AUSTRALIAN
ENERGY
COUNCIL

Sebastian Roberts
Network Expenditure
Australian Energy Regulator
GPO Box 3131
Canberra, ACT, 2601

Submitted online: incentivereview@aer.gov.au

3 March 2023

Dear Mr Roberts,

Draft decision: Review of incentive schemes for networks

The Australian Energy Council (AEC) welcomes the opportunity to respond to the Draft decision: Review of incentive schemes for networks made by the Australian Energy Regulator (AER).

The Australian Energy Council (AEC) is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. Our members collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to millions of homes and businesses, and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035 and is part of the Australian Climate Roundtable promoting climate ambition.

Protecting competition in developing markets

Retailers are increasingly concerned with regulated supply costs increasing beyond what is absolutely necessary. These increases place further pressure on households and business. The AEC's general thesis is that the benefit to networks of the incentive framework is excessive and leads to consumers paying far more than necessary for their energy supply.

The AER has largely decided to retain its existing incentive framework, comprising:

- the Efficiency Benefit Sharing Scheme (EBSS),
- the Capital Expenditure Sharing Scheme (CESS) and
- the Service Standards Performance Incentives Scheme (STPIS)

This incentive-based regulation framework is founded upon an ongoing information asymmetry between regulator and the network service providers (NSPs) it regulates. In spite of this, the AER has played down the impact of information asymmetry on its ability to evaluate NSP forecasts. In this way it has missed an important opportunity to utilise tools deployed by other regulators to elicit accurate forecasts.

The AER has also underestimated the potential for cost substitution between capital and operating expenditure. The emerging role of customer energy resources with the capability to provide services back to the grid has opened up a new opportunity for optimising between network investment (capex) and payments to customers and other service providers (opex). Concerns of capex bias are not new, but confidence could be better achieved by clear parity of incentive strength between capital and operating expenditures. A total expenditure (totex) framework could

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potentially be even more effective in driving NSPs to optimise total network costs, as it is already doing in other jurisdictions such as the UK. Whilst a significant change of approach, the AEC believes that sufficient emphasis has not been placed on what superior alternatives exist.

Finally, service quality incentives such as the STPIS can be important counterweights to efficiency incentives. However, where NSPs are able to earn additional revenue on service quality, the implication is that they have had to spend extra resources to do so. But if they are simultaneously earning revenue on efficiency incentives, the AER should consider the risk that service quality targets have been set at a level too easy to achieve.

In its response to the Draft, the AEC has engaged the advice of Boardroom Energy, and their analysis and report to us is attached. In our view there is a great deal more to be done before consumers can be confident that they are getting value for money for these incentive payments. We urge the AER to further review its draft, and to consider:

- Greater use of regulatory tools such as menu regulation to better incentivise accurate capex forecasting.
- Applying its benchmarking results more directly, to drive opex efficiency of all networks closer to the frontier.
- Abandoning its "bright line" step down in capex incentive strength for large underspends.
- Equalising incentives for capex and opex, by the simple expedient of setting the EBSS strength at 30 per cent.
- Carrying out a formal and full review of totex approaches to consider whether they are appropriate in the Australian context.
- Calibrating the STPIS scheme to minimise the risk of windfall gains to NSPs (or windfall losses, though this seems less likely).
- Clearly specifying the incentive properties of any proposed alternatives to applying the CESS to large transmission projects. And,
- Transparency requirements that aim for a comparison between NSP forecasts and outturn costs, rather than AER allowances and outturn costs.

Please contact the undersigned at [redacted] should you wish to discuss.

Yours sincerely,

David Markham
Australian Energy Council