

Draft Decision

Evoenergy

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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Version	Date	Pages
1	28 September 2023	6

Contents

8	Efficiency benefit sharing scheme	1
8.1	Draft decision.....	1
8.2	Evoenergy’s proposal	2
8.3	Assessment approach	2
8.4	Reasons for draft decision	4
	Shortened forms.....	6

8 Efficiency benefit sharing scheme

The efficiency benefit sharing scheme (EBSS) is intended to provide a continuous incentive for service providers 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 consumers.¹ Consumers benefit from improved efficiencies through lower regulated prices.

This section sets out our draft decision and reasons on the EBSS carryover amounts Evoenergy has accrued over the 2019–24 regulatory control period, and how we will apply the EBSS over the 2024–29 regulatory control period.

8.1 Draft decision

Our draft decision is to not apply an EBSS carryover penalty to Evoenergy from the application of the EBSS in the 2019–24 regulatory control period. The EBSS is intended to work in conjunction with a revealed cost forecasting approach for opex.² However, given we have not used this approach to forecast Evoenergy's opex for the 2024–29 regulatory control period, we consider it would not be consistent with the intended operation of the EBSS, and would not implement the EBSS in accordance with the National Electricity Rules (NER), if we were to subtract the accrued EBSS penalties from Evoenergy's revenues. This is because if we included the EBSS penalties and an efficiency adjustment to Evoenergy's base year, Evoenergy would carry a greater share of losses than we initially intended when we applied the EBSS for the 2019–24 regulatory control period. This is not consistent with the objectives defined in the NER, including the fair sharing of efficiency losses.³ We provide more details below, and set out our draft decision in table 8.1.

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

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Evoenergy's proposal	-0.8	-2.4	-1.5	-	0.3	-4.3
AER's draft decision	-	-	-	-	-	-
Difference	0.8	2.4	1.5	-	-0.3	4.3

Source: Evoenergy, *Evoenergy – RIN Appendix 4 Final RIN – Workbook 3 – EBSS – January 2023*, 31 January 2023; AER analysis.

Note: Numbers may not add up due to rounding. '-' represents zero.

As it is uncertain whether we will rely on Evoenergy's revealed costs in the 2024–29 regulatory control period in forecasting Evoenergy's efficient opex in the future, our draft decision is that we will not apply the EBSS during the 2024–29 regulatory control period.

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

² AER, *AER explanatory statement – efficiency benefit sharing scheme – November 2013*, November 2013, p. 5.

³ NER, cl. 6.5.8(a).

8.2 Evoenergy’s proposal

8.2.1 Carryover amounts accrued during the 2019–24 regulatory control period

Evoenergy included EBSS carryover amounts totalling –\$4.3 million (\$2023–24) in its proposed revenues for the 2024–29 regulatory control period, from the application of the EBSS in the 2019–24 regulatory control period. Evoenergy excluded the following cost categories in calculating its EBSS carryover amounts:⁴

- debt raising costs
- demand management innovation allowance mechanism opex
- movements in provisions related to opex.

8.2.2 Application in the 2024–29 control period

Evoenergy proposed that we apply version 2 of the EBSS to it in the 2024–29 regulatory control period.⁵

8.2.3 Stakeholder submissions

We did not receive any stakeholder submissions on Evoenergy’s EBSS proposal.

8.3 Assessment approach

Under the NER we must determine:

- the revenue increments or decrements for each year of the 2024–29 regulatory control period arising from the application of the EBSS during the 2019–24 regulatory control period⁶
- how the EBSS will apply to Evoenergy in the 2024–29 regulatory control period.⁷

The EBSS must provide for a fair sharing of opex efficiency gains and efficiency losses between Evoenergy and network users.⁸ We must also have regard to the following matters when implementing the EBSS:⁹

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

⁴ Evoenergy, *Evoenergy – RIN Appendix 4 Final RIN – Workbook 3 – EBSS – January 2023*, 31 January 2023.

⁵ Evoenergy, *Evoenergy – Attachment 4 – Incentives schemes – January 2023*, 31 January 2023, p. 6.

⁶ NER, cl. 6.4.3(a)(5).

⁷ NER, cl. 6.3.2(a)(3); cl. 6.12.1(9).

⁸ NER, cl. 6.5.8(a).

⁹ 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.¹⁰

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 therefore serves two important functions:

- 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
- 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 6 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.

For these reasons, our decision on how we will apply the EBSS to Evoenergy has a strong interrelationship with our decision on its opex (see Attachment 6). We have 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 account of) our past and current decisions on Evoenergy's opex.

¹⁰ 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

This section provides the reasons for our draft decision on the carryover amounts that arise from applying the EBSS during the 2019–24 regulatory control period, and how we will apply the EBSS in the 2024–29 regulatory control period.

8.4.1 Carryover amounts from the 2019–24 control period

Our draft decision is to not include Evoenergy’s negative carryover amounts from the application of the EBSS in the 2019–24 regulatory control period. This is because we have not used a revealed cost forecasting approach to forecast opex in this draft decision. We therefore consider that applying the EBSS penalties would not be consistent with the intended operation of the EBSS, nor give effect to the objective of fair sharing of efficiency losses in accordance with the NER.

As noted above, the opex forecasting approach and the EBSS are closely related. We consider use of the revealed cost forecasting approach together with the EBSS allows for the fair sharing of efficiency gains and losses, and provides the appropriate incentive to service providers to avoid efficiency losses and to promote efficiency gains. However, in this circumstance, we consider the change in our opex forecasting approach warrants reconsideration of the EBSS penalties that apply to Evoenergy. As discussed in Attachment 6, we have not used Evoenergy’s actual opex as a base for forecasting its opex for the 2024–29 regulatory control period. This is because this would not produce a total forecast that reasonably reflects the opex criteria.

If we applied both the EBSS penalties and a benchmark opex allowance for the next regulatory control period, this would have implications for how the efficiency losses Evoenergy made during the 2019–24 regulatory control period would be shared with consumers. Evoenergy will carry a greater share of efficiency losses than was intended when we decided to apply the EBSS prior to the start of the 2019–24 regulatory control period. This is because Evoenergy’s efficiency losses do not affect our alternative opex forecast, and are not shared with consumers. This is not consistent with the objective of fairly sharing efficiency losses as defined under the NER. When implementing an EBSS, we must also have regard to whether benefits to electricity consumers from the scheme are sufficient to warrant a penalty we might apply under the scheme.¹¹ In these circumstances, where we have not used a revealed cost approach to forecast opex, we do not consider that a carryover penalty is warranted.

8.4.2 Application in the 2024–29 regulatory control period

Our draft decision is that we will not apply the EBSS in the 2024–29 regulatory control period.

As discussed above, the EBSS is closely linked to the revealed cost forecasting approach. We have not used Evoenergy’s revealed cost to forecast opex for the 2024–29 regulatory control period. We also note that Evoenergy has just over four years before it submits its next regulatory proposal. It is therefore uncertain whether and to what extent we are likely to rely

¹¹ NER, cl. 6.5.8(c)(1).

on Evoenergy's revealed costs in the 2024–29 regulatory control period in forecasting opex in the following regulatory control period.

If we do not use a revealed costs approach for forecasting opex in the future, there is not a strong reason to apply the current version of the EBSS. Evoenergy will already have an incentive to make efficiency improvements in the 2024–29 regulatory control period while its actual opex is more than that of a benchmark efficient service provider. We do not need to apply an EBSS to further strengthen this incentive. Conversely, if we were to apply the EBSS in the 2024–29 regulatory control period, but do not rely on revealed costs to forecast opex in the 2029–34 regulatory control period, there are some potentially perverse outcomes. For instance, Evoenergy would face high penalties if it continues to make incremental efficiency losses. It would receive negative EBSS carryovers as well as a benchmark opex allowance. This outcome is not consistent with what we seek to achieve through the application of the EBSS, nor is it consistent with the implementation requirements for an EBSS as set out in the NER.¹²

¹² NER, cl. 6.5.8.

Shortened forms

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