

Better Regulation Program

Public Forum Presentations

This document is not a transcript. It is based on notes of the discussion taken by AER staff and is not a verbatim account. Given the nature of the document, not all comments made at the workshop are included.

On Tuesday 18 December the AER held a national videoconference forum on its Better Regulation program. More information including the speech given by AER Chairman Andrew Reeves, and the issues paper that was circulated for the forum is at <http://www.aer.gov.au/node/18824>.

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1 Expenditure assessments

Presenter: Lawrence Irlam

Contact: expenditure@aer.gov.au

Website: <http://www.aer.gov.au/node/18864>

Presentation points

Context

In doing our first round of network price determinations we have gained a fair bit of experience in employing various expenditure assessment techniques, however a lot of these were specific to network service providers and stemmed from maintaining the same data categories established by previous state regulators e.g. to undertake trend analysis.

The new requirements to publish assessment guidelines and benchmarking reports, as well as the “break” in determinations over 2013, provide us an important opportunity to build on our experience and solidify our assessment approaches in consultation with network businesses and customers

In particular we are keen to establish standardised assessment approaches which we hope will streamline the task of determining efficient capex and opex allowances as well as significantly improve the robustness of our decisions in accordance with the National Electricity Objective and revenue and pricing principles

A key element of our approach will be benchmarking and utilising more quantitative methods rather than a heavy reliance on detailed bottom up assessments. We will still be using detailed engineering assessments such as where other techniques suggest further scrutiny is required and where it may assist with our overall view of efficiency. We note that the degree of reliance on existing versus new methods will depend on improved data availability and refinements to methods which we expect will occur over the medium to long term

Issues paper

We are about to release an issues paper in the next few days which outlines our current thinking on where assessment methods can be improved or introduced through consultation. It will cover techniques to be employed in our new expenditure assessment guidelines, determinations and in our new annual benchmarking reports

The issues paper is meant to assist the intensive consultation process that will be required

The core of our current thinking revolves around two areas of further work with the sector, which are outlined in the issues paper and in more detailed appendices to the main paper:

- category based assessments which do not depart significantly from existing reporting against expenditure drivers, however we are suggesting further details in some areas in order to enable more robust comparisons between network businesses as well as to feed tools like our repex model and augex model
- Supplementing this, we are proposing to establish more higher level economic benchmarks through methods such as total factor productivity and data envelopment analysis

Much of our current thinking as expressed in the issues paper reflects methods for distribution networks, given we had until recently devoted considerable effort in preparing for the next NSW/ACT distribution determinations. However we consider many techniques will also be applicable to transmission businesses and will be interested in views on this

We are also mindful of recent comments by the AEMC and the Productivity Commission with respect to expenditure assessment, and are also closely monitoring approaches being developed or employed by Ofgem and the NZCC where we have established contacts

The issues paper will give some thought to some of our objectives for expenditure assessment and principles for the selection of techniques from the guidelines. In particular

- any techniques we develop and apply will need to be transparent and replicable
- in looking at more quantitative approaches we will be resisting the tendency to debate finer details in the name of chasing apparent accuracy – the NER require us to form a view on overall expenditures, noting that this will be informed by disaggregated analysis in some form
- we will be keen to rely on objective and ideally independently published data where this is available
- where methods are imperfect we will be interested in using whatever other information is available to form a view on the overall reasonableness of proposals. Weighing up available information will require judgment on our part and we will ultimately be held accountable for this
- we will be mindful of the expected costs and benefits of implementing new approaches, reflecting on the net costs and effectiveness of assessments undertaken to date

Other matters to be canvassed in the issues paper will include:

- How the new approach will be implemented through information notices given the requirement to publish multiple determinations and a benchmarking report each year
- Relationships between expenditure setting and incentive arrangements e.g. under the existing efficiency benefit sharing scheme
- How techniques might be applied in a “first pass” preliminary assessment to feed into issues papers we publish during determination processes
- The potential standardisation of assessment approaches to things like real price escalators, demand forecasting, related party margins and self-insurance

Next steps in consultation

- In terms of consultation we expect to make contact with those individuals that have registered interest in this workstream early in the new year, with a view of having an overall roundtable in late January to discuss our issues paper and consider the scope of work over 2013, including the sequencing and administration of working groups
- At present we consider the methods will not be directly applicable to gas service providers – although there may be some that with some further work could be made suitable in time.

- We may also consider breaking the workstream into distribution and transmission specific methods, noting that much of this should overlap, although may be better logistically – we will be seeking views from the sector on this.

Discussion

The AER indicated that the guidelines would be issued separately, rather than as a single guideline. Further that interested parties would receive notification dates about future consultation when known. Presentations from today's forum would also be circulated to attendees.

Stakeholders queried whether the AER had considered the timing of the release of the expenditure assessment guidelines, noting that Queensland distribution networks would be required to submit their forecasting methodology on November 30th, the day after the guidelines are released. Representatives of the AER indicated that there did not appear to be any obligation in the rules for networks to comply with the assessment guidelines when submitting their forecasting methodology. It was also noted that through consultation, businesses would be well informed of the AER's approach ahead of time and would need to work with stakeholders in addressing transitional issues. It was considered that, for example, proposals could be submitted on the basis of draft guidelines.

The AER also endeavoured to refrain from using acronyms as there were attendees unfamiliar with the terms.

Stakeholders queried if the AER was intending to move away from the revealed cost approach in its expenditure assessments. Representatives from the AER responded that this was something the AER would be consulting on, noting that it may be the case that some networks might not be adequately responding to incentives. It was noted that this was simply up for assessment; it was not necessarily the case that the AER was moving away from this approach.

2 Rate of return

Presenter: Craig Madden

Contact: rateofreturn@aer.gov.au

Website: <http://www.aer.gov.au/node/18859>

Presentation

The main issues we will explore in the guideline development process include the methods, approaches, theory and practice for estimating return on equity and return on debt, to meet the overall rate of return objective. In addition, we will also review the method for calculating imputation credits, or gamma.

These topics will be the focus of workshops and extensive individual and small group discussions between AER staff and stakeholders over the coming year.

We have already held informal discussions with the following groups who have an interest in the rate of return:

- Consumer roundtable
- Energy Networks Association
- State Government finance departments
- Energy consumer groups, comprising mostly larger energy users

Our issues paper on the rate of return guidelines will be released within hours of the conclusion of this meeting. Submissions will be due by 15 February 2013.

Workshops in February (and maybe late January), to help develop the rate of return methodology will be held. Following this process, we will publish a consultation paper by 29 March 2013, with submissions due mid May.

Further workshops and consultation will be undertaken in June and July to explore issues from the consultation paper. This may include one on one discussion and small group interactions, to supplement the detail from workshops.

We will proceed to a draft guideline in early August. Further workshops will follow on substantive and/or unresolved matters to inform the final guideline, to be published in November 2013.

The content of the rate of return guidelines issues paper revolves around a discussion of key principles for which the AER will have regard, to guide it and stakeholders come to a robust methodology for establishing a rate of return guideline.

Further, we are seeking stakeholder feedback and comment on the key concepts and terms from the new rules. For example, efficient financing costs; benchmark efficient entity, differences in risk characteristics between electricity and gas.

We are asking if stakeholders have a preference for predictability or flexibility, and do these views differ at each level (the overall rate of return, the return on equity and debt, and parameter specific) of the rate of return.

We have also included a high level discussion of the various options for assessing return on equity and the return of debt, as these are key elements of any rate of return framework.

No AER decisions are set out in the issues paper. Rather a brief outline of previous AER approaches is provided and we seek stakeholder comments on these.

Discussion

Stakeholder questions largely related to:

- the timing of the stages in the rate of return guideline process
- what information and data the AER would consider, including benchmarking regulated entities with other sectors
- who the AER would consult with during the rate of return guideline process, and whether this would include expert consultants and private investors
- whether the AER had considered releasing initial positions as a first step, rather than its higher level issues paper.

In general, AER representatives noted that the AER has considerable experience with the issues involved in estimating the rate of return, but noted that it is approaching the guideline process with an open mind, but not a vacant mind. The AER has not yet formed initial positions. This is in part because the updated rules give the AER scope to consider the interrelationships between parameters. Also, the guideline process is an opportunity for the AER and stakeholders to comprehensively reassess the available methods and evidence for estimating individual parameters. They identified that the AER will be considering a wide range of information and will consult broadly with both expert commentators and private investors, consumer groups and major energy users. The intent is to make this information and its findings available to stakeholders in a transparent and useable form.

Richard Begley from the Economic Regulation Authority of Western Australia commented that the Authority also regulates three gas businesses under the national gas rules and is therefore also required to produce a rate of return guideline. It recognises the desirability of consistency where appropriate and will continue to liaise with the AER. However, the Authority's initial consultation paper will include some differences on topics covered in the AER's rate of return issues paper. It was expected that these differences will draw out further commentary from all stakeholders.

3 Expenditure incentives

Presenter: Arek Gulbenkoglou

Contact: incentives@aer.gov.au

Website: <http://www.aer.gov.au/node/18869>

Presentation

Capital expenditure

The new rules require us to develop capital expenditure incentive guidelines. These guidelines will cover a number of mechanisms and approaches that, taken together, should;

1. Incentivise electricity network service providers to undertake efficient capital expenditure.
2. Safeguard consumers from paying prices that reflect inefficiently incurred capital expenditure
3. Provide for appropriate sharing of efficiency benefits between consumers and NSPs

The guidelines will cover:

- What type of Capital expenditure sharing scheme/s we will apply and in what circumstances these may be applied
- What form of ex post review/s we will apply and the relevant circumstances in which an ex-post review of capex may occur
- How we will determine whether to use actual or forecast depreciation to roll forward the regulatory asset base at the start of a regulatory period
- How we will assess whether related party margins were efficient and whether these should be included in the regulatory asset base.
- In terms of capitalisation policy changes, how we will assess whether to roll into the regulatory asset base any expenditure that was previously classified as opex at the time of the AER's determination.

Operating expenditure

We will also be reviewing the AER's current approach to incentivising efficient operating expenditure.

Specifically the existing opex EBSS will need to be reviewed to ensure that the incentives between capex and opex are balanced and to ensure that the EBSS is consistent with the AER's revised approach to forecasting expenditure.

Process

- **Issues paper—March**
- Working group—May
- Submissions due—Late May

- **Proposed guidelines—9 August**
- Submissions due—20 September
- **Final guideline—29 November**

Consultation

As noted in the Better Regulation issues paper, we will be forming a working group to input into the development of the expenditure incentive guidelines. This working group will be chaired by an AER board member and interested stakeholders are invited to participate in the working group.

We will have an initial working group meeting in May following the release of the issues paper.

We also anticipate that we will hold another working group meeting after the release of the proposed guidelines, probably in August.

We are yet to fully determine our process for the working groups for this work stream. It will depend a bit on the level of interest and the diversity of interested stakeholders. We are proposing to develop the consultation to suit the audience. Any views you have on this would be most welcome.

Next steps: issues paper

The next stage in developing the expenditure incentive guidelines will be the release of an issues paper in March next year. In terms of our approach to the issues paper, we aim to build on the work already undertaken by the AEMC and interested stakeholders. We understand that considerable work has already been undertaken and we will start by reviewing this work and developing our thinking from there.

Discussion

A representative from Energy Networks Association offered to meet prior to the issues paper being released.

4 Shared assets

Presenter: Moston Neck

Contact: costallocations@aer.gov.au

Website: <http://www.aer.gov.au/node/18878>

Presentation

The new rules required the AER to develop a guideline for the treatment of shared assets. Shared assets are used to provide regulated services as well as unregulated services. Until now, the Rules did not provide a mechanism for revenues from unregulated services using a shared asset to reduce the costs of providing regulated services. For example, a pole that is used to support electricity wires is paid for by electricity customers. If the poles are also used to support telecommunications wires, revenues from this unregulated activity should be shared with the customers paying for the poles, that is, electricity customers. The Shared Asset Guidelines, therefore, will provide a mechanism for revenue sharing.

Timeline for Shared Asset Guideline development:

- issues paper release in late January or early February
- stakeholder working group meeting in March
- draft guidelines released in August
- final guidelines in November

However, this workstream is relatively limited and we may choose to insert key actions into times when other workstreams are relatively quiet.

Discussion

Most stakeholder questions related to coverage of the shared asset arrangements — communication infrastructure, easements and digital communications bandwidth. Representatives from the AER indicated the AER would like to canvass these topics in the issues paper and invited stakeholders to take advantage of the AER email address to engage on these issues ahead of issues paper release. A further stakeholder question related to whether costs would be considered in addition to revenues and would reliability of electricity supply services be a relevant factor. Moston again offered to engage on these issues out of session and indicated they may also be covered by the issues paper.

Stakeholders proposed that shared asset guidelines be established earlier than November, as such an approach would allow stakeholders to focus on other issues in the latter part of the 2013 calendar year.

5 Power of choice

Presenter: John Skinner

Contact: demandmanagement@aer.gov.au

Website: <http://www.aer.gov.au/node/18899>

Presentation

On 30 November 2012 the Australian Energy Markets Commission (AEMC) released the final report on its review of demand-side participation (DSP) in the National Electricity Market (NEM), titled, the 'Power of Choice'.

The 'Power of Choice' final report outlined a comprehensive list of recommendations which, if implemented, will have a fundamental impact on electricity markets. Key reform areas included:

1. Introducing efficient (peak cost reflective) and flexible (time varying) network tariffs for consumers in the NEM – encouraging efficient consumer behaviour.
2. Enabling the roll-out of smart meters via a phased and contestable model, thereby enabling the provision of efficient price signals.
3. Improving consumer access to information and education, and improving consumer engagement to facilitate the shift to a new pricing environment.
4. Improving incentives for distributors to engage in DSP (reform of the demand management and embedded generation incentive scheme – DMEGCIS)
5. Introducing a demand response mechanism in the wholesale electricity market to facilitate consumer participation in the spot market.
6. On 11 December 2012 the AEMC released its final report regarding energy market arrangements for Electric Vehicles (EV). The EV review recommended amending the metering arrangements in the NEM to provide greater flexibility in how consumers can configure their metering. E.g. allowing consumers to seek the services of more than one retailer or DSP services provider if desired (to obtain a separate tariff for their EV).
7. The AEMC's recommendations in both the Power of Choice final report and EV final report present some immediate short term implications for the AER, including the need to refine various current guidelines (e.g. retail frameworks for third parties, service incentives, ring-fencing). However, the majority of recommended reforms require the initiation of rule changes.

At its meeting on Friday 14 December 2012 the Standing Council on Energy and Resources (SCER) agreed to progress work on the recommendations in the Power of Choice review. SCER agreed that Department officials should prepare rule change proposals for consideration by the AEMC. The AER will be actively involved in these rule change processes and will then be looking to begin its own processes to amend or develop guidelines and schemes to give effect to these reforms.

1. It is worth noting also that due to timing of SCER rule changes, it is unclear whether the demand management scheme reforms will be implemented in time for the AER's next ACT/NSW electricity distribution determinations. The AER will be liaising with AEMC over coming weeks to understand the possible timing of rule changes.

2. Another related area of work is the RIT-D (Regulatory Investment Test - Distribution). The RIT-D is related to a similar test in transmission and is intended to ensure that electricity distribution companies use appropriate measures to test investment projects against other credible alternatives, including non network options, such as demand management initiatives. The AER must publish a RIT-D and associated guidelines by August 2013. We expect to release an initial Issues paper early in the new year.

Discussion

There was a brief discussion around the timing of the Power of Choice rule changes and the AER's broader work program under the new chapter 6/6A rule changes.

The AER indicated that it has no further information at this stage regarding the timing of the Power of Choice rule changes. For the broader work program, the AER indicated that it would look to publish a calendar in the new year.

6 Managing confidential information

Presenter: Adam Petersen

Contact: confidentiality@aer.gov.au

Website: <http://www.aer.gov.au/node/18888>

Presentation

The purpose of the guideline is to set out a clear approach to the identification of confidential information up front, rather than on a determination by determination basis. The guideline will improve the regulatory decision making process by ensuring:

1. The businesses are aware of what will be considered a genuine confidentiality claim
2. A reduction in the administrative burden of the determination process
3. Transparency, which will provide stakeholders with a better opportunity to engage in the determination process.

A key objective is to establish a consensus between the regulator, businesses and consumers on what should be considered confidential information, recognising that there are legitimate reasons for claiming confidentiality.

The guideline will cover types of information that may be confidential and the process for the disclosure of information in regulatory determinations.

To ensure that this objective can be achieved, an open consultation process will be established. A working group will be established to address matters raised in an issues paper. The issues paper is to be released at the beginning of April 2013 and the working group to commence shortly afterwards.

To get involved you will need to send us an email – the address is: confidentiality@aer.gov.au.

Other key milestones include:

1. A draft guideline to be released in early August 2013; and
2. The Final guideline by 29 November 2013.

Discussion

The AER indicated that its general position on information that the AER generates, is to be as open and transparent as possible. The AER's requirements in relation to treating and releasing confidential information are set out in the NEL. The AER's aim is to put information in its control in the public domain where that information is useful to stakeholders.

7 Customer engagement

Presenter: Moston Neck

Contact: customerengagement@aer.gov.au

Website: <http://www.aer.gov.au/node/18894>

Presentation

The AEMC's recent rule change requires electricity network businesses to demonstrate how they have engaged with customers. Further, the businesses will be required to show how they have responded to issues raised by customers in their regulatory proposals.

To facilitate these new requirements, the AER is developing a guideline that will set out how the AER considers regulated energy businesses should engage with customers.

The AER is aware that some businesses already engage with their customers while for others, particularly transmission businesses, this may be new.

The AER will be undertaking a stock take of current the network businesses customer engagement activities. This will form the basis of discussions to be held in early 2013 that will assist in developing a best practice guideline to customer engagement.

A range of meetings, rather than consultation on the papers, will be undertaken by the AER. Discussions will be ongoing with service providers and customer representative groups

The AER expects to release its draft customer engagement guideline in May with the final guideline to follow in August 2013.

8 Customer reference group

Presenter: Tanja Warre

Contact: customerreferencegroup@aer.gov.au

Website: <http://www.aer.gov.au/node/18824>

Presentation

The AER will be setting up a customer reference group early in the New Year.

Purpose of the customer reference group is to facilitate customer input into the 'Better regulation' process and the development of guidelines under this framework

The group has a number of objectives

1. We want to make this process manageable for customers and their representative groups
2. We want to get meaningful input from customers
3. This group is about giving guidance about where customers can invest their limited resources to most effectively contribute to the regulatory process

Currently developing the structure for this panel, loosely

1. It will represent customers
2. We aim to be very focussed on the issues in which customers can most useful invest their resources
3. Cognisant that customers groups are resource and time constrained – key focus is to be effective
4. Initial thoughts – a number of VCU meetings in the first half of next year while the guidelines are being developed (monthly as a rough guide)
5. Will also progress issues offline where particular parties have specific interest, knowledge and experience on specific issues

We will invite prospective members based on existing consultative bodies we have in operation

Early in the New Year will map out timings and key issues.