

Draft Decision

Endeavour Energy

Electricity Distribution

Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 8

Efficiency benefit sharing scheme

September 2023

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

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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 the benefits of these efficiencies between network service providers and users.¹ Consumers benefit from improved efficiencies through lower regulated prices.

This attachment sets out our draft decision on the EBSS carryover amounts Endeavour Energy (Endeavour) accrued over the 2019–24 regulatory period, and how we will apply the EBSS over the 2024–29 regulatory period.

8.1 Draft decision

Our draft decision is to include EBSS carryover amounts totalling \$131.2 million (\$2023–24) from the application of the EBSS in the 2019–24 regulatory period.² This is \$1.9 million (\$2023–24) lower than Endeavour’s proposed carryover amount of \$133.1 million (\$2023–24).³ This difference reflects our use of the most recent inflation figures (not available at the time Endeavour submitted its proposal) to convert amounts into 2023–24 dollars.

We set out our draft decision on Endeavour’s EBSS carryover amounts in Table 8.1.

Table 8.1 Draft decision on carryover amounts (\$million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Endeavour’s proposal	53.3	18.9	33.2	27.7	–	133.1
AER draft decision	52.8	18.4	32.7	27.3	–	131.2
Difference	–0.5	–0.4	–0.5	–0.5	–	–1.9

Source: Endeavour Energy, *9.01 EBSS Model*, January 2023; AER analysis.

Note: Numbers may not add up to total due to rounding. ‘–’ represents zero.

We will continue to apply version 2 of the EBSS to Endeavour in the 2024–29 regulatory period.⁴ Consistent with Endeavour’s proposal, we will exclude debt raising costs from the scheme because we have forecast them on a category specific basis and expect to continue doing so in the 2029–34 regulatory period. We will also make other adjustments as permitted

¹ AER, *AER explanatory statement – efficiency benefit sharing scheme – November 2013*, November 2013, p. 5.

² NER, cl. 6.4.3(a)(5).

³ Endeavour Energy, *9.01 EBSS Model*, January 2023.

⁴ We must make a decision on how any EBSS is to apply to distributors as part of this determination under cl. 6.12.1(9) of the NER; See also AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

by the EBSS, such as removing demand management innovation allowance mechanism costs and movements in provisions from actual opex, and adding approved opex for pass throughs and contingent projects to forecast opex (as outlined in section 8.4).

8.2 Endeavour Energy’s proposal

8.2.1 Carryover amounts accrued during the 2019–24 regulatory period

Endeavour proposed to include EBSS carryover amounts totalling \$133.1 million (\$2023–24) in its revenue in the 2024–29 regulatory period, from the application of the EBSS in the 2019–24 regulatory period. Endeavour made the following adjustments in calculating its EBSS carryover amounts:⁵

- added the approved forecast opex for the 2019–20 bushfires season pass through event to forecast opex
- removed demand management innovation allowance expenditure from actual opex
- reversed movements in provisions from actual opex
- removed the impact on opex caused by changes in capitalisation policies and/or accounting standards which occurred over the 2019–24 period.⁶

8.2.2 Application in the 2024–29 regulatory period

Endeavour proposed we continue to apply the latest version of the EBSS in the 2024–29 regulatory period. It also proposed that we apply the following adjustments and exclusions:⁷

- debt raising costs
- non-network alternatives costs (demand management innovation allowance) and Innovation Fund costs
- movements in provisions
- any changes in capitalisation policies and/or accounting standards that occur over the 2024–29 period (if any).

8.2.3 Stakeholder submissions

In terms of stakeholder submissions, Origin Energy was concerned with the opex underspend achieved by Endeavour in the 2019–24 regulatory period and whether this

⁵ Endeavour Energy, *0_01 Regulatory Proposal*, January 2023, p. 127.

⁶ Endeavour reversed the effect of the mid-period accounting treatment changes to lease capitalisation by continuing to record these costs as opex throughout the 2019–24 regulatory period. This negated the impact of these mid-period accounting changes on opex and the EBSS.

⁷ Endeavour Energy, *0_01 Regulatory Proposal*, January 2023, p. 128.

underspend reflected sustainable efficiency improvements.⁸ Origin argued that networks on the efficiency frontier would presumably have limited scope to achieve efficiencies in excess of our efficiency targets. The ability of distribution network service providers, particularly those on (or close to) the efficiency frontier, to consistently achieve EBSS payments tends to suggest that the incentive regime may not be operating as intended. It considered that this was either a result of insufficient rigor in our opex forecast assessment or that the efficiency targets for network service providers were not challenging enough.

We acknowledge that Endeavour has been able to achieve efficiency gains in previous periods, while being assessed as having base year opex that is not materially inefficient. This outcome is consistent with the operation of the incentive framework. Our opex efficiency assessments incorporate a degree of conservatism, given we utilise benchmarking tools which are necessarily imperfect and imprecise. The EBSS provides an ongoing incentive to achieve opex efficiencies. It is then important that these efficiencies are shared with consumers, through lower forecast opex. We will continue to regularly examine the effectiveness and appropriateness of our opex forecast assessment process and efficiency incentives and implement changes where there is a need to do so.

8.3 Assessment approach

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

- the revenue increments or decrements for each year of the 2024–29 regulatory period arising from the application of the EBSS during the 2019–24 regulatory period⁹
- how the EBSS will apply to Endeavour in the 2024–29 regulatory period.¹⁰

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between service providers and network users.¹¹ We must also have regard to the following matters when developing and implementing the EBSS:¹²

- 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 Endeavour with a continuous incentive to reduce opex
- the desirability of both rewarding Endeavour for efficiency gains and penalising it for efficiency losses
- any incentives that Endeavour may have to capitalise expenditure

⁸ Origin Energy, *Submission - 2024–29 Electricity Determination - NSW and ACT*, May 2023, pp. 4–5.

⁹ These amounts constitute one of the building blocks we must use to determine the annual revenue requirement: cl. 6.4.3(a)(5) of the NER.

¹⁰ NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

¹¹ NER, cl. 6.5.8(a).

¹² NER, cl. 6.5.8(c).

- 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.¹³

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 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 period
2. it provides a continuous incentive for a service provider to pursue efficiency improvements across the regulatory 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 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 single year 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 necessarily benefit through a lower revealed cost forecast in the subsequent regulatory period. Therefore, we typically exclude costs that we do not forecast using a single year revealed cost forecasting approach.

For these reasons, our decision on how we will apply the EBSS to Endeavour has a strong interrelationship with our decision on its opex (see Attachment 6 – operating expenditure). 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 Endeavour’s opex.

¹³ 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).

8.4 Reasons for draft decision

8.4.1 Carryover amounts from the 2019–24 regulatory period

Our draft decision is to include EBSS carryover amounts totalling \$131.2 million (\$2023–24) from the application of the EBSS in the 2019–24 regulatory period.¹⁴ This is a \$1.9 million (\$2023–24) decrease compared to Endeavour’s proposed carryover amount of \$133.1 million (\$2023–24). This difference reflects our use of the most recent inflation figures (not available at the time Endeavour submitted its proposal) to convert amounts into 2023–24 dollars. We discuss the impact of inflation in more detail below.

We consider that the EBSS carryover amounts we have calculated provide for a fair sharing of efficiency gains and losses between Endeavour and its network users. It both rewards Endeavour 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.

8.4.1.1 Inflation

Consistent with our standard approach and our opex forecast, we used unlagged inflation to convert amounts to 2023–24 dollars.¹⁵ We have also used the latest inflation forecasts which were not available at the time Endeavour submitted its proposal, which decreased our draft decision EBSS carryover amount by \$1.9 million (\$2023–24) compared to Endeavour's estimate.

For 2022–23, we used the actual headline Consumer Price Index figure published by the Australian Bureau of Statistics.¹⁶ For 2023–24, we used the inflation forecast in the Reserve Bank of Australia's August 2023 *Statement on monetary policy*.¹⁷

8.4.2 Application in the 2024–29 regulatory period

Our draft decision is to continue to apply version 2 of the EBSS to Endeavour during the 2024–29 regulatory period. We consider applying the scheme will benefit long-term electricity customers as it will provide continuous incentives for Endeavour to reduce opex. Provided we forecast Endeavour’s future opex using its revealed costs in the 2024–29 regulatory period, any efficiency gains that Endeavour achieves will lead to lower opex forecasts, and thus lower network tariffs.

Version 2 of the EBSS specifies our approach to adjusting forecast or actual opex when calculating carryover amounts.¹⁸ We provide details on these below.

¹⁴ NER, cl. 6.4.3(a)(5).

¹⁵ This ensures Endeavour is not accruing carryovers that are not being passed on to customers.

¹⁶ Australian Bureau of Statistics, *Catalogue number 6401.0, Consumer price index*, June 2023.

¹⁷ Reserve Bank of Australia, *Statement on monetary policy, Appendix: Forecasts*, August 2023.

¹⁸ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

8.4.2.1 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 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 these 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.

For the 2024–29 regulatory period, we have not forecast debt raising costs using a single year revealed cost forecasting approach. If we do the same for the 2029–34 regulatory period, we will exclude these costs from the EBSS for the 2024–29 regulatory period.

As well as excluding costs not forecast using a single year revealed cost approach, our standard approach is to exclude the impact of mid-period capitalisation and/or accounting treatment changes from the EBSS. This is achieved by ensuring any mid-period capitalisation and/or accounting changes are not implemented until the start of the new period. We do this to ensure the EBSS rewards (and penalties) reflect genuine efficiency changes rather than capitalisation and/or accounting treatment changes. We consider that under this approach there would be no opportunity for a service provider to incur windfall gains or losses that have resulted purely from movement of expenditure between opex and capital expenditure due to mid-period cost reclassification.

For the 2024–29 regulatory period, we have excluded the impact on opex of changes in the accounting treatment of lease and software-as-a-service costs from the EBSS. We intend to do the same for any capitalisation and/or accounting treatment changes which occur in the 2024–29 regulatory period.

In addition to the excluded cost categories discussed above, we will also make the following adjustments when we calculate the EBSS carryover amounts accrued during the 2024–29 regulatory 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 projects¹⁹

¹⁹ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

- adjust actual opex to remove demand management innovation allowance mechanism expenditure because it is not included in the opex forecast (but is often reported by service providers as part of their standard control services opex)²⁰
- adjust actual opex to add capitalised opex that has been excluded from the regulatory asset base²¹
- adjust forecast opex and actual opex for inflation²²
- 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 2029–34 regulatory 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.²³

As discussed in Attachment 6, we have not included any opex associated with Endeavour's proposed Innovation Fund in our estimate of total forecast opex for the 2024–29 regulatory control period. Endeavour included these forecast costs as a revenue adjustment item in its post-tax revenue model for the 2024–29 regulatory control period. We are therefore not required to make a decision on whether to exclude these costs from the EBSS. However, we note that if we were to include costs such as those proposed by Endeavour for its Innovation Fund in our forecast of total opex, we expect these costs would be excluded from the EBSS as they have not been forecast on a single year revealed cost basis.

²⁰ 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.

²¹ 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.

²² AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 7.

²³ AER, *Explanatory Statement: Efficiency benefit sharing scheme for electricity network service providers*, November 2013, pp. 14–16.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
EBSS	efficiency benefit sharing scheme
NER	national electricity rules
opex	operating expenditure
