals 2020–25_Redacted*, January 2020, p. 2.

10 ECA, *ECA submission on Energy Queensland revised proposals*, January 2020, p. 4.

11 CCIQ, *CCIQ submission to the AER, 2020–25 Energy Queensland Price Determination*, January 2020, p. 5.

12 NER, cl. 6.4.3(a)(5).

13 NER, cll. 6.3.2(a)(3) and 6.12.1(9).

14 NER, cl. 6.5.8(a).

15 NER, cl. 6.5.8(c).

- the desirability of both rewarding Energex for efficiency gains and penalising it for efficiency losses
- any incentives that Energex may have to capitalise expenditure
- the possible effects of the scheme on incentives for the implementation of non-network alternatives.

8.3.1 Interrelationships

The EBSS is closely linked to our revealed cost approach to forecasting opex. When we assess or develop our opex forecast, the NER require us to have regard to whether the opex forecast is consistent with any incentive schemes.[16]

Our opex forecasting method typically relies on using the 'revealed costs' of the service provider in a chosen base year to develop a total opex forecast if the chosen base year opex is not considered to be 'materially inefficient'. Under this approach, a service provider would have an incentive to spend more opex in the expected base year. Also, a service provider has less incentive to reduce opex towards the end of the regulatory control period, where the benefit of any efficiency gains is retained for less time.

The application of the EBSS serves two important functions:

1. It removes the incentive for a service provider to inflate opex in the expected base year in order to gain a higher opex forecast for the next regulatory control period.
2. It provides a continuous incentive for a service provider to pursue efficiency improvements across the regulatory control period.

The EBSS does this by allowing a service provider to retain efficiency gains (or losses) for a total of six years, regardless of the year in which the service provider makes them. Where we do not propose to rely on the single year revealed costs of a service provider in forecasting opex, this has consequences for the service provider's incentives and our decision on how we apply the EBSS.

When a business makes an incremental efficiency gain, it receives a reward through the EBSS, and consumers benefit through a lower revealed cost forecast for the subsequent regulatory control period. This is how efficiency improvements are shared between consumers and the business. If we subject costs to the EBSS that are not forecast using a revealed cost approach, a business would in theory receive a reward for efficiency gains through the EBSS (at a cost to consumers), but consumers would not benefit through a lower revealed cost forecast in the subsequent regulatory control period.

Therefore, we typically exclude costs that we do not forecast using a single year revealed cost forecasting approach.

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[16] NER, cl. 6.5.6(e)(8). Further, we must specify and have regard to the relationship between the constituent components of our overall decision: NEL, s 16(1)(c).

For these reasons, our decision on how we will apply the EBSS to Energex has a strong interrelationship with our decision on its opex (see attachment 6). We have careful regard to the effect of our EBSS decision when making our opex decision, and our EBSS decision is made largely in consequence of (and takes careful account of) our past and current decisions on Energex's opex.

8.4 Reasons for final decision

8.4.1 Carryover amounts from the 2015–20 control period

Energex addressed each of the issues we identified in our draft decision and adopted the same approach as we used to calculate its EBSS carryover in its revised regulatory proposal.[17] The only change we have made to Energex's revised proposal is to update the inflation forecast for the year to June 2020 to use the trimmed mean inflation forecast in the RBA's May 2020 *Statement on Monetary Policy*.[18]

We consider that the EBSS carryover amounts we have calculated, as set out in table 8.1, provide for a fair sharing of efficiency gains and losses between Energex and its network users. It both rewards Energex for the efficiency gains it has made and penalises it for its efficiency losses. Further, we consider that the benefit to networks users, through lower forecast opex, is sufficient to warrant the EBSS carryover amounts we have determined.

8.4.2 Application in the 2020–25 control period

Our final decision is to continue to apply version 2 of the EBSS to Energex during the 2020–25 regulatory control period. We consider applying the scheme will benefit long-term electricity customers as it will provide continuous incentives for Energex to reduce opex. Provided that we forecast Energex's future opex using its revealed costs in the 2020–25 regulatory control period, any efficiency gains that Energex achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to determining the length of the carryover period and adjusting forecast or actual opex when calculating carryover amounts.[19] We provide details on these below.

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17 Energex, *Energex revised regulatory proposal 2020–25*, December 2019, pp. 45–46.

18 Reserve Bank of Australia, *Statement on Monetary Policy – May 2020*, *Forecast Table*, May 2020, available at https://www.rba.gov.au/publications/smp/2020/may/forecasts.html. We have used the trimmed mean inflation series for conversion into $2019–20. Our usual implementation is to use the (headline) CPI forecast for the year ending June 2020. In the current COVID circumstances, we consider the trimmed mean forecast better reflects core expectations of inflation as set out in the RBA's *Statement of Monetary Policy*. Further, the trimmed mean smooths the transient volatility in the CPI forecasts in the May *Statement of Monetary Policy*.

19 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

Length of carryover period

To ensure continuous incentives, the length of the carryover period for the 2020–25 regulatory control period will be the same as the length of Energex's following regulatory control period.[20] We expect Energex's following regulatory control period will be five years, starting from 1 July 2025.

Adjustments to forecast or actual opex when calculating carryover amounts

The EBSS allows us to exclude categories of costs that we do not forecast using a single year revealed cost forecasting approach. We do this to fairly share efficiency gains and losses. For instance, where a service provider achieves efficiency improvements, it receives a benefit through the EBSS and network users receive a benefit through lower forecast opex in the next regulatory control period. This is the way network users and the service provider share in the benefits of an efficiency improvement.

If we do not use a single year revealed cost forecasting approach, we may not pass the benefits of revealed efficiency gains to network users. It follows that network users should not pay for EBSS rewards where they do not receive the benefits of a lower opex forecast.

Consistent with version 2 of the EBSS, we will only exclude debt raising costs from the EBSS as a pre-defined 'excluded category'. This is because we do not forecast debt raising costs on a revealed cost basis. We instead forecast these based on a benchmark amount.

In addition we will also make the following adjustments when we calculate the EBSS carryover amounts for the next regulatory control period:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination, such as approved pass through amounts or opex for contingent projects[21]
- adjust actual opex to remove demand management innovation allowance opex because it is not included in the opex forecast (but is often reported by service providers as part of their standard control services opex)[22]
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base[23]

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20 NER, cl. 6.5.8(c)(2).

21 AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

22 Clause 6.5.8(c)(5) of the NER requires us to have regard to the possible effects of the scheme on incentives for the implementation of non-network options.

23 Clause 6.5.8(c)(4) of the NER requires us to have regard to any incentives the service provider may have to capitalise expenditure.

- adjust forecast opex and actual opex for inflation[24]
- adjust actual opex to reverse any movements in provisions
- adjust opex for any services that will not be classified as standard control services in the 2025–30 regulatory control period, to the extent these costs are not forecast using a single year revealed cost approach and excluding these costs better achieves the requirements of clauses 6.5.8 of the NER.[25]

[24] AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

[25] AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers,* November 2013, p. 14.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CCP14	Consumer Challenge Panel, sub-panel 14
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
ECA	Energy Consumers Australia
NEL	National Electricity Law
NER	National Electricity Rules
opex	operating expenditure
RBA	Reserve Bank of Australia