



**DRAFT DECISION**  
**Evoenergy**  
**Access Arrangement**

**2021 to 2026**

**Attachment 8**  
**Efficiency carryover**  
**mechanism**

November 2020

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## Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital 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 carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

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## 8 Efficiency carryover mechanism

An efficiency carryover mechanism (ECM) 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 these between service providers and network users.

This attachment sets out our draft decision on the ECM carryover amounts Evoenergy accrued over the 2016–21 access arrangement period, and the ECM we will apply in the 2021–26 period.

### 8.1 Draft decision

#### 8.1.1 ECM carryover amounts

Our draft decision is to approve carryover amounts totalling –\$1.3 million (\$2020–21) from the application of the ECM in the 2016–21 access arrangement period. This is more than the amended proposal Evoenergy submitted on 1 October 2020, which was –\$5.0 million (\$2020–21).<sup>1</sup> It is \$4.8 million (\$2020–21) more than Evoenergy’s proposal of –\$6.1 million (\$2020–21), which was submitted on 26 June 2020 (initial proposal).<sup>2</sup>

Our calculated carryover amounts differ from Evoenergy’s amended carryover amounts because we have:

- Used audited 2019–20 opex, consistent with our draft decision on opex and Evoenergy’s amended opex proposal
- Used different inflation figures to convert amounts into 2020–21 dollars
- Removed movements in provisions
- Included insurance and superannuation costs, which Evoenergy excluded, rolling them over from the 2010–15 access arrangement period.

We set out our draft decision on the carryover amounts Evoenergy accrued from the operation of the ECM during the 2016–21 access arrangement period in Table 8.1.

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<sup>1</sup> Evoenergy, *Response to AER information request 14 – ECM Model*, 1 October 2020.

<sup>2</sup> Evoenergy, *RIN 9 Workbook 3 ECM*, June 2020.

**Table 8.1 AER’s draft decision on Evoenergy’s carryover amounts (\$ million, 2020–21)**

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Evoenergy’s amended carryover (as at 1 October 2020)	–0.4	–2.3	–0.9	–1.3	0.0	<b>–5.0</b>
AER’s draft decision	0.5	–1.3	–0.1	–0.5	0.0	<b>–1.3</b>
<b>Difference</b>	<b>1.0</b>	<b>1.0</b>	<b>0.8</b>	<b>0.9</b>	<b>0.0</b>	<b>3.7</b>

Source: Evoenergy, *Response to AER information request 14 – ECM Model*, 1 October 2020; AER analysis.

Note: Numbers may not add up due to rounding.

### 8.1.2 Application of the ECM for the 2021–26 period

Our draft decision is to approve the application of an ECM to Evoenergy in the 2021–26 access arrangement period, subject to minor amendments that we discuss in section 8.4.2 below. Our revisions to Evoenergy’s proposed ECM are set out in section 8.5.

In applying the ECM to Evoenergy in the access arrangement period commencing on 1 July 2026, consistent with Evoenergy’s proposal, we will exclude:

- Unaccounted for gas (UAG) costs
- Utility Network Facility Tax (UNFT) costs
- Energy Industry Levy (EIL) costs
- Debt raising costs
- Cost categories that are not forecast using a single year revealed cost approach in the access arrangement period commencing on 1 July 2026
- Any cost that we agree with Evoenergy to exclude from the operation of the ECM.

However, we will not exclude IT asset utilisation fee (ITAUF) costs (see section 8.4.2).

Table 8.2 sets outtable 8.2 the forecast opex we will use to calculate efficiency gains and losses for the 2021–26 period.

**Table 8.2 AER’s draft decision on Evoenergy’s forecast opex for the ECM for the 2021–26 access arrangement period (\$ million, 2020–21)**

	2021–22	2022–23	2023–24	2024–25	2025–26
Total forecast opex	32.9	33.4	33.7	34.5	35.6
Less UNFT costs	–8.5	–8.8	–9.1	–9.3	–9.6
Less EIL costs	–0.7	–0.7	–0.6	–0.6	–0.6
Less UAG costs	–1.4	–2.0	–1.9	–2.0	–2.1
Less debt raising costs	–0.2	–0.2	–0.2	–0.2	–0.2
<b>Forecast opex for the ECM</b>	<b>22.1</b>	<b>22.7</b>	<b>21.8</b>	<b>22.3</b>	<b>23.2</b>

Source: AER, *Draft decision – Evoenergy gas – Post tax revenue model*, November 2020; AER analysis.

Note: Numbers may not add up due to rounding.

## 8.2 Evoenergy’s proposal

In its initial proposal, Evoenergy calculated carryover amounts totalling –\$6.1 million (\$2020–21) from the application of the ECM in the 2016–21 access arrangement period. Evoenergy subsequently amended its calculations to correct an error following our request for further information.

On 1 October 2020, Evoenergy submitted an amended proposal with carryover amounts totalling –\$5.0 million (\$2020–21).<sup>3</sup> Evoenergy excluded the following cost categories in calculating its ECM carryover amounts:

- EIL
- UNFT
- UAG
- ITAUF
- Insurance
- Superannuation.

### 8.2.1 Application in the 2021–26 period

Evoenergy proposed that we apply an ECM consistent with version 2 of the electricity network Efficiency Benefit Sharing Scheme (EBSS) in the 2021–26 access arrangement period.<sup>4</sup>

<sup>3</sup> Evoenergy, *Response to AER information request 14 – ECM Model*, 1 October 2020.

<sup>4</sup> Evoenergy, *Attachment 9 – Incentive schemes, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 9-2.

Evoenergy updated the proposed ECM so that any cost category not forecast using a single year revealed cost approach in the access arrangement period commencing 1 July 2026 will be automatically excluded from the operation of the ECM — consistent with other gas business' access arrangements, such as AusNet Services and Multinet. It also included an adjustment for costs that we agree should be excluded.<sup>5</sup>

Evoenergy proposed that the ECM be a fixed principle for the 2021–26, 2026–31 and 2031–36 access arrangement periods.<sup>6</sup>

### 8.2.2 Stakeholder submissions

We received submissions from seven stakeholders on Evoenergy's 2021–26 access arrangement proposal, three of which raised issues on opex. The Consumer Challenge Panel (CCP24) and Energy Consumers Australia (ECA) supported the continuation of ECM over the 2021–26 access arrangement period.<sup>7</sup> However, CCP24 considered Evoenergy should exclude opex associated with new connections from to be consistent to with the approach it adopted for the Capital Expenditure Sharing Scheme (CESS). Evoenergy proposed to exclude capex associated with new connections from CESS.<sup>8</sup>

## 8.3 Assessment approach

An ECM is a form of incentive mechanism. A full access arrangement may include (and we may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.<sup>9</sup> An incentive mechanism must be consistent with the revenue and pricing principles.<sup>10</sup>

We consider the following revenue and pricing principle is most relevant for assessing Evoenergy's proposed efficiency carryover mechanism:

“A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides.

The economic efficiency that should be promoted includes:

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<sup>5</sup> Evoenergy, *Attachment 9 – Incentive schemes, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 9-2.

<sup>6</sup> Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, June 2020, clause 6.1(d).

<sup>7</sup> CCP24, *Advice to the Australian Energy Regulatory on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 39; Energy Consumers Australia, *Evoenergy and Australian Gas Networks (SA) Gas access arrangement proposals 2021–26 submission*, August 2020, p. 27.

<sup>8</sup> CCP24, *Advice to the Australian Energy Regulatory on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 39.

<sup>9</sup> NGR, r. 98(1).

<sup>10</sup> NGR, r. 98(3).



- (a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services
- (b) the efficient provision of pipeline services
- (c) the efficient use of the pipeline.”<sup>11</sup>

### 8.3.1 Interrelationships

The ECM is intrinsically linked to our opex revealed cost forecasting approach.

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 would have less incentive to reduce opex towards the end of the access arrangement period, where the benefit of any efficiency gains is retained for less time.

The application of the ECM 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 access arrangement period
2. It provides a continuous incentive for a service provider to pursue efficiency improvements across the access arrangement period.

The ECM 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 ECM.

When a business makes an incremental efficiency gain, it receives a reward through the ECM, and consumers benefit through a lower revealed cost forecast for the subsequent access arrangement period. This is how efficiency improvements are shared between consumers and the business. If we subject costs to the ECM that are not forecast using a revealed cost approach, a business would in theory receive a reward for efficiency gains through the ECM (at a cost to consumers), but consumers would not benefit through a lower revealed cost forecast in the subsequent access arrangement 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 ECM to Evoenergy has a strong interrelationship with our decision on its opex (see Attachment 6). We have careful regard to the effect of our ECM decision when making our opex decision, and

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<sup>11</sup> NGL, s. 24(3).

our ECM decision is made largely in consequence of (and takes careful account of) our past and current decisions on Evoenergy's opex.

## 8.4 Reasons for draft decision

### 8.4.1 Carryover amounts from the 2016–21 period

Our draft decision is to approve carryover amounts totalling –\$1.3 million (\$2020–21) from the application of the ECM in the 2016–21 access arrangement period. This is higher than the carryover amounts of –\$5.0 million (\$2020–21) proposed by Evoenergy in its amended proposal. This is because, among other things, our ECM calculations use actual opex for 2019–20 provided by Evoenergy as part of its amended opex proposal.<sup>12</sup> In contrast, Evoenergy's carryover calculation used estimated 2019–20 opex.<sup>13</sup> We have used actual reported opex for 2019–20 to ensure consistency with the 2019–20 opex amount used in our draft decision to determine the total forecast opex.

The other drivers of the difference between our calculation of the carryover amounts and Evoenergy's are:

- Different inflation figures to convert amounts into 2020–21 dollars
- Exclusion of the amounts of movements in provisions reported in Evoenergy's access arrangement RIN
- Inclusion of insurance and superannuation costs for 2015–16, which Evoenergy excluded, rolling over our 2010–15 determination.

We discuss each of these issues below.

#### Inflation

We have used different inflation figures for 2019–20 and 2020–21. For 2019–20 we used the actual CPI figures published by the Australian Bureau of Statistics (ABS), which were released after Evoenergy submitted its proposal.<sup>14</sup> For 2020–21 we used the latest inflation forecast published by the Reserve Bank of Australia's (RBA) available at the time of our assessment.<sup>15</sup> This was also published after Evoenergy submitted its proposal.

#### Movements in provisions

Consistent with our standard approach we have removed movements in provisions in our carryover calculation. We consider movements in provisions should be excluded from the ECM carryover calculations because the increases in provisions do not

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<sup>12</sup> Our decision on Evoenergy's 2019–20 opex is set out in Attachment 6 of this draft decision.

<sup>13</sup> Evoenergy, *Response to AER information request IR 014 – Evoenergy RIN 9 Workbook 3 ECM - revised*, 1 October 2020.

<sup>14</sup> ABS, *Catalogue number 6401.0, Consumer price index* (ref 'A2325846C'), June 2020.

<sup>15</sup> RBA, *Statement on monetary policy, Appendix: Forecasts*, August 2020.

represent the actual cost incurred in delivering reference services when calculating efficiency gains or losses. The ECM is designed to reward businesses for becoming more efficient over time and penalise them for becoming less efficient. It is the actual costs a service provider incurs that we are concerned about when measuring efficiency improvements. In contrast, provisions are estimates of future costs a business expects to incur. A change in a provision is, in essence, a revised estimate. Estimating future costs usually involves making assumptions. These assumptions often change over time as new information becomes available, creating forecasting uncertainty.

In contrast, Evoenergy's amended proposal did not adjust actual opex by removing movements in provisions in its carryover calculation.<sup>16</sup>

### **Insurance and superannuation costs for 2015–16**

We do not accept that insurance and superannuation costs should be excluded from the operation of the efficiency carryover mechanism as they were not excluded from the carryover mechanism in the 2016–21 access arrangement.<sup>17</sup> In addition, when opex is forecast, it takes into account expected changes (increases and decreases) in costs.<sup>18</sup> The risk that the forecast is too high or low is symmetrical. We consider this risk should be shared between Evoenergy and its customers through the operation of the efficiency carryover mechanism in the same way other forecasting risks are shared.

## **8.4.2 Application in the 2021–26 period**

Our draft decision is to approve the application of an ECM to Evoenergy in the 2021–26 access arrangement period. We have made minor amendments to Evoenergy's proposed ECM in this draft decision to be consistent with version 2 of the EBSS for electricity service providers and other gas distribution business equivalent incentive mechanisms.<sup>19</sup> In particular, we have specified the cost category to be excluded and specified the forecast opex in clause 3.7(b).

### **Length of carryover period**

To ensure continuous incentives, the length of the carryover period for the 2021–26 access arrangement period will be the same as the length of Evoenergy's following access arrangement period. We expect Evoenergy's next access arrangement period will be five years, starting from 1 July 2026.

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<sup>16</sup> Evoenergy, *Response to AER information request IR 014 – Evoenergy RIN 9 Workbook 3 ECM - revised*, 1 October 2020.

<sup>17</sup> AER, *Draft determination, ActewAGL 2016–21 Access Arrangement, Attachment 9 – Efficiency carryover mechanism*, 26 November 2015, pp. 17–18.

<sup>18</sup> Attachment 6 contains our draft decision on total opex that complies with the opex criteria. Insurance and superannuation costs have been forecast using a single year revealed cost approach.

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

## Adjustments to forecast or actual opex when calculating carryover amounts

In applying the ECM to Evoenergy in the 2021–26 access arrangement period, consistent with Evoenergy’s proposal, we will exclude:

- UNFT costs, EIL costs, UAG costs and debt raising costs, but we will not exclude ITAUF costs (see below)
- cost categories that are not forecast using a single year revealed cost approach in the access arrangement period commencing on 1 July 2026
- any cost that we agree with Evoenergy to exclude from the operation of the ECM.

For avoidance of doubt, consistent with our standard approach, we will also adjust:

- forecast opex to add (subtract) any approved revenue increments (decrements) made after our 2021–26 final decision, such as approved pass through amounts
- actual opex to reverse any movements in provisions
- forecast and actual opex for inflation.

### ITAUF costs

We have not excluded ITAUF costs. Consistent with our draft decision on opex (see section 6.4.1.2 in Attachment 6), we consider that ITAUF costs should be included in base opex and therefore should be subject to the ECM.

### Fixed principle

Evoenergy proposed that the ECM be a fixed principle for the 2021–26, 2026–31 and 2031–36 access arrangement periods. However, we do not accept Evoenergy’s proposal that the ECM be a fixed principle.<sup>20</sup> We consider that the NGR already allow for the inclusions of increments or decrements from the application of incentive schemes in previous access arrangement periods. There is no need to include the ECM as a fixed principle to facilitate the inclusion of increments or decrements in revenues in subsequent access arrangement periods.

We have set out our revisions to Evoenergy’s proposed ECM in section 8.5.

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<sup>20</sup> Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network*, 1 July 2021 – 30 June 2026, June 2020, clause 6.1(d).

## 8.5 Revisions

We require the following revisions set out in Table 8.3 to make the access arrangement proposal acceptable:

**Table 8.3 Evoenergy’s efficiency carryover mechanism revisions**

Revision	Amendment																																										
	Add clause 3.8 - opex for ECM calculation in the access arrangement commencing 1 July 2026																																										
	<table border="1"> <thead> <tr> <th></th> <th>2021–22</th> <th>2022–23</th> <th>2023–24</th> <th>2024–25</th> <th>2025–26</th> </tr> </thead> <tbody> <tr> <td>Total forecast opex</td> <td>32.9</td> <td>34.3</td> <td>33.7</td> <td>34.5</td> <td>35.6</td> </tr> <tr> <td>Less UNFT costs</td> <td>-8.5</td> <td>-8.8</td> <td>-9.1</td> <td>-9.3</td> <td>-9.6</td> </tr> <tr> <td>Less EIL costs</td> <td>-0.7</td> <td>-0.7</td> <td>-0.6</td> <td>-0.6</td> <td>-0.6</td> </tr> <tr> <td>Less UAG costs</td> <td>-1.4</td> <td>-2.0</td> <td>-1.9</td> <td>-2.0</td> <td>-2.1</td> </tr> <tr> <td>Less debt raising costs</td> <td>-0.2</td> <td>-0.2</td> <td>-0.2</td> <td>-0.2</td> <td>-0.2</td> </tr> <tr> <td><b>Forecast opex for the ECM</b></td> <td><b>22.1</b></td> <td><b>22.7</b></td> <td><b>21.8</b></td> <td><b>22.3</b></td> <td><b>23.2</b></td> </tr> </tbody> </table>		2021–22	2022–23	2023–24	2024–25	2025–26	Total forecast opex	32.9	34.3	33.7	34.5	35.6	Less UNFT costs	-8.5	-8.8	-9.1	-9.3	-9.6	Less EIL costs	-0.7	-0.7	-0.6	-0.6	-0.6	Less UAG costs	-1.4	-2.0	-1.9	-2.0	-2.1	Less debt raising costs	-0.2	-0.2	-0.2	-0.2	-0.2	<b>Forecast opex for the ECM</b>	<b>22.1</b>	<b>22.7</b>	<b>21.8</b>	<b>22.3</b>	<b>23.2</b>
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Revision 8.1																																											
Revision 8.2	Delete clause 6.1(d)																																										

## Shortened forms

Shortened form	Extended form
ABS	Australian Bureau of Statistics
ACTCOSS	ACT Council of Social Service
AER	Australian Energy Regulator
CESS	Capital Expenditure Sharing Scheme
CCP / CCP24	Consumer Challenge Panel, sub-panel 24
EBSS	Efficiency Benefit Sharing Scheme
ECA	Energy Consumers Australia
ECM	Efficiency Carryover Mechanism
EIL	Energy Industry Levy
ITAUF	IT asset utilisation fee
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Opex	Operating expenditure
RBA	Reserve Bank of Australia
UAG	Unaccounted for gas
UNFT	Utility Network Facility Tax