

3 July 2020

Mr John Pierce AO  
Chair  
Australian Energy Market Commission

Dear Mr Pierce,

### **Electricity network economic regulatory framework 2020 review – EPR0085**

The strength of the economic regulatory framework applying to Australian electricity networks plays a critical role in underpinning the promotion of the long-term interests of all consumers. For that reason and as you are aware, the COAG Energy Council has tasked the Australian Energy Market Commission (the Commission) to monitor and report annually on the status of market developments that may impact on the ability of the regulatory framework to continue to deliver the National Electricity Objective (NEO) in the event of an increase in decentralised supply options.

A regulatory framework which develops in a collaborative and evidence-based way in response to these changes enables the realisation of value from customer-led investments. It also strengthens the capacity to efficiently finance the long-term investments needed to provide the services consumers require at the least cost.

The important element that is added to economic regulation by a network undergoing fundamental technology change, is the need to ensure that the choices being made about the future operation of the network reflect consumer preferences and priorities. Regulation needs a greater appreciation of dynamic efficiency rather than just extracting more technical efficiency for doing the same things.

The *Approach Paper for the 2020 Electricity Network Economic Regulatory Framework* review has identified the need for enhanced consumer engagement as one of three issues that it proposes will be covered. In doing so, it refers to the New Reg project and reflects the Commission's understanding that the project has identified a number of key learnings from the trial and their implications for the regulatory framework.

In June 2017, the Australian Energy Regulator (AER), Energy Networks Australia (ENA) and Energy Consumers Australia (ECA) launched a joint initiative to explore ways to improve sector engagement and identify opportunities for regulatory innovation. The goal of 'New Reg' is to ensure that customers' preferences drive energy network businesses proposals and regulatory outcomes.

As noted in the Approach Paper, the AER, ENA and ECA consider that this project has reached the position where it is able to provide an early set of directional inputs for the Commission's current review. We are writing on behalf of the project partnership to the Commission to provide our initial feedback on areas in which the trialling of the New Reg model has highlighted areas for potential future attention in the regulatory framework.

## **Background - the New Reg model and trial process**

Under the New Reg process the most significant departure from traditional practice is the appointment of a Customer Forum with whom the network business seeks to reach agreement on aspects of the regulatory proposal in advance of lodgement with the AER. The Customer Forum provides a report specifying their agreement, or reasons for their failure to agree, that accompanies the proposal to the AER.

The Customer Forum does not represent the perspectives of particular interests, instead it and the business conduct research and customer engagement to ensure it can effectively represent the perspectives of all the network businesses' customers.

The Customer Forum's representatives are selected to credibly represent perspectives of all end users, be they residential, small business or commercial and industrial. These persons are also required to have relevant skills and experience to ensure they function as an effective and robust counterparty to the network business.

Over the past two years the New Reg model has been undergoing active trialling by the AER and AusNet Services as part of the current Victorian electricity distribution network determination process. This has now reached the point of the commencement of formal consultation on the regulatory proposal submitted by AusNet Services, with the support of the Customer Forum.

## **Priority areas in promoting a more flexible and consumer-focused framework**

The AEMC Approach paper poses the question:

*Does the economic regulatory framework provide sufficient flexibility to allow and incentivise networks to adapt to changes in the market, including increased decentralised supply?*

From December 2019 the New Reg Project Team and Board have held initial discussions around key New Reg trial learnings and potential implications for the current regulatory framework, and some possible directional options for reform. This has identified areas where the framework may not be sufficiently flexible to accommodate the delivery of outcomes that consumers want.

Through previous briefings to the Commission, staff and the involvement of the Commission as an observer on the New Reg Program Board we have sought to ensure these early learnings in this area are available to the Commission.

The major areas identified have been divided into shorter-term, potentially discrete reform components, and a longer-term reform direction.

Examples of some of the trial learnings, which could lead to potentially valuable shorter-term reforms to the current framework, include:

### **» Package vs separate individual assessments**

The trial found that the 'siloes' rules framework of individual building block decisions can work against the flexibility that may be required to better reflect consumer-network agreed price and service combinations. This risks customers under the current framework receiving a suboptimal different decision 'package' (which is a sum of individual decisions – operating and capital costs, application of incentives, and depreciation) purely as a function of inflexibilities in the rules rather than getting the combination they actually prefer.

» **Incentive schemes for meeting consumer preferences**

The trial also highlighted that established incentive schemes do not fully target the service outcomes customers value and take time to introduce or adjust (e.g. Customer Service Incentive Scheme process). This means that the current incentive scheme may not promote the delivery of the full range of service outcomes consumers truly value. A further identified issue is that introducing and applying incentive schemes may require a delay of 4 to 5 years until the next regulatory period for any given network. Making the incentives framework more flexible could potentially reward consumer-valued outcomes without undermining incentives for productivity.

» **Supporting and empowering consumers to engage with technical content underlying outcomes**

The trial found that Customer Forums need to be adequately empowered to engage with issues with highly technical content. To meaningfully agree, consumers need to be able to trust the trade-offs they may be being asked to make and be able to provide preferences.

» **Rewarding effective engagement in regulatory timing and assessment of proposals**

The regulatory process needs to deliver clear value to customers and networks when proposals are well-founded on, and follow from, effective engagement. Rewarding effective engagement in regulatory timing and assessment of proposals may be appropriate.

A standardised 'cookie cutter' process does not reflect the diversity of relevant circumstances and review priorities. It risks duplication, and the costs and outcomes where effective engagement has occurred becoming indistinguishable from the "standard" process. This could frustrate consumer and network efforts to design and tailor an appropriate outcome.

» **Addressing issues outside of the building block model**

The trial found that the network determination process can highlight important issues outside of the building blocks model. The current framework therefore needs a mechanism to give stakeholders confidence that 'whole of chain' issues they raise in the process will be treated satisfactorily, while not compromising quality and resourcing of core determination decisions.

In addition, the trial found that network revenue determinations (and hence engagement) are dominated by an input focus, rather than consumer valued outputs. This heavily directs limited resources towards contested debates on the precise inputs to be used to achieve the desired outcome. A possible longer-term directional change to the economic regulatory framework could be a potential move to an effectively calibrated system where networks are more directly compensated on the delivery of outputs consumers value.

Please feel free to contact any of the New Reg partner bodies to discuss any of these issues further. We look forward to engaging with you further on this.

Yours sincerely,



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