

New Reg: AusNet Services Trial

Interim Evaluation Report

Australian Energy Regulator

4 December 2020



FINAL REPORT

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1. EXECUTIVE SUMMARY

Cambridge Economic Policy Associates (CEPA) has been engaged by the Australian Energy Regulator (AER) to undertake an evaluation of AusNet Services' trial of the New Reg process ('the New Reg Trial').

Our evaluation framework, finalised 31 October 2018, provides further information on our overall approach to evaluating the New Reg Trial. This Interim Evaluation Report follows the series of three Insights Reports that we have provided to the AER over the course of the New Reg Trial. The Interim Evaluation covers events up to and including the AER's Draft Decision. This will be followed by a Final Evaluation Report, which will be prepared after the AER has delivered its Final Decision.

In this Interim Evaluation Report, we present our reflections in relation to:

- How the Customer Forum's Engagement Report informed the AER's Draft Decision (**Section 4**).
- Whether there are aspects of the New Reg (Early Engagement) process where a different approach to that followed in the New Reg Trial might better support the objectives (**Section 5**); and
- Interactions between the New Reg process and the overall regulatory framework, including constraints that the National Electricity Law (NEL) and/or National Electricity Rules (NER) may have imposed on the process (**Section 6**).

Our reflections on these points are preliminary and will be confirmed and discussed in greater detail in the Final Evaluation Report. In the Final Evaluation we will also:

- Report on events up to the Final Decision, including the submission of AusNet Service's revised regulatory proposal and stakeholder submissions on the AER's Draft Decision.
- Report on the trial participants' estimates of their costs associated with the New Reg Trial.
- Present our evaluation against the Trial Assessment Factors (TAFs) that were set out in our evaluation framework, drawing on the observations from the Insights Reports and this Interim Evaluation Report.
- Present our overall assessment of the New Reg Trial, and recommendations.

The remainder of this executive summary briefly highlights our main observations at this stage of the trial.

1.1. THE AER'S DRAFT DECISION

In preparing this Interim Evaluation Report we have made several observations on how the negotiation position reached by the Customer Forum and AusNet Services appears to have influenced the AER's Draft Decision. In summary, the key themes emerging from this stage of the process are:

- While there are some learnings for future Early Engagement processes (see below), the overall vision for New Reg – to enable a regulatory proposal from AusNet Services that can be considered to reflect consumer preferences and have been consulted on with customers via the Customer Forum – appears to have been largely realised through the New Reg Trial. This is evidenced by the AER's conclusions on AusNet Services' consumer engagement strategy in the Draft Decision.
- There were relatively limited cases¹ where the AER did not accept positions that had been agreed between the Customer Forum and AusNet Services. The governance and process arrangements established at the outset of the New Reg Trial, including the role of the AER staff in supporting the negotiations, appears to

¹ Aside from changes to correct errors and reflect the impact of the COVID-19 pandemic.

have been an important factor in the parties reaching negotiated positions that were largely capable of acceptance.

- The AER was able to place weight on evidence from the Engagement Report to inform aspects of its Draft Decision. This was particularly the case when the Customer Forum was able to use the evidence gathered on customers' perspectives to inform a more definitive view on AusNet Service's proposed expenditure. The AER's Draft Decision appears to have placed less weight on negotiation positions that the Customer Forum agreed to 'in principle', but subject to the AER's assessment.
- In line with the New Reg process², the AER has followed its standard assessment process to arrive at its Draft Decision. It will be open to the AER to adopt an expedited or streamlined determination process for the Final Decision, if it considers that this is justified given AusNet Services' revised proposal. Accordingly, a key consideration for the Final Evaluation report will be how the evidence provided by the Engagement Report informs this decision, in combination with the other evidence before the AER.

1.2. REFLECTIONS ON THE NEW REG PROCESS

The Final Evaluation Report will include a more comprehensive discussion of our views on whether there are changes to the process that could better achieve the stated objectives for the New Reg model. In this report, we offer some more limited observations on aspects of the trial process that may require further investigation if the Early Engagement Process is adopted for future regulatory determinations. In summary:

- Experience from the trial indicates that a **flexible negotiation scope** adds value to the process. However, amendments to other aspects of the process could be considered to ensure that scope flexibility does not create an excessive resourcing burden for parties involved in the process. These options should be considered together with the overall staging of the Early Engagement Process.
- The ability for the New Reg process to enable the **early involvement** of customers in the development of a network's business plan is valuable, as it allows strategic or contentious issues to be aired at an early stage, so that they can be addressed. There may be opportunities for the New Reg model to retain this feature, while also improving the efficiency of the process at future price control reviews.
- There is some indication that the New Reg Trial has helped to **enhance confidence** of consumers, consumer advocates and other stakeholders in the network's consumer engagement strategy and the overall consumer legitimacy of the regulatory review process. For the most part, stakeholders have been supportive of the process to date, although there have been some differing views on the positions the Customer Forum took on certain issues³ and the Customer Forum's engagement with some stakeholder groups. There may be ways in future to improve the clarity of the Customer Forum's role and its expected engagement with consumer bodies.
- There are **risks** associated with early engagement processes – for example, that the process is not sufficiently transparent or robust to produce outcomes that the regulator can place weight on. Certain features of the New Reg process, that were established as part of the trial, thus far have appeared to

² Process step 10: "While the AER would continue to undertake its current assessment process, it would now be able to have regard to the Engagement Report in forming a view about the regulatory proposal. [...]" Process step 11: "If a business successfully undertakes an Early Engagement Process, and reflects the outcomes of this process in its regulatory proposal, the AER may if it considers appropriate expedite and/or streamline the revenue determination process. For the purposes of a trial, the AER may expedite its regulatory process only after the draft decision stage to allow for consultation on the outcomes of the Early Engagement Process (among other practical considerations)." New Reg Directions Paper, page 6-7.

³ For example, its capacity to opine on the overall reasonableness of the revenue proposal, given the limited scope of the Forum's negotiations.

mitigate these risks. However, some of these aspects may have contributed significantly to the resourcing requirements of the trial process.

1.3. INTERACTIONS WITH THE NEL AND NER

In addition to the broad requirement to issue a determination that achieves the NEO, the NER prescribe certain specific aspects of the regulatory determination process that the AER must follow. In the third Monitoring Report, AusNet Services and the Customer Forum noted instances where, based on their experience during the New Reg Trial, these requirements (or the AER's interpretation of these) created a degree of inflexibility that could prevent the acceptance of proposals that customers support.⁴ The AER has also identified some areas of the framework that may, in its view, be overly restrictive.

In thinking about these issues, we consider that the key question in evaluating the success of the trial is not whether the AER did or did not accept particular agreed positions, but rather whether there is appropriate flexibility within the existing regulatory framework for the AER to both incentivise and implement proposals that are consistent with consumers' long-term interests. This may help to enable future New Reg (Early Engagement) processes to achieve the most effective outcomes for customers as possible at future regulatory reviews.

Our initial observations on the issues raised by trial participants, in the specific context of the New Reg Trial and Early Engagement Process, are that:

- In making its Draft Decision following an Early Engagement Process, the AER appears to have faced some constraints in accepting positions that the Customer Forum considered to reflect the preferences of AusNet Services' customers. For example, based on its interpretation of the NER, the AER was not able to adopt the revenue path agreed between the Customer Forum and AusNet Services, which maximised the reduction in allowed revenue in the first year of the price control. Based on our reading of the Draft Decision, it is not necessarily clear that the AER would have accepted the negotiated revenue path as being in the long-term interest of consumers, had the NER provided it with the freedom to do so.

Nonetheless, there may be scope to consider how the regulatory framework could better facilitate the implementation of proposals that are tailored to a particular network and its customers following a process of Early Engagement. For example, the consultation process that the AER was required to follow to implement the agreed Customer Service Incentive Scheme, in line with its interpretation of the NER, might have been implemented in a more timely manner under a more flexible regulatory framework.

- It is appropriate that future Customer Forums' have the ability to consider non-building blocks issues that relate to the provision of regulated services, as this may allow for the identification of potential improvements to the regulatory framework.⁵ For example, the Customer Forum's findings in relation to customer experience have indicated that there may be a need to consider whether a separate and/or additional process in the regulatory framework is required to ensure that service levels are appropriately identified and reflected in companies' business plans.
- The existing regulatory framework may place some constraints on the extent to which the AER is able to adopt an expedited process, or other mechanism to encourage companies to 'put their best foot forward' in developing proposals that, through an Early Engagement process, incorporate consumers' priorities and perspectives. Experience from other jurisdictions, that have adopted either process or financial incentives to encourage these outcomes, can inform consideration of potential approaches for Australia.

⁴ Farrierswier, Stage 3 Monitoring Report, page 41-42.

⁵ The building blocks approach to allowed revenue regulation establishes the benchmark revenue requirement for a period based on a build-up of separate benchmarks for the component costs (including operating expenditure, depreciation, cost of capital (return on asset base) etc).

2. INTRODUCTION

2.1. BACKGROUND

In June 2017, the Australian Energy Regulator (AER), Energy Networks Australia and Energy Consumers Australia (ECA) launched a joint initiative to explore ways to improve sector engagement and identify opportunities for regulatory innovation. On 23 March 2018, the agencies jointly released a Directions Paper and Approach Paper which set out a draft process that would enable consumer perspectives to be reflected in regulatory proposals in advance of those proposals being lodged with the AER for assessment. This draft process is called New Reg: Towards Consumer-Centric Energy Network Regulation.⁶

Box 1: What is New Reg?⁷

The central idea of the New Reg process is that before a regulatory proposal is submitted to the AER, a **Customer Forum** and the network business can reach agreement that the proposal reflects consumer perspectives and preferences.⁸

There are two distinct stages:

- The **Early Engagement Process**, through which the Customer Forum and the network business will seek to agree all or part of the regulatory proposal. The Customer Forum is intended to act as a conduit for the views of all consumers. AER staff play a key role in supporting the Customer Forum, to ensure that the Early Engagement Process is sufficiently robust that the AER can have regard to the agreed positions when making its revenue determination. At the conclusion of the Early Engagement Process, the Customer Forum will prepare an Engagement Report, providing reasoning and evidence for the positions that it has reached.
- The **regulatory determination process**, where the AER will assess the network's regulatory proposal in line with the requirements of the legislative and regulatory framework. In making its determination, the AER will have regard to areas of agreement, or disagreement, between the network and the Customer Forum. The AER is not bound to accept agreements reached between the parties.

Further details on the defining features of the New Reg process are set out in section 2.1.1.

On 23 March 2018 it was announced that AusNet Services would trial the New Reg process⁹ for its Electricity Distribution Price Review 2021-25 (EDPR 2021-25). CEPA has been engaged by the AER to undertake an evaluation of the AusNet Services trial of the New Reg process ('the New Reg Trial').

2.1.1. Defining features of New Reg

There are numerous ways network service providers (NSPs) can involve consumers in developing their regulatory proposals to help ensure that consumer perspectives and preferences are taken account of, and for the AER to consider consumers' views in assessing proposals. There are some key differences between other NSPs' consumer engagement approaches and the New Reg process.

These defining features of the New Reg process, along with the process objectives (see section 2.1.2 below) are important for the New Reg Trial evaluation, as these help us to identify what aspects of New Reg are 'alternative' to the typical approach taken by NSPs and the AER.

⁶ <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/regulatory-innovation>

⁷ New Reg Directions Paper, pages 3-4.

⁸ New Reg Directions Paper, page 3.

⁹ We refer to the trial throughout this document as the 'New Reg trial', 'trial' and 'AusNet Services trial'.

Below we summarise our view on what differentiates the New Reg process from other consumer engagement processes deployed by NSPs in Australia. This is based on the New Reg Directions and Approach Papers, which set out the elements of the New Reg process in more detail. We consider that the defining features of New Reg are:

- New Reg provides for the creation of an officially recognised platform – the ‘Customer Forum’ – for consumers to negotiate elements of AusNet Services’ revenue proposal in advance of its submission to the AER, so that it reflects consumers’ perspectives and preferences.¹⁰ The Forum is “*to represent the long-term perspective of consumers and not to represent consumers directly*”.¹¹
- The composition, roles, and responsibilities (and therefore appropriate resourcing levels) of the Customer Forum are defined at a high-level with input from the AER, ECA, AusNet Services, and the Customer Forum.
- New Reg requires the publication of an Engagement Report setting out the Customer Forum’s positions on the matters it considered, and how these *represent the long-term perspective of consumers*. The Engagement Report will set out the Customer Forum’s decision-making process and evidence that it used to justify matters of agreement (and disagreement) with AusNet Services.
- New Reg encourages AusNet Services to demonstrate links between its regulatory proposal and the negotiations with the Customer Forum.
- The AER provides support to the Customer Forum throughout the process, including, upon request, boundary notes on what is or may be permissible under the NEL/NER, providing advice and other information or resources necessary to analyse information provided by AusNet Services, and providing advice about how it might assess a particular matter.¹²
- The AER’s involvement will help ensure that “*the process is sufficiently robust that the AER can have regard to the agreed outcomes in making formal revenue determination*”.¹³
- The AER has agreed to have regard to the negotiated positions reached by the Customer Forum and AusNet Services, and the supporting documentation.

We note that there is experience of direct negotiations in other countries and sectors that are subject to economic regulation. These are usually applied where large consumers exist, such as airlines, pipeline users, etc., with commercial views and positions on required outputs, approach to risk sharing and general price levels to input to a direct negotiation process with the infrastructure provider.

The context of the New Reg Trial is different, applying to an electricity distribution network serving a broad range of consumer groups, including small users. As a consequence, the New Reg process is intended to facilitate a dynamic conversation between the network company and its consumers, via the Consumer Forum and its direct negotiations with the network on consumers behalf, that recognises:

- the broad range of consumer groups that use and rely on the services provided by the electricity distribution network; and
- the range of views and preferences these different consumer groups may have of the requirements and price levels of the network company.

¹⁰ New Reg Directions Paper, page 1.

¹¹ New Reg Directions Paper, page 10.

¹² MOU, Clause 6.3.

¹³ New Reg Directions Paper, page 4.

2.1.2. New Reg trial objectives

The overall vision for the New Reg initiative is “*that energy consumers’ priorities and stated preferences should drive, and be seen to drive, energy network businesses proposals and regulatory outcomes*”.¹⁴

We interpreted the vision as the New Reg ‘Project Objective’:

To develop an alternative regulatory path whereby energy consumers’ priorities and stated preferences would drive and, through a negotiation process, be seen to drive energy network businesses’ proposals and regulatory outcomes.

The outcomes of the New Reg process must contribute to the achievement of the National Electricity Objective (NEO).¹⁵

For the trial, AusNet Services developed an Early Engagement Plan, which explained how the business proposed to implement the New Reg process.¹⁶ The Early Engagement was formalised through a Memorandum of Understanding (MOU),¹⁷ which was agreed between AusNet Services, the AER and the Customer Forum. We take this MOU as the definitive source of the AusNet Services’ and the AER’s objectives for the trial. These objectives are to:

- improve the speed and reduce the cost of the regulatory review process;
- enhance consumer confidence in the regulatory review process; and
- improve the overall outcomes of the regulatory review process with a view to promoting the long-term interests of consumers of electricity.¹⁸

The MOU also set out specific objectives for the Customer Forum within the Scope of Negotiations¹⁹ to:

- understand and represent to AusNet Services the perspectives and preferences of AusNet Services’ customers;
- seek to understand AusNet Services’ business, including its revenue requirement;
- identify the elements of the Regulatory Proposal which, in the opinion of the Customer Forum, will or are likely to contribute to the achievement of the NEO;
- negotiate with AusNet Services’ with a view to preparing, as far as possible, a Regulatory Proposal that, in the opinion of the Customer Forum, will or is likely to contribute to the achievement of the NEO;
- provide input into AusNet Services’ customer research program for the Electricity Distribution Price Review (EDPR) 2021-25;
- prepare the draft version of the Engagement Report and the final version of the Engagement Report; and

¹⁴ New Reg Approach Paper, page 3.

¹⁵ As stated in the National Electricity Law (NEL), Section 7.

¹⁶ AusNet Services, Early Engagement Plan: EDPR 2021-25 Customer Forum.

¹⁷ Available here: <https://www.aer.gov.au/system/files/AER%2C%20AusNet%2C%20Customer%20Forum%20-%20Revised%20Early%20Engagement%20MoU.pdf>, as ‘AusNet trial – Early Engagement Memorandum of Understanding, June 2018.

¹⁸ MOU, *Recitals*, page 1.

¹⁹ Scope of Negotiations means the matters which the Customer Forum and AusNet Services agree will be the subject of negotiation between them in accordance with clause 4.3 of the MOU. The Scope of Negotiations and any variations must be agreed with the AER.

- understand and operate within the constraints of the regulatory framework established by the NEL, the NER and the regulatory instruments developed by the AER or other jurisdictional regulators, as applicable.²⁰

The project was to have a ‘live engagement’ process where consultation on the New Reg process will happen in parallel with the trial, to enable the approach to develop based on contributions from stakeholders.

2.2. EVALUATION PROCESS

We developed an evaluation framework in November 2018 that set out our overall approach for assessing the New Reg Trial. Our approach involved the preparation of three Insights Reports, an Interim Evaluation Report and a Final Evaluation Report (the latter two reports will be prepared at the conclusion of the AER’s Draft and Final Decisions, respectively). To guide our assessment of whether the outcomes of the trial met the various objective, the evaluation framework set out several Trial Assessment Factors, summarised in 0 and Figure 2.1 below. Further information on our evaluation framework has been published on the AER’s website.²¹

Figure 2.1: Trial Assessment Factors

Trial Assessment Factors*	
Process	Engagement and representation - Did the Forum provide improved information to AusNet on its customers’ perspectives and preferences?
	Scope and negotiations - Did the Forum adequately and appropriately represent customers’ perspectives and preferences during the negotiations?
Outcomes	Impact on the content of regulatory proceedings – What customer priorities and preferences did the New Reg process identify?
	Impact on the AusNet proposal – How did the Forum’s negotiations impact AusNet’s final regulatory proposals?
	Impact on the determination(s) - Did the AER’s determinations benefit from the Forum’s negotiations (the Engagement Reports)?
Learnings	Overall - Did the New Reg process lead to the achievement of the NEO?
	If so was this achieved in an efficient way? Does the current NER allow AER to consider properly the outcomes of the New Reg process?

* Each Trial Assessment Factor has a series of sub-factors (see Appendix B)

Source: CEPA

The New Reg Trial, its process and resourcing, and the coverage of each of our reports are illustrated in Figure 2.. In April 2019, the Victorian Government announced its intention to shift the timing of annual Victorian electricity and gas network price changes to a financial, rather than calendar, year basis. Due to the associated change in the commencement date of AusNet Services’ next regulatory period, the negotiation process was six months longer than intended.

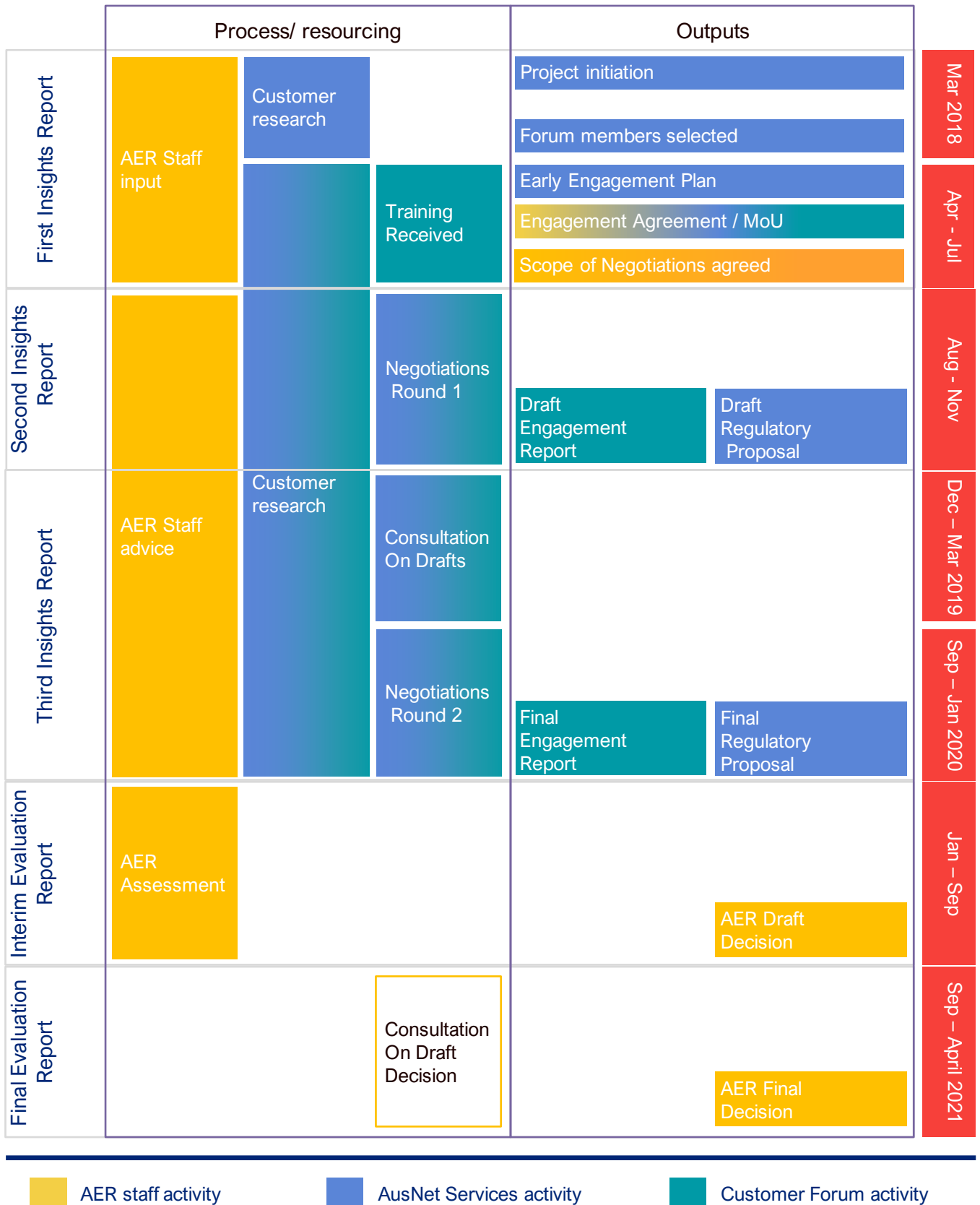
The three Insights Reports have been published on the AER’s website,²² and we have reproduced a summary of our findings from these reports in Appendix B.

²⁰ MOU, Clause 2.3, page 3.

²¹ CEPA (2018), New Reg Trial Evaluation Framework, November. Available here: <https://www.aer.gov.au/system/files/D18-177714%20New%20Reg%20AusNet%20Trial%20-%20Trial%20Assessment%20Factors.PDF>

²² <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/consultation-on-the-new-reg-process/update>

Figure 2.2: Overview of the evaluation process



AER staff activity
 AusNet Services activity
 Customer Forum activity

Source: CEPA

2.3. SCOPE OF THIS REPORT

The Evaluation Framework set out the questions and assessment framework that would be explored at the evaluation stage. However, the framework did not describe the respective scopes of the Interim and Final Evaluation Reports. We have agreed with the AER that this Interim Evaluation Report will cover events up to and including the Draft Decision. We have also agreed that this report will not present an evaluation of the trial against the Trial Assessment Factors. This reflects that, within the timelines for delivering this report, we have not been able to review AusNet Services' revised proposal, submissions on the Draft Decision or trial participants' estimates of their costs throughout the process (which will in any event not be known until the Final Decision).

Accordingly, similar to the three Insights Reports, this report is focussed on describing and commenting on the Draft Decision, adding to the body of evidence that we will rely on for the Final Evaluation Report.

In this report we also present our initial reflections and conclusions on:

- Aspects of the New Reg process where, based on our interim evaluation findings, a different approach might have better achieved the trial objectives.
- Interactions between the New Reg process and the overall regulatory framework, including constraints that the NEL/NER may have imposed on the process.

The initial reflections and conclusions will be confirmed, and elaborated on, in the Final Evaluation Report.

The Final Evaluation Report will:

- cover events up to the Final Decision;
- presents the trial participants' cost data; and
- set out our evaluation of the New Reg trial against the Trial Assessment Factors, and present our overall assessment of the trial and recommendations.

3. EVOLUTION OF THE TRIAL

As a point for reference for later sections, below we provide an overview of how the trial progressed from the initial negotiating position to the AER’s Draft Decision.

3.1. OVERVIEW OF THE TRIAL

Following its decision to participate in a trial, AusNet Services developed an Early Engagement Plan, which explained how the business proposed to implement the New Reg process.²³ The Early Engagement Plan closely followed the requirements set out in the New Reg Directions Paper. Among other arrangements, the Early Engagement Plan described how the Customer Forum would be recruited and the skills that members of the Customer Forum would need. The Early Engagement Plan was accepted by the AER in March 2018.

In June 2018, the Early Engagement was formalised through a MOU,²⁴ which was agreed between AusNet Services, the AER and the Customer Forum. The MOU set out, among other elements, the objectives of the trial, governance arrangements, and the roles and responsibilities of AusNet Services, the Customer Forum and the AER.

The MOU required AusNet Services and the Consumer Forum to agree a Scope of Negotiations, which must be accepted by the AER. The draft New Reg process envisaged that for the purpose of a trial, the AER may be more closely involved in the scoping phase.²⁵ For this trial, the formal Scope of Negotiation was agreed without significant input from the Customer Forum. However, the New Reg process also provided the Customer Forum and AusNet Services with the ability to agree to negotiate on topics outside of the Scope of Negotiation as the discussions progressed.²⁶ The Customer Forum and AusNet Services took advantage of this flexibility, agreeing to discuss a range of other issues. While the Customer Forum and AusNet Services agreed not to negotiate on all elements of the regulatory proposal, the Customer Forum received updates on the status of the overall proposal.

The issues that the Customer Forum and AusNet Services agreed to discuss, and the topics that were not part of the negotiation, are summarised in *Figure 3.1* below.

Figure 3.1: Topics of negotiation

In scope		Out of scope
(AER Assisted)	(AusNet Services and Customer Forum agreed)	
<ul style="list-style-type: none"> • Operating expenditure • Major growth projects (to meet population growth) • Customer experience and hardship arrangements • Price path 	<ul style="list-style-type: none"> • Major asset replacement projects (replacing old equipment) • Solar integration • Innovation expenditure • Smart metering • Overall ‘reasonableness’ of proposal 	<ul style="list-style-type: none"> • All other capital expenditure • Rate of return • Tax allowance • Opening Regulatory Asset Base • Pricing structures

Source: CEPA adapted from AusNet Services (2020), *Electricity Distribution Price Review 2022–26, Part I & II, January, page 28.*

²³ AusNet Services, *Early Engagement Plan: EDPR 2021-25 Customer Forum*.

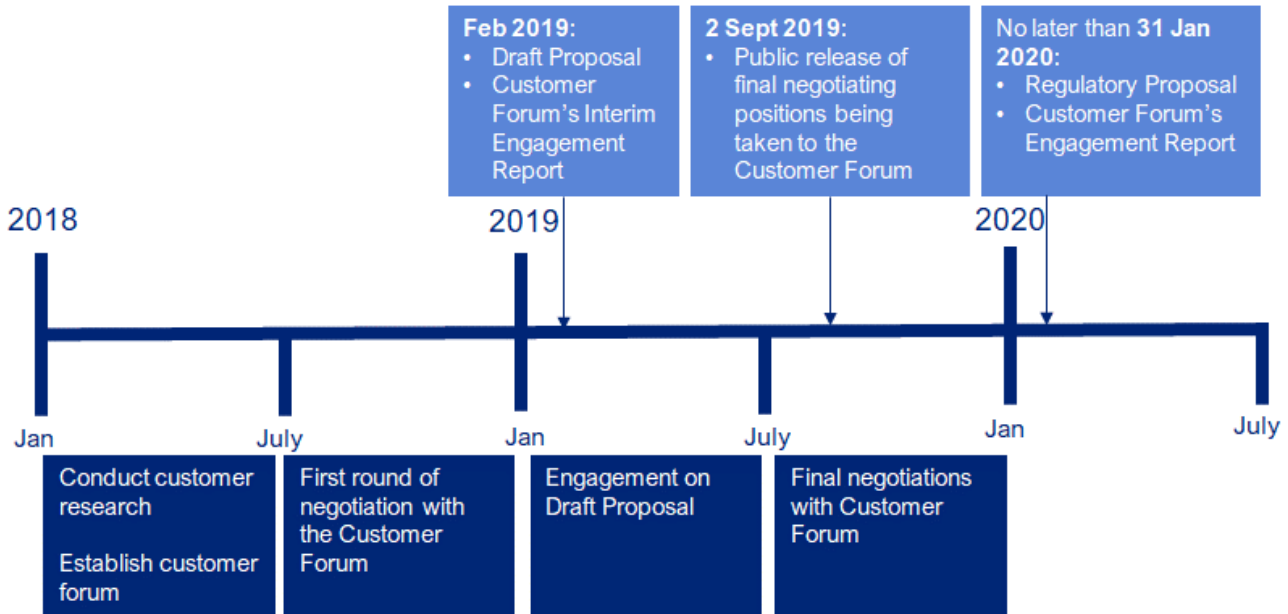
²⁴ Available here: <https://www.aer.gov.au/system/files/AER%2C%20%20AusNet%2C%20Customer%20Forum%20-%20Revised%20Early%20Engagement%20MoU.pdf>, as ‘AusNet trial – Early Engagement Memorandum of Understanding, June 2018.

²⁵ Directions Paper, page 10.

²⁶ It was envisaged that discussions on topics outside of the formal Scope of Negotiations would not be supported by in-depth guidance from AER staff.

In the lead up to the negotiations, the Customer Forum received presentations from AusNet Services, the AER and other parties, providing background information on the current regulatory framework, among other issues. As illustrated in Figure 3.2, the formal negotiations between the Customer Forum and AusNet Services were conducted in several stages over approximately 18 months.

Figure 3.2: Phases of the AusNet Services trial



Source: AusNet Services, available at https://www.ausnetservices.com.au/en/Misc-Pages/Links/About-Us/Charges-and-revenues/Electricity-distribution-network/EDPR-2021_25#r708b6f6047e3408dbc9aedf7cb2e48c4.

In August 2018, AusNet Services provided the Customer Forum with its initial negotiating positions on the topics that the parties had agreed to discuss. The first round of negotiations culminated with the publication of AusNet Services' Draft Regulatory Proposal and the Customer Forum's Interim Engagement Report in January 2019. In September 2019, AusNet Services released a revised set of negotiating positions. The subsequent discussions between the parties concluded with the January 2020 submission of AusNet Services' regulatory proposal to the AER, and the publication of the Customer Forum's final Engagement Report.

Submissions on the regulatory proposal closed in June 2020, and the AER subsequently published its Draft Decision in September 2020.

3.2. OUTCOMES OF THE EARLY ENGAGEMENT PROCESS

In this section, we provide an overview of how AusNet Service's business plan evolved through the trial, from the initial negotiating position to the final proposal submitted to the AER. A more comprehensive breakdown of the changes that occurred, and the reasons for these, will be included in our Final Evaluation Report.

Overall, AusNet Services and the Customer Forum were able to reach agreement on most of the topics they agreed to discuss. In summary:

- In some cases, the Customer Forum was able to draw on its understanding of consumers' preferences to reach agreement with AusNet Services that proposed activities were necessary *and* that the amount of proposed expenditure was reasonable. For example, this was the case in relation to an innovation allowance related to the integration of distributed energy resources (DER), and in relation to the IT Cloud opex step change to implement Customer Relationship Management (CRM) and Outage Management systems.

- In other instances, the Customer Forum expressed in-principle support for the activity proposed by AusNet Services, subject to the AER's assessment that the proposed costs were efficient. For example, this was the case for operating expenditure (opex) changes related to bushfire mitigation.
- In a couple of cases, the Customer Forum was not able to form a view on AusNet Service's proposals. For example, this was the outcome in relation to proposed expenditure to satisfy cyber security requirements set by AEMO²⁷, and in relation to the selection of the opex base year.

In relation to **opex**, at the total level AusNet Services' proposed expenditure did not change markedly over the course of the negotiations. In its interim negotiating position, AusNet Services proposed total opex of \$1,199m (\$2020). The final proposal agreed with the Customer Forum was \$1,222m (\$2021). Reflected in this overall total, are a number of changes agreed between the Customer Forum and AusNet Services from the initial negotiating position. These include:

- AusNet Services agreed to absorb several proposed step changes, totalling \$21m (\$2021). AusNet Services claimed that these changes were equivalent to a productivity adjustment of 0.5%, which combined with the AER's mandatory 0.5% adjustment resulted in overall productivity gains of 1.0%. This was viewed as a compromise position between the AER's productivity assessment, and the Customer Forum's original target of 1.5%.²⁸
- AusNet Services agreed to reduce the size of its proposed innovation allowance, from \$11.4m (\$2020) to \$7.5m (\$2021). In forming its views on the appropriate scope and budget for innovation projects, the Customer Forum drew on the findings of customer research and stakeholder feedback provided through 'Deep Dive' sessions.²⁹ The Customer Forum and AusNet Services also agreed to governance arrangements for the utilisation of the innovation allowance, including reporting on innovation project outcomes through the Customer Interaction and Monitoring Report (CIMR – see below).

For the **capex** items that the parties agreed to discuss, a number of changes occurred between the initial negotiating position, and the regulatory proposal submitted to AER. These included:

- In relation to major replacement expenditure (repex), the Customer Forum and AusNet Services agreed to a revised proposal that would defer one project, bring forward another into the current regulatory period, and reduce the scope of several other proposals. In reaching its conclusions on the major repex projects within the scope of negotiations, the Customer Forum drew on the results of research it had commissioned into customer preferences in relation to price and reliability trade-offs.³⁰ Overall, these revisions resulted in a major repex projects proposal that was approximately \$29m (27 per cent) lower, in total, over the regulatory period. Based on its investigation of customers' preferences on price and reliability trade-offs, the Customer Forum was satisfied that these changes were in the long-term interest of consumers.³¹
- In relation to augmentation expenditure (augex), AusNet Services had proposed two projects at Clyde North and Doreen. The Customer Forum requested further information, and an independent assessment of alternatives, to form its views on these proposals. Ultimately, AusNet Services withdrew its proposal for Doreen following updated demand forecasts indicating that the economic timing for the works (based on a

²⁷ We note that the regulatory requirements driving this step change had not been finalised prior to the conclusion of the negotiations.

²⁸ Customer Forum, Final Engagement Report, page 17-18.

²⁹ Customer Forum, Final Engagement Report, pages 37-38.

³⁰ Customer Forum, Final Engagement Report, pages 31-33.

³¹ Customer Forum, Final Engagement Report, page 29.

cost benefit assessment) now fell outside the regulatory period. This resulted in an approximately \$5m (\$2021) reduction in proposed capex.³²

- AusNet Services did not present a specific expenditure proposal for the integration of DER in its initial negotiating position or draft proposal. In its final proposal, it had agreed expenditure of \$43m (\$2021) with the Customer Forum, who considered that this provided value of money for consumers, based on its interpretation of research on customers' willingness to pay for DER integration.³³ The parties also agreed to governance arrangements related to this expenditure, including that AusNet Services would: report on DER expenditure through the CIMR (see below); only recover the full amount if it is utilised; and partially fund expenditure to enable additional export capacity, in the event that this became economic.³⁴

AusNet Services has reported that its discussions with the Customer Forum influenced not only the capex items that were directly negotiated between the parties, but also AusNet Services' broader capex proposal.³⁵

In relation to **metering**, the parties agreed that AusNet Services' proposed \$8.4 million (\$2010) expenditure to transition to the 4G network was justified, after the Customer Forum sought further information of the required timing of the transition.³⁶ The parties also discussed AusNet Services' proposed reallocation of metering operating expenditure to the distribution business (i.e. a rebalancing of expenditure from alternative control services to standard control services).³⁷

In addition to seeking to reach agreement on elements of the building blocks revenue allowance, the Customer Forum and AusNet Services also discussed **customer experience and hardship** arrangements. These discussions reflected the Customer Forum's concern that the existing building blocks assessment framework would not adequately consider the service levels that customers require.³⁸ As a result of these discussions, the Customer Forum and AusNet Services agreed to establish a Customer Service Incentive Scheme (CSIS), which considers a broader range of customer service metrics. The parties also agreed to a range of customer service improvement initiatives, which AusNet Services agreed to implement in advance of the next regulatory period, at no additional cost to consumers.³⁹ In addition, the Customer Forum secured agreement from AusNet Services to publish an annual Customer Interaction and Monitoring Report (CIMR), which is intended to track progress against the agreed service improvement initiatives. AusNet Services has since published the inaugural CIMR.⁴⁰

The Customer Forum was ultimately satisfied that the overall proposal, inclusive of out of scope items, was broadly reasonable:

"In recognition of the \$110 (\$2021) minimum average price reduction per customer and other customer benefits listed above, the Customer Forum concludes the revenue proposal represents overall value for money for customers."⁴¹

³² Customer Forum, Final Engagement Report, page 21.

³³ Customer Forum, Final Engagement Report, page 39.

³⁴ Customer Forum, Final Engagement Report, page 43.

³⁵ AusNet Services, Regulatory Proposal 2022-26 – Part III, page 71.

³⁶ Customer Forum, Final Engagement Report, page 44.

³⁷ The costs of providing alternative control services are recovered solely from the users of those services, while costs associated with standard control services are shared across all network users.

³⁸ Customer Forum, Interim Engagement Report, page 27.

³⁹ With the exception of "a modest increase in costs for improved communication systems)". AER, Draft Decision – Overview, page 51.

⁴⁰ <https://www.ausnetservices.com.au/en/Community/Customer-Interactions-and-Monitoring-Report>

⁴¹ Customer Forum, Final Engagement Report, page 51.

The Customer Forum has noted that making this assessment was challenging without detailed oversight of the out of scope topics.⁴²

3.3. OUTCOMES OF THE DRAFT DECISION

In making its Draft Decision, the AER has followed its standard assessment process. As described in Box 2, this was the approach envisaged at the outset of the AusNet Services trial.

Box 2: The AER's assessment process

The New Reg Directions Paper envisaged that, for the purpose of trialling the New Reg process, the AER would follow its standard assessment approach in reaching its Draft Decision:

"... for the purposes of a trial, the AER may expedite its regulatory process only after the draft decision stage to allow for consultation on the outcomes of the Early Engagement Process. This is for two principal reasons:

- *it is important for all stakeholders to have an opportunity to fully understand the trial of the New Reg process and to be heard if there are further concerns*
- *changing the timeline of a revenue determination for one business could create practical problems in managing the process. The AER is required to assess a high number of regulatory proposals every year. The process of publishing proposal and decision documents—whilst managing confidentiality claims—creates significant logistical challenges.*⁴³

AusNet Services' Early Engagement Plan was consistent with this position.⁴⁴

The Directions Paper noted that for future processes, *"the AER may, where it considers appropriate, shorten its determination process—although some limitations exist under the Rules."*⁴⁵ The scope for an expedited process under the current framework is considered further in section 6.

Based on its assessment, there were limited instances where the AER did not accept positions that had been agreed between the Customer Forum and AusNet Services. More detailed commentary on particular aspects of the AER's Draft Decision is included in section 4.

Overall, the AER's Draft Decision in relation to **opex** was 3.7 per cent lower than AusNet Services' proposal. Of this, the majority – 3.1 percent – related to the impact of economic conditions on real price effects and output growth. In its Draft Decision, the AER noted that:

*"We have reviewed AusNet Services' total opex proposal and find it is largely reasonable, with the main difference to our alternative estimate being the impact of unforeseen changes in economic conditions on the rate of change as a result of COVID-19. Without these changes in economic conditions impacting the rate of change we would have been likely to accept AusNet Services' proposal."*⁴⁶

Similarly, in relation to **capex**, the AER found that:

*"... with the exception of modelling errors, reclassification of some expenditures and changes to economic conditions, AusNet Services' forecast of total capex was reasonable and represented value for money for its customers."*⁴⁷

Due to these factors, the AER's Draft Decision for capex was 4.4 per cent lower than AusNet Services' proposal.

⁴² Farrierswier, Stage 3 Monitoring Report, page 14.

⁴³ New Reg Directions Paper, page 12.

⁴⁴ AusNet Services, EDPR 2021-25 Early Engagement Plan, page 15.

⁴⁵ New Reg Directions Paper, page 12.

⁴⁶ AER (2020), Draft Decision – Overview, September 2020, page 38.

⁴⁷ Draft Decision – Overview, page 35.

The AER gave effect to the **CSIS** agreed between the two parties through a separate consultation process (discussed further in section 4).

4. OBSERVATIONS ON THE DRAFT DECISION

The Final Evaluation Report will set out our assessment of the New Reg Trial against the evaluation framework described in 0. This report builds on the body of evidence set out in our three Insights Reports, by capturing our main observations on how the Engagement Report informed the AER's Draft Decision.

We have based our observations around the 'Impact on Determination' Trial Assessment Factor, which poses the question – *Did the AER's determinations benefit from the Customer Forum's negotiations (the Engagement Reports)?* Our evaluation framework identified a number of sub-factors for this Trial Assessment Factor, which we have used to structure our observations.

In summary, the key themes emerging from this stage of the process are:

- While there are some learnings for future Early Engagement processes (see below), the overall vision for New Reg – to enable a regulatory proposal from AusNet Services that can be considered to reflect consumer preferences and have been consulted on with customers via the Customer Forum – appears to have been largely realised through the New Reg Trial. This is evidenced by the AER's conclusions on AusNet Services' consumer engagement strategy in the Draft Decision.
- There were relatively limited cases⁴⁸ where the AER did not accept positions that had been agreed between the Customer Forum and AusNet Services. The governance and process arrangements established at the outset of the process, including the role of the AER staff in supporting the negotiations, appears to have been an important factor in the parties reaching negotiated positions that were largely capable of acceptance.
- The AER was able to place weight on evidence from the Engagement Report to inform aspects of its Draft Decision. This was particularly the case when the Customer Forum was able to use the evidence gathered on customers' perspectives to inform a more definitive view on AusNet Service's proposed expenditure. The AER's Draft Decision appears to have placed less weight on negotiation positions that the Customer Forum agreed to 'in principle', but subject to the AER's assessment.
- In line with the New Reg process⁴⁹, the AER has followed its standard assessment process to arrive at its Draft Decision. It will be open to the AER to adopt an expedited or streamlined determination process for the Final Decision, if it considers that this is justified given AusNet Services' revised proposal. Accordingly, a key consideration for the Final Evaluation Report will be how the evidence provided by the Engagement Report informs this decision, in combination with the other evidence before the AER.

4.1. SUMMARY OF OUR OBSERVATIONS

Our observations against each of the sub-factors are summarised in Table 4.1. A more detailed discussion of each observation is set out in the following sections.

⁴⁸ Aside from changes to correct errors and reflect the impact of the COVID-19 pandemic.

⁴⁹ Process step 10: "While the AER would continue to undertake its current assessment process, it would now be able to have regard to the Engagement Report in forming a view about the regulatory proposal. [...]" Process step 11: "If a business successfully undertakes an Early Engagement Process, and reflects the outcomes of this process in its regulatory proposal, the AER may if it considers appropriate expedite and/or streamline the revenue determination process. For the purposes of a trial, the AER may expedite its regulatory process only after the draft decision stage to allow for consultation on the outcomes of the Early Engagement Process (among other practical considerations)." New Reg Directions Paper, page 6-7.

Table 4.1: Trial Assessment Factor - Impact on Determination

Sub-Factor	Observation
<p>To what extent did AER’s Draft Decision reflect the engagement and negotiations between AusNet and the Forum?</p>	<p>Observation 1.1: By design, the New Reg process does not bind the AER to accept the positions agreed between the Customer Forum and AusNet Services. Nonetheless, a desired outcome is that by meaningfully reflecting consumers’ perspectives in the regulatory proposal, New Reg can facilitate a less adversarial and resource intensive determination process. Aside from changes to correct errors in the regulatory proposal and account for the impact of COVID-19, there were limited cases where the AER did not accept positions that were agreed between AusNet Services and the Customer Forum. This suggests that, overall, the New Reg process appears to have supported the parties in agreeing many positions that were capable of acceptance under the NEL and NER.</p>
<p>Where the AER adopted a different position to the negotiated positions and outcomes of the early engagement process, what was the reason for this?</p>	<p>Observation 1.2: As discussed in previous Insights Reports, participation in the New Reg process is voluntary. Therefore, the outcomes of the AusNet Services trial in relation to the time, cost and ‘tone’ of the regulatory determination process will affect the incentives that other networks have to adopt the process.</p> <p>At the Draft Decision stage, it is too early to reach a definitive view on this issue. We can observe that there are some areas where the AER has not accepted agreed positions, where these were not adequately justified (IT cloud opex step change) or aligned with its standard application of NER requirements (revenue path profile). However, the Draft Decision appears to have resulted in few ‘surprises’. This indicates that the process thus far has been successful in identifying issues, and for the most part resolving these, at an early stage.</p>
<p>To what extent did the AER consider the negotiated positions in the Forum’s Engagement Report provided an effective evidence base for its draft determination and were in the best interests of AusNet’s customers?</p>	<p>Observation 1.3: For some elements of AusNet Services’ proposal, the AER was able to place weight on the Customer Forum’s views in its Draft Decision. It appears that greater weight was placed on this evidence when the Customer Forum was able to:</p> <ul style="list-style-type: none"> • Clearly link its position to specific evidence on customers’ preferences. • Reach a position on both the need for expenditure and the level of expenditure, rather than an ‘in principle’ agreement that AusNet Services’ proposal was reasonable, subject to the AER’s assessment of efficiency. <p>Observation 1.4: The support provided by AER staff and the Consumer Challenge Panel (CCP) to the Customer Forum during the negotiations appears to have been an important factor in the Early Engagement process producing evidence that the AER was able to have regard to.</p> <p>Observation 1.5: For a number of AusNet Services’ expenditure proposals, the Customer Forum provided ‘in principle’ support for the proposed activity, but subject to the AER assessing that the proposed costs were efficient. These instances of conditional agreement appear to have been a less consequential factor in the AER’s Draft Decision. This evidence may suggest ways in which the Scope of Negotiations could be refined to enhance the overall efficiency of the New Reg process in future.</p>
<p>Did the AER consider that AusNet’s final regulatory proposal ‘better’ reflected and presented the</p>	<p>Observation 1.6: The AER has provided, as part of its Draft Decision, guidance on the aspects of customer engagement processes that would allow it to place weight on the evidence that these processes provide. The AER considered that the engagement undertaken by AusNet</p>

Sub-Factor	Observation
customer perspectives and preferences?	<p>Services over the course of the New Reg Trial achieved a high standard against these principles. Specific elements of the New Reg process have supported this assessment, by design.</p> <p>Observation 1.7: The AER’s Draft Decisions for other distribution networks suggest that other engagement processes also have the potential to perform well against these criteria.</p>

4.2. REFLECTING THE ENGAGEMENT OUTCOMES

This sub-factor considers the extent to which the AER’s Draft Decision reflected the engagement and negotiations between AusNet Services and the Customer Forum.

Observation 1.1

By design, the New Reg process does not bind the AER to accept the positions agreed between the Customer Forum and AusNet Services. Nonetheless, a desired outcome is that by meaningfully reflecting consumers’ perspectives in the regulatory proposal, New Reg can facilitate a less adversarial and resource intensive determination process. Aside from changes to correct errors in the regulatory proposal and account for the impact of COVID-19, there were limited cases where the AER did not accept positions that were agreed between AusNet Services and the Customer Forum. This suggests that, overall, the New Reg process appears to have supported the parties in agreeing many positions that were capable of acceptance under the NEL and NER.

As set out in section 3.3, the Draft Decision reflected many of the positions agreed between the parties.

Some of the areas where the AER reached a different view related to developments since the Customer Forum and AusNet Services concluded their negotiations, such as the impact of the COVID-19 pandemic on the inflation and growth elements of the opex trend component. There are some instances, in addition to changes related to economic conditions and the correction of errors, where the AER has taken a different view to the positions reached by the parties. These are discussed in section 4.3.

4.3. AREAS OF DISAGREEMENT

This sub-factor considers, in cases where the AER adopted a different position to the negotiated positions and outcomes of the early engagement process, what the reasons for this decision were.

Observation 1.2

As discussed in previous Insights Reports, participation in the New Reg process is voluntary. Therefore, the outcomes of the AusNet Services trial in relation to the time, cost and ‘tone’ of the regulatory determination process will affect the incentives that other networks have to adopt the process.

At the Draft Decision stage, it is too early to reach a definitive view on this issue. We can observe that there are some areas where the AER has not accepted agreed positions, where these were not adequately justified (IT cloud opex step change) or aligned with its standard application of NER requirements (revenue path profile). However, the Draft Decision appears to have resulted in few ‘surprises’. This indicates that the process thus far has been successful in identifying issues, and for the most part resolving these, at an early stage.

As discussed in our first Insights Report, the fact that a distribution network may *choose* to follow the Early Engagement Process, rather than being required to participate, is an interesting feature of New Reg. The decision to enter into early engagement is a formalised and transparent process, that requires the network to adopt a different approach to the process it would typically follow to prepare a regulatory proposal. It is not an ‘easy’ option for the company. Therefore, in our first Insights Report, we considered why a network would choose to participate.

AusNet Services has stated that for this trial that “[b]eyond enhancing the way we listen to our customers, this is an exciting and innovative approach that aims to ensure that AusNet Services’ plans for the 2021-25 period genuinely

reflect the preferences and perspectives of our customers.”⁵⁰ AusNet Services’ reflections on the New Reg Trial indicate that it considers this outcome to have been achieved.⁵¹

More broadly, we noted that the New Reg trial appears to offer an opportunity for a network to:

- develop regulatory proposals that are demonstrably informed by consumer preferences, which includes the publication of the Customer Forum’s Engagement Reports;
- benefit from the negotiated outcomes potentially being accepted by the AER, with AER staff involvement helping to ensure that the process is sufficiently robust for the AER to have regard to the negotiated outcomes; and
- receive some relatively early views on its proposals from the AER.

While the customer engagement aspects of the process are important, it is also the governance arrangements – in particular, the agreement reached with the Customer Forum and the AER staff’s involvement throughout the process – that help to give the ‘status’ to AusNet Services’ final regulatory proposal. This provides the incentive for networks like AusNet Services to use the New Reg process to negotiate matters and avoid, or lessen, a potentially more adversarial and/or resource intensive determination process. The extent to which the process delivers these outcomes may affect whether other networks choose to participate in New Reg (or a similar process), given that the decision to participate is voluntary.

Accordingly, in our first Insights Report, we noted that if AusNet Services and the Customer Forum reached a negotiated position that was accepted by the AER without amendment, this should be considered a good outcome for the company. At the Draft Decision stage, it is too early to know whether from AusNet Services’ perspective, the process has been ‘worth the effort’.⁵² In particular, this is because:

- Outcomes may change between now and the Final Decision.
- We have not yet reviewed the trial participants’ estimates of their costs of engaging in the process, and how these compare to a more ‘standard’ process.
- For the Draft Decision, the AER has followed its standard assessment process (see section 3.3).

At the Final Evaluation stage, we will revisit the points around the benefits of the process, including efficiency, with reference to the outcomes of the Final Decision and the cost data that will be provided by the parties. Nonetheless, with the release of the Draft Decision, we can observe that the positions agreed during the negotiations have been largely, but not completely, accepted by the AER.

It is interesting to note that the substantive points of difference⁵³ between the Draft Decision and the agreed negotiation positions related to topics that were highlighted in guidance provided by AER staff during the negotiation process, as areas were the direction of the negotiations might not result in a position capable of acceptance. In particular:

- **IT cloud opex step change.** AusNet Services had proposed an opex step change of \$2.6m (\$2021) to establish a customer relationship management (CRM) system and outage management system. In Guidance Note 10, consistent with earlier comments on the draft regulatory proposal in Guidance Note 9,

⁵⁰ <https://www.ausnetservices.com.au/Misc-Pages/Links/About-Us/Charges-and-revenues/Electricity-distribution-network/Customer-Forum>

⁵¹ AusNet Service, Regulatory Proposal 2022-26 – Part I & II, page 32.

⁵² As the scope of this report covers events up to the publication of the AER’s Draft Decision, we have not sought the views of AusNet Services, Customer Forum or other stakeholders on the determination. These perspectives will be considered as part of the Final Evaluation Report.

⁵³ That is, differences unrelated to the impact of COVID-19 or the correction of modelling errors.

AER staff observed that to “justify the step change AusNet could outline the additional customer benefits and how a reduction in ongoing capex would offset the step change.”⁵⁴ In the final regulatory proposal, the Customer Forum had agreed to the logic of the proposed step change, noting that evidence had been provided to demonstrate that IT capex would reduce by a corresponding amount.⁵⁵ However, at the Draft Decision stage, the AER considered that “AusNet Services has not demonstrated there is a capex/opex trade-off for its cloud transition costs to justify a step change”.⁵⁶

- **Revenue path profile.**⁵⁷ The Customer Forum and AusNet Services agreed a revenue profile which maximised the price reduction in the first year of the regulatory period, and maintained a flat price path in real terms over the remaining years. During the negotiations, AER staff noted that while negotiations on this topic provided useful information in relation to customers’ preferences, carriage of the agreed position into the Draft Decision would be challenging for a number of reasons. In particular, AER staff highlighted that the revenue profile it would be able to accept would be impacted by late changes to components of allowed revenue (i.e. on out of scope items, after the Early Engagement Process had concluded) and also NER requirements that are intended to minimise the likelihood of significant price changes in the first year of the subsequent regulatory period.⁵⁸ In its Draft Decision, the AER noted that while it has not been able to precisely match the position agreed between the parties, it has “been able to achieve a significant reduction to the revenue for 2021–22 as sought by the Customer Forum.”⁵⁹
- **Bottom-up capex assessment.** As noted in section 3.3, in the Draft Decision the AER notes that, in line with its standard process, it has conducted both a top-down and bottom-up review of AusNet Services’ capex proposal. However, as the AER’s top-down assessment indicated that the proposal reasonably reflected the capex criteria set out in the NER, the bottom-up assessment was immaterial. Accordingly, the AER noted that its “examination of the proposed expenditures at the program level was given relatively less weight” than would otherwise have been the case. Overall, the AER concluded that “[w]hile we identified some areas where individual capex categories were not fully justified we are satisfied that, having regard to AusNet Services’ top-down challenge, these concerns are not material. That is, the top-down adjustment made by AusNet Services was as large, or larger, than the total sum of the adjustments that we would otherwise make at the individual category level.”⁶⁰ The issues identified through the bottom-up assessment related primarily to DER-related expenditure (the AER identified DER-related capex of \$58.9 (\$2021) in AusNet Services’ proposal).⁶¹ In Guidance Note 9, AER staff had highlighted some potential concerns in relation to the cost-benefit analysis presented in support of this expenditure.
- **Metering systems reallocation.** AusNet Services had proposed to reallocate \$29.4 million (\$2021) of metering system IT costs from alternative control services to standard control services. AusNet Services’ justified this proposal on the basis of its increasing reliance on advance metering infrastructure to operate the distribution, and this rationale was accepted by the Customer Forum.⁶² The AER’s Draft Decision

⁵⁴ AER, Staff Guidance Note 10, page 6.

⁵⁵ Customer Forum, Final Engagement Report, page 17.

⁵⁶ AER, Draft Decision – Attachment 6 – Operating expenditure, September 2020, page 58.

⁵⁷ Note, this was generally referred to as ‘price path’ within the negotiation documents.

⁵⁸ AER, Staff Guidance Note 9.

⁵⁹ AER, Draft Decision – Attachment 1 – Annual revenue requirement, September 2020, page 9.

⁶⁰ AER, Draft Decision – Attachment 5 – Capital expenditure, September 2020, page 8.

⁶¹ AER, Draft Decision – Attachment 5 – Capital expenditure, September 2020, page 22.

⁶² AER, Draft Decision – Attachment 6 – Operating expenditure, September 2020, page 43.

concluded that a lower reallocation of \$7.8 million (\$2021) was appropriate, based on its assessment of the extent to which metering data contributes to the provision of standard control services.⁶³

These outcomes may highlight that it was challenging for the negotiating parties to fully appreciate how certain expenditure proposals are likely to be assessed, despite the provision of guidance throughout the review process. However, the limited number of areas in which the AER was not able to accept the agreed positions, indicates that the process thus far appears to have been relatively successful in identifying material issues, and for the most part resolving these, at an early stage. We consider this aspect of the New Reg process further in section 5.3.

In making this observation, it is important to acknowledge that the overall (downward) price trajectory may have supported the ability of AusNet Services and the Customer Forum to reach agreed positions, by contributing to the overall productive 'tone' of the negotiations. Reaching agreed positions between both parties, including on service quality improvements, may have been more difficult if AusNet Services' proposed price path was increasing. Further, in an environment of rising costs or prices, the regulator's scrutiny of positions agreed between a Customer Forum and a network business might also increase. The overall context of the negotiations will therefore need to be considered when evaluating the ability of the New Reg process to support the parties in reaching agreed positions that are capable of acceptance by the AER. In particular, while an Early Engagement process could still be helpful in the context of a more challenging cost and price trajectory environment, it is important to note that this has not been tested in this particular trial.

4.4. QUALITY OF THE EVIDENCE

This sub-factor considers the extent to which the AER considered that the negotiated positions in the Customer Forum's Engagement Report provided an effective evidence base for its Draft Decision and were in the best interests of AusNet Services' customers.

Observation 1.3

For some elements of AusNet Services' proposal, the AER was able to place weight on the Customer Forum's views in its Draft Decision. It appears that greater weight was placed on this evidence when the Customer Forum was able to:

- Clearly link its position to specific evidence on customers' preferences.
- Reach a position on both the need for expenditure and the level of expenditure, rather than an 'in principle' agreement that AusNet Services' proposal was reasonable, subject to the AER's assessment of efficiency.

In its Draft Decision, the AER placed weight on the Customer Forum's support for innovation expenditure in accepting this element of AusNet Services' proposal:

"We have included the proposed innovation expenditure in our alternative estimate of total opex on the basis that:

- *it is supported by the Customer Forum and is consistent with the conditions negotiated with the Customer Forum regarding financial arrangements, number of projects and total expenditure sought to undertake these projects. There was also support through AusNet Services' qualitative customer research and from the CCP17 in response to AusNet Services initial proposal. ..."*⁶⁴

The AER's Draft Decision refers extensively to the position reached by the Customer Forum, and the evidence of customer preferences that it used to justify its support for AusNet Services' proposal:

⁶³ AER, Draft Decision – Attachment 6 – Operating expenditure, September 2020, page 43.

⁶⁴ AER, Draft Decision – Attachment 6 - Operating expenditure, September 2020, page 62-63.

“AusNet Services’ qualitative customer research tested customers’ willingness to pay for an increase in expenditure capped at \$7.5 million (\$2020–21) for projects broadly related to innovation. ... While AusNet Services’ testing did not look for a firm willingness to pay outcome for each project we note the results were supportive of the proposed innovation expenditure.”⁶⁵

We also note that the innovation allowance was one area where the Customer Forum had expressed a detailed opinion on the expenditure proposal, reaching agreement with AusNet Services on both the need for expenditure, the level of expenditure, and the governance arrangements for utilisation of the innovation allowance. This is in contrast to the more general ‘in principle’ support that it expressed for some of the other elements of AusNet Services’ proposal (see Observation 1.5).

As noted in previous Insights Reports, the Customer Forum was also able to influence AusNet Services’ customer engagement strategy during the Early Engagement Process, including the focus, breadth and depth of consumer engagement undertaken. This has informed and helped to strengthen the quality of the evidence base that the AER has had regard to in making this aspect of its Draft Decision.

Observation 1.4

The support provided by AER staff to the Customer Forum during the negotiations appears to have been an important factor in the Early Engagement Process producing evidence that the AER was able to have regard to.

During the course of the negotiations, AER staff provided a series of Guidance Notes to inform discussions between the parties. Returning to innovation expenditure, we note that this was an area where AER staff had provided guidance during the negotiation process. In particular, in Guidance Note 9, AER staff noted that:

“It would be helpful if the Customer Forum and AusNet undertook further work clarifying their positions on innovation. The Customer Forum advised AusNet the proposed innovation expenditure should only proceed where AusNet could link the potential customer benefits to customer and stakeholder expectations. AusNet is yet to do this. The Customer Forum would prefer AusNet Services to construct an innovation budget of \$7.5 million (\$2020) but does not link this level of funding to customer preferences. The Customer Forum and AusNet do not appear to have agreed on any specific innovation projects. AusNet does not clearly state its proposed innovation expenditure in its draft proposal.”⁶⁶

The Guidance Note went on to suggest a range of matters that the Customer Forum and AusNet Services could address, in order to reach a robust negotiated position. Given the outcome of the Draft Decision, it appears that the AER staff’s involvement in the negotiation process has been an important element in the parties reaching a position that was capable of acceptance, and providing sufficient evidence to support their reasoning.

For example, during the process, AER staff have indicated to us that the negotiated positions were likely to be more persuasive if, in addition to being evidence-based, stakeholders consider that the Customer Forum had formed its views independently of AusNet Services. The importance of independence was subsequently highlighted in the AER’s Draft Decision. Several aspects of the process assisted in supporting the Customer Forum’s independence, including: the AER’s role in providing guidance and technical support; the publication of minutes and negotiation materials, which show how the Customer Forum challenged AusNet Services; and the publication of an independent report by the Customer Forum.

Another aspect of the New Reg Trial, that has allowed the AER to place weight on the negotiated positions, is the requirement for the Customer Forum to clearly describe in its Engagement Report, for each topic of negotiation,

⁶⁵ AER, Draft Decision – Attachment 6 - Operating expenditure, September 2020, page 62-63.

⁶⁶ AER, Staff Guidance Note 9, page 19.

how the position it reached was in the interests of consumers. In particular, the MOU required the Customer Forum to structure the Engagement Report around three key points:

- *“Matters in scope and considered by the Forum*
- *Areas of agreement and disagreement with AusNet Services*
- *How these positions are in the interests of consumers”*

During the course of the trial, the AER provided feedback that the Interim Engagement Report had not clearly responded to these issues. This appears to have assisted the Customer Forum to develop a final Engagement Report that was more aligned to the AER’s evidentiary requirements.

Observation 1.5

For a number of AusNet Services’ expenditure proposals, the Customer Forum provided ‘in principle’ support for the proposed activity, but subject to the AER assessing that the proposed costs were efficient. These instances of conditional agreement appear to have been a less consequential factor in the AER’s Draft Decision. This evidence may suggest ways in which the Scope of Negotiations could be refined to enhance the overall efficiency of the New Reg process in future.

For example, the Customer Forum expressed in principle agreement for AusNet Services’ proposals, in relation to bushfire mitigation expenditure (rapid earth fault current limiters – REFCLs) and electricity market settlement, but with the caveat that the AER would undertake an assessment of efficiency:

“The Customer Forum was unable to comprehensively determine the REFCL testing step change of \$6.0 million (\$2021) due to its highly technical nature but agreed to it subject to the AER being satisfied it was warranted.”⁶⁷

“The Customer Forum accepted AusNet Services’ five-minute metering step change proposal, subject to the AER being satisfied the revenue sought fairly covered the cost involved of this mandatory change.”⁶⁸

In its Draft Decision in relation to these expenditure items, the AER does not refer to the ‘in principle’ agreement reached between AusNet Services and the Customer Forum.

As discussed further in section 0, these outcomes may suggest that there are opportunities to refine the process for both determining the initial Scope of Negotiations, and ensuring that it remains appropriate over the course of the negotiation process.

4.5. ‘BETTER’ REPRESENTING CONSUMER PERSPECTIVES

This sub-factor explores whether the AER considered that AusNet Services’ final regulatory proposal ‘better’ reflected and presented customers perspectives and preferences.

As described in section 2.1, the role and impact of the Customer Forum is a central feature of the New Reg model, as compared to alternative processes to reflect consumer engagement in a network’s regulatory proposal. For our Final Evaluation Report, in considering whether the New Reg Trial has achieved its objectives, we will therefore need to consider three key questions:

- Did the consumer engagement undertaken by AusNet Services improve because of the New Reg process and, in particular, the role of the Customer Forum ‘in bringing the consumer perspective’?

⁶⁷ Customer Forum, Final Engagement Report, page 12.

⁶⁸ Customer Forum, Final Engagement Report, page 13.

- Were the consumer preferences and priorities that this engagement identified more effectively translated into AusNet Service’s draft proposal, than would otherwise have been the case?
- Did New Reg process meaningfully impact the AER’s determination?

All of these questions can be considered from different perspectives:

- In absolute terms – did the New Reg process meaningfully impact the process leading up to the AER’s Draft Decision?
- In relative terms – is the outcome demonstratively better compared to an alternative process that AusNet Services may have followed?

The observations we set out below present some initial reflections on these points.

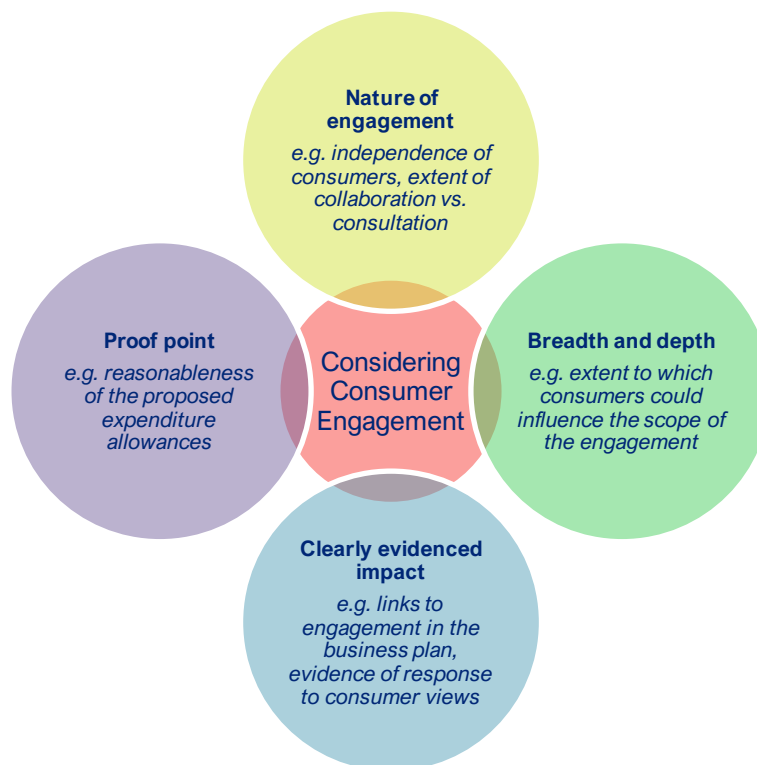
Observation 1.6

The AER has provided, as part of its Draft Decision, guidance on the aspects of customer engagement processes that would allow it to place weight on the evidence that these processes provide. The AER considered that the engagement undertaken by AusNet Services over the course of the New Reg trial achieved a high standard against these principles.

Specific elements of the New Reg process have supported this assessment, by design.

In its Draft Decision, the AER has set out an explanation of the factors (summarised in Figure 4.1) that it considered in assessing the evidence from customer engagement, that arose from the very different engagement processes adopted by the Victorian distribution networks. This builds on the Customer Engagement Guidance issued by the AER in 2013. AER staff have indicated to us that the framework described in the Draft Decision is not definitive guidance, but intended to assist stakeholders to understand how particular characteristics or features allowed it to place weight, or not, on the findings of these different engagement processes.

Figure 4.1: Summary - AER framework for considering consumer engagement



Source: AER, Draft Decision – Overview, page 45.

The AER has referenced key aspects of the New Reg Trial that allowed it to have confidence in the outcomes of the engagement process, based on these criteria. We note that many of these qualities were supported by specific features of New Reg that were established in the original design of the process. For example:

- **Nature of engagement.** The AER referred to the **structured support** provided to the Customer Forum throughout the process, including from AER staff: *“Under the Early Engagement Plan and Memorandum of Understanding, we had a formal role in providing support to the Customer Forum. ... This provided the Customer Forum the opportunity to drill down into the detail to better understand the technical aspects of the proposed positions.”*⁶⁹ Further, the Customer Forum members were selected to on the basis of **skills and experience** that would allow them to fully engage in the process: *“The Customer Forum was selected to have the skills and expertise to serve the role of being a credible counterparty to AusNet Services in order to represent its customer base and negotiate on their behalf. AusNet Services sought input on the selection criteria for the Customer Forum and tested a shortlist of candidates with AER and ECA, as well as included a member of their consumer consultative committee reference group on the selection committee.”*⁷⁰
- **Breadth and depth.** The AER noted that the Customer Forum has been able to undertake its own **consumer engagement** and has also improved the breadth and depth of the engagement undertaken by AusNet Services: *“Importantly this consultation and research involved multiple channels and covered many different customer cohorts. This included face-to-face meetings with residential, rural and business customers, telephone surveys, observing customer focus groups, and meetings with customer representative groups, Members of Parliament, local Government, and peak body organisations.”*⁷¹
- **Clearly evidenced impact.** The AER has had access to an **independent Engagement Report** prepared by the Customer Forum, which allowed the AER to verify AusNet Services’ claims in relation to areas of agreement and disagreement: *“As agreed under the Memorandum of Understanding, the Customer Forum delivered a detailed report, supported by its independent research, on its negotiations with AusNet Services.”*⁷² The AER considered that the impact of the Customer Forum was **clearly evidenced** in both the Engagement Report, and AusNet Services’ regulatory proposal: *“we believe that overall the Customer Forum has assisted in focussing AusNet Services’ attention on the priorities of consumers, which has had a positive impact on the development of its regulatory proposal. This has resulted in a demonstrated cultural shift in AusNet Services’ approach to developing its regulatory proposals and putting customers at the heart of its decision making.”*⁷³
- **Proof of point.** As outlined in sections 4.2 and 4.3, the AER was broadly satisfied with the overall reasonableness of AusNet Services’ proposed capex and opex allowances: *“[...] once we made the adjustments to address changes in economic conditions, reclassification of some expenditures and corrections proposed by AusNet Services, the proposed capex forecast was in line with our top down analysis. [...] our assessment found that but for the unforeseen changes in economic conditions as a result of COVID-19 we would have been likely to accept the opex proposal.”*⁷⁴

⁶⁹ AER, Draft Decision – Overview, September 2020, page 50.

⁷⁰ AER, Draft Decision – Overview, September 2020, page 46.

⁷¹ AER, Draft Decision – Overview, September 2020, page 46.

⁷² AER, Draft Decision – Overview, September 2020, page 48.

⁷³ AER, Draft Decision – Overview, September 2020, page 51.

⁷⁴ AER, Draft Decision – Overview, September 2020, page 52.

Observation 1.7

The AER's Draft Decisions for other distribution networks suggest that other engagement processes also have the potential to perform well against these criteria.

An important consideration for our Final Evaluation Report is that other types of customer engagement approaches could also satisfy these criteria. For example, in its Draft Decision for Jemena, the AER also noted that the Peoples Panel established by the network also performed well on many of the AER's criteria, although it took quite a different approach to the New Reg process.

Nonetheless, the AER's Draft Decisions indicate that, at this stage, it considers that the Early Engagement process trialled by AusNet Services has, overall, performed most strongly against its assessment framework. We will revisit this observation in light of the revised regulatory proposals that the AER receives, and how it assesses the evidence that has been provided.

5. REFLECTIONS ON THE NEW REG PROCESS

The Final Evaluation Report will include a more comprehensive discussion of our views on whether there are changes to the New Reg process that could better achieve the trial objective. In this report, we offer some more limited observations on aspects of the trial process that may require further investigation if the New Reg process is adopted for future trials and/or regulatory determinations.

As discussed further in section 2.1.2, the trial had three main objectives, which are to:

- improve the speed and reduce the cost of the regulatory review process;
- enhance consumer confidence in the regulatory review process; and
- improve the overall outcomes of the regulatory review process with a view to promoting the long-term interests of consumers of electricity.⁷⁵

Below, we summarise our reflections on how four aspects of the AusNet Services New Reg trial process – establishment, determining the Scope of Negotiations, the overall staging of negotiations and the impact of the Early Engagement on different stakeholders’ confidence in the determination process, have contributed, or potentially hindered, achievement of the objectives. These reflections draw on our previous Insights Reports, and the observations set out in section 4.

We have made other observations on the New Reg process throughout the Insights Report. We do not cover these in detail in this report, although we will return to them in the Final Evaluation Report. However, for reference these insights are summarised in Appendix B.

5.1. ESTABLISHMENT OF THE TRIAL

Summary

There are risks associated with early engagement processes. Certain features of the New Reg process, that were established as part of the trial, thus far have appeared to mitigate these risks. However, some of these aspects may have contributed significantly to the resourcing requirements of the trial.

From the perspective of a network business considering whether to participate in an Early Engagement Process, there is an accompanying loss of certainty and degree of control over how customer preferences are reflected in the regulatory proposal. For example, in the New Reg process this results from the publication of both draft and final independent engagement reports by the Customer Forum, meaning that the network business will have only partial control over how its customer engagement process is represented. Further, reaching substantial agreement with a Customer Forum is not guaranteed in advance. Accordingly, the process could be seen to involve risks for the company: fundamental points of difference between the network and the Customer Forum would potentially result in a challenging context for the regulatory determination process with the AER. As noted in section 4.3, there are nonetheless offsetting incentives for a network business to participate in such a process.

Another risk in principle relates to the potential loss of transparency in the early engagement process if positions agreed between a Customer Forum and the network business are settled in non-public forums (for example, without a record of the basis for decisions or minutes). There is also the risk that the process simply increases the regulatory burden of the revenue control process, if AER staff need to be closely involved in both the preparation of the regulatory proposal, and draft and final determinations.

Finally, there is also a risk of the Customer Forum being ‘captured’ by the regulated company – that is, not acting independently.

⁷⁵ MOU, *Recitals*, page 1.

Based on our insights and observations on the New Reg Trial to date, thus far the trial appears to have largely avoided these risks. There are particular aspects of the process that we consider may have supported this outcome. For example:

- Clarity in the roles and responsibilities of the parties and governance arrangements (such as the – unused – process for escalating disputes), as set out in the MOU, appear to have provided the parties with a degree of certainty around how the process would play out.⁷⁶
- There has been ‘structure’ to the dynamic conversation, which may have helped to mitigate some of the risks noted above. For example, AER staff have provided guidance throughout the process, that appears to have supported the parties in structuring their negotiations and evidencing positions in a way that the regulator has generally found useful (see section 4.4 and Insight 3.4).
- The interim and final engagement reports produced by the Customer Forum, and the records of discussions published on AusNet Services’ website, have provided transparency around how negotiated positions were reached. See Insights 1.6 and 2.6.
- The view of the AER and stakeholders, as referenced in our earlier Insights Reports, has indicated that the Customer Forum has generally demonstrated independence from AusNet Services. See Insights 2.2 and 3.2 in Appendix B.

At the same time, our Insights Reports referenced some evidence that the process has been relatively burdensome for the AER, in particular during the early stages of the negotiations. For example, in our first Insights Report we noted that *“AER Staff have indicated that while the AER has allocated sufficient resources, they have found it challenging to mobilise appropriate staff to comment on relevant AusNet material, because limited time had been provided to review that material in advance of Forum meetings”* (Insight 1.11).

While we will consider this issue further when information on the parties’ costs of participating in the trial are finalised, this may indicate that amendments to the process might need to be considered in future if there was a desire to make the process more ‘scalable’ (i.e. capable of being applied efficiently across multiple network businesses). A key challenge will be to consider how this can be achieved, while preserving the advantages identified in the original New Reg process. We consider this in relation to one particular aspect of the New Reg process – the Scope of Negotiations – in the following section.

5.2. THE SCOPE OF NEGOTIATIONS

Summary

Experience from the trial indicates that a flexible scope adds value to the process. However, amendments to other aspects of the process could be considered to ensure that scope flexibility does not create an excessive resourcing burden. These options should be considered together with the overall staging of the Early Engagement Process, discussed in section 0.

The New Reg process involves the AER, AusNet Services and the Customer Forum agreeing a Scope of Negotiation. The Scope of Negotiation is intended to help ensure that negotiations are kept to those matters within the boundaries of the NER and NEL, to help with the efficiency of the process, and to ensure sufficient resourcing.

In its Early Engagement Plan, AusNet Services proposed a set of criteria for determining the Scope of Negotiation. This provided a flexible route to agree the scope of the matters to be covered. However, for this trial the Scope of Negotiation was agreed without significant input from the Customer Forum and before customers’ perspectives or priorities were researched. Therefore, while the criteria provided flexibility, this may have not been utilised to its fullest potential, particularly considering the timing of when the Scope of Negotiation was agreed.

⁷⁶ For example, refer to Insights 1.1 and 1.2 in Appendix B.

However, the New Reg process also provided the Customer Forum and AusNet Services with the ability to negotiate on topics outside of the Scope of Negotiation, although discussions on topics outside of this scope would not be supported by in-depth guidance from AER staff. As noted in the Insights Reports, the Customer Forum and AusNet Services did agree to discuss matters that were not categorised as ‘in scope’ (i.e. explicitly AER staff assisted). The two parties have indicated that they valued this flexibility.

As noted in our third Insights Report, this suggests that in future applications of the New Reg process, there could be benefits from retaining the MOU provisions that allowed changes to the Scope of Negotiations, and also allowed the Customer Forum and AusNet Services to agree to negotiate on matters outside this scope. This provides flexibility for the negotiations to evolve as the Customer Forum gains familiarity with the material and forms a clearer understanding of where customers’ perspectives can add value to the regulatory process.

At the same time, this will need to be balanced against the practical implications of a dynamic scope in terms of the support required from AER staff and the DNSP. As noted in the preceding section, experience from the early stages of the trial indicates that a flexible scope of negotiations can pose some resourcing challenges. Therefore, mindful that one objective of the trial was to reduce the time and cost of the determination process, it may be appropriate to consider changes to other aspects of the process to support this.

While we will reflect further on this issue in developing our Final Evaluation, we have identified the following considerations for further exploration:

- **The skill set of the Customer Forum.** For example, greater familiarity with the NER / NEL requirements and the AER’s assessment process could, potentially, reduce the need for guidance from AER staff throughout the process. Although initial discussions on the composition of the Customer Forum emphasised the value of ‘fresh’ perspectives, the Customer Forum has also noted that there would be benefit from having access to someone with prior experience in the process.⁷⁷
- **A defined period of scope refinement.** If an alternative staging process were adopted (see section 5.3), this could potentially permit a longer period of exploration and discussion on the scope, before a final, fixed Scope of Negotiations is agreed and formal negotiations on the regulatory proposal commence.
- **Refined criteria for including a matter within the Scope of Negotiations.** As noted in section 4.4, the weight that the AER was able to place on agreed positions varied. For example, this was particularly the case where the Customer Forum spent time considering expenditure items that AusNet Services considered were mandatory, and arrived at a position that AER should determine if the expenditure was efficient. It may therefore be appropriate to revisit the criteria for determining the scope of negotiations that were developed by AusNet Services at the outset of the trial to reflect these learnings. It is also relevant to note that a Customer Forum may not necessarily need to negotiate directly on a particular cost item, or comment on its efficiency, for customer preferences to be adequately and clearly reflected in the regulatory proposal. For example, AusNet Services has noted the Customer Forum’s impact on its overall capex proposal, although much of this was not expressly considered in the negotiations.
- **Active review of the scope as the negotiations progress.** For example, the process may need to clarify when / how topics for negotiation should be dropped if the parties consider that they are not likely to reach a meaningful negotiated position. Comparing the initial discussions on scope with the evidence produced through the trial indicates that it can be challenging to determine at a very early stage what issues a Customer Forum can and cannot deliver meaningful views on. For example, although innovation was not in the Scope of Negotiations agreed with the AER, the Customer Forum and AusNet Services were ultimately able to reach agreement on this issue that was accepted in the Draft Decision. On the other hand, opex, broadly, was included in the agreed scope on the basis that it would likely involve substantial price – service level trade-offs. However, this issue was not a particular feature of the negotiations for this trial,

⁷⁷ Farrieswier, Stage 3 Monitoring Report, page 29.

perhaps due to the nature of the opex forecast components that were proposed in this determination. This is not to say particular issues should be ruled out of scope based on the evidence from this trial alone. However, it could suggest that a change in process may help the parties in defining a scope of negotiations that will provide the most value to the regulatory determination.

- **Clarification of the process to define the scope.** For example, the MOU (or equivalent) could set out how scope is to be agreed, how changes can be formally agreed and how scope changes affect the roles of different parties. For example, we note that the MOU did not specifically deal with how AER staff would provide support on topics that AusNet Services and the Customer Forum decided to discuss without the AER's agreement to include these in the formal Scope of Negotiations.

5.3. STAGING OF THE NEGOTIATIONS

Summary

The ability for the New Reg process to enable the early involvement of customers in the development of a network's business plan is valuable, as it allows strategic or contentious issues to be aired at an early stage, so that they can be addressed. There may be opportunities for the New Reg model to retain this feature, while also improving the efficiency of the process.

A desired outcome of the New Reg process is to “create a basis on which the regulator can be involved early and assist the network and consumers to reach an agreement to which the AER can have regard to when considering the network's revenue proposal.”⁷⁸ As discussed in section 4.3, the outcomes of the trial thus far suggest that the process has been relatively successful in identifying material issues, and for the most part resolving these, at an early stage. A key advantage of an early engagement process may be that strategic, or contentious, issues can be ‘brought to the table’ quickly, increasing the likelihood that they can be resolved.

For example, the experience from this trial can be contrasted to the Challenge Group established under Ofgem's RIIO-2 process.⁷⁹ In this case, the Challenge Group evaluated developed business plans of the network companies relatively late on in the process of their development. The Challenge Group had the skills and experience to raise fundamental questions of the plans, which they did – for example, in relation to the need for the ongoing programme to replace iron gas mains in the gas distribution sector. However, the phasing of the Challenge Group's involvement in the process meant any fundamental issues it raised came relatively late in the process and within a limited time period that the Challenge Group had available to review and discuss the plans with the network companies.⁸⁰ An Early Engagement Process, underpinned by an experienced Customer Forum with the necessary skill set, can in principle help to address this by bringing issues to the table earlier.

There are, however, also trade-offs associated with early engagement. In particular, the Customer Forum has noted that agreeing expenditure levels was difficult given the moving nature of AusNet Services' forecasts. AusNet Services noted that estimates will move around as the network is trying to establish expenditure estimates eighteen months or more before they are due to be incurred, and some estimates will not be finalised until close to the submission of its Regulatory Proposal. This appears to have presented challenges in meeting certain requirements of the process. For example, the MOU stated that the Interim Engagement Report would set out the Customer Forum's initial positions (i.e., the extent of agreement or disagreement between the parties). However, due to the timing issues noted above, at the time of the Interim Engagement Report the Customer Forum had not been able to reach an initial position on some matters. The Customer Forum considered that in hindsight it would have excluded numbers from the Interim Engagement Report.

⁷⁸ Approach Paper, page 9.

⁷⁹ See Appendix C for further discussion.

⁸⁰ See discussion in Complete Strategy (January 2020): ‘The RIIO-2 Challenge Group report: useful, in part!’ <https://complete-strategy.com/2020/01/31/the-riio-2-challenge-group-report-useful-in-part/>

These trade-offs raise questions to explore on whether an alternative phasing of the New Reg process could retain the identified advantages, while reducing some of the less desirable outcomes.

In its interview for the third Monitoring Report, the Customer Forum stated that a two-stage engagement with customers may have been better, where it assessed the need, before presenting options that were costed out in more detail. For example, such a process could involve:

- In **Step 1** – the company and Customer Forum would focus on broader envelopes of forecast spend – capex and opex – and customer preferences on outputs and the need for spend.
- In **Step 2** – the company and Customer Forum would take a deeper dive into the expected efficiency of the spend associated with the regulatory proposal, with a focus on particular areas where the parties agree that they are likely to reach meaningful agreement.

This may be an approach that merits consideration in future New Reg processes. Potential benefits of this approach are that:

- A staged process may provide opportunities for the parties to agree the Scope of Negotiations on a more informed basis (i.e. to more easily rule out areas where a negotiation on the cost of specific expenditure items may not produce useful information).
- It could allow for customer engagement to provide evidence on the services and/or service levels that customers require, in a way that is unduly not shaped by the building blocks framework.

This needs to be balanced against the potential additional complexity of a two-stage process and the possible drawbacks of delineating discussions on customer preferences on outputs, the need case for programmes of expenditure, and the negotiations on the level of expenditure itself. The MOU would need to clearly set out the expected stage 1 and 2 delineation which could, in certain circumstances, lead to a less clear and satisfactory process for all parties. An advantage of the approach followed in the New Reg Trial is the focus of the negotiations provided a degree of discipline to focus on the end goal of reaching well evidenced negotiation positions that can impact the revenue proposals, rather than only general customer engagement of required outputs.

In the Final Evaluation Report, we will consider customer engagement approaches from energy networks and sectors to form a view on a spectrum of alternative staging arrangements.

5.4. CONFIDENCE IN THE CONSUMER ENGAGEMENT STRATEGY

There is some indication from the New Reg Trial to date that the Early Engagement process has helped to enhance confidence of consumers, consumer advocates and other stakeholders in AusNet Services' consumer engagement strategy and more generally the regulatory review process. This should help to enhance the overall consumer legitimacy of the determination process.

The AER's CCP commented that:

*"We recognise that this trial has exposed AusNet Services to a degree of transparency and scrutiny of its operations beyond that which has been observed in any other regulatory process to date ... It is our view that the AusNet Services' Regulatory Proposal strongly reflects customer perspectives for those aspects within scope for the Customer Forum. It is also clear that the Customer Forum, with its laser-like focus on customer service, has influenced and accelerated a major change in culture and approach within the AusNet Services business. We have observed a genuine commitment by AusNet Services to drive the necessary changes through the business which will deliver better service outcomes for customers."*⁸¹

⁸¹ CCP17, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, pages 18 -19.

Our Third Insight Report noted that the majority of respondents to a commissioned customer and customer advocate survey considered that the Customer Forum was independent from AusNet Services in its engagement and representation, and was considered to have operated in an open and engaging way.⁸²

Consumer bodies, including ECA and the Energy Users Association of Australia (EUAA) commenting that “[t]he Customer Forum undertook extensive engagement itself which brought the ‘voice of the customer’ to the table and challenged AusNet’s assumptions. The Customer Forum has shown how people from different walks of life, who are not energy experts, can effectively scrutinise elements of a regulatory proposal”⁸³ and “AusNet is to be congratulated for taking on the New Reg trial. It was prepared to take on the risks associated with a major change from conventional consumer engagement and lay itself open to the extensive scrutiny that came with the trial. AusNet recognised that it needed significant change in its approach to customer engagement and the Forum has provided the mechanism for that paradigm change.”⁸⁴

While for the most part stakeholders appear to have considered that the Early Engagement Process helped to enhance the consumer engagement strategy, there has been some differing views:

- on the justification for the positions that the Customer Forum took on certain issues; and
- the Forum’s level of engagement with certain stakeholder groups during the course of the negotiation process.

For example, both the CCP and the EUAA queried whether the Customer Forum was in a position to assess the overall reasonableness of AusNet Services’ revenue proposal given the Customer Forum’s limited scope for negotiation, e.g. without being able to consider factors such as accelerated depreciation.⁸⁵ Some stakeholders also indicated that they would have appreciated more interaction with the Customer Forum as part of the engagement and a greater focus in the negotiation proceedings on the needs of certain customer groups.⁸⁶ One stakeholder (Victorian Greenhouse Alliances) also noted that the replicability of the New Reg Trial pilot is likely to be highly dependent on the skills and experience of the Customer Forum representatives.⁸⁷

In its Issue Paper, the AER requested stakeholder feedback on “*the extent to which AusNet’s proposal opex and capex are amenable to assessment at the total level with less detailed assessment at the level of capex and opex components, compared to other Victorian DNSPs’ proposals*”.⁸⁸ It is interesting to note that stakeholders had varying views on the extent to which AusNet Services’ participation in the New Reg trial meant that the AER should focus on a more top-down assessment. For example, the EUAA noted while that there “*may be a case for a lighter AER touch*” for topics of negotiation that were supported by AER staff, this should not apply to other topics that were discussed by AusNet Services and the Customer Forum. However, the EUAA also noted that this view depended on what a lighter touch assessment would consist of.⁸⁹ In contrast, the Victorian Community Organisations considered that in light of the “*limitations to which a distributor-led customer engagement process can be taken as a direct reflection of the customer base’s priorities*” meant that “*applying a standard approach to the valuation of revenue proposals by the regulator will remain an important aspect of the determination process*”.⁹⁰

⁸² CEPA (2020): ‘New Reg: AusNet Services Trial: Insights Report 3: Conclusion of the Early Engagement Process, AER’, p. 10

⁸³ ECA, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 14.

⁸⁴ EUAA, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 1.

⁸⁵ CCP, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 19.

⁸⁶ EUAA, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 15.

⁸⁷ Victorian Greenhouse Alliances, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 41.

⁸⁸ AER, Issues Paper – Victorian electricity distribution determination 2021-26, April 2020, page 5.

⁸⁹ EUAA, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 2.

⁹⁰ Victorian Community Organisations, Submission on the Victorian Electricity Distribution Proposal 2021-16, June 2020, page 15.

Building on other reflections we have set out above, many of these comments highlight the importance of the scoping phase to the overall success of the Early Engagement Process, i.e. the agreed scope of the negotiation, the level and form of expected engagement with different stakeholder groups over the course of the negotiations and the composition of the Customer Forum itself. Ensuring that the effective establishment of an Early Engagement Plan and the early operation of the engagement would seem to be critical to the overall success, and the confidence in the consumer engagement strategy adopted, leading into the AER's determination process.

There might be ways to enhance this in future, for example, by introducing clearer statements in the MOU or Early Engagement Plan on how customer advocates and the networks' Customer Consultative Committee are expected to be involved in the process. While consideration was certainly given to these issues (e.g. as part of the preparation of the trial's Early Engagement Plan) there may be opportunities to improve clarity as part of future Early Engagement processes. Given the apparent importance of an effective start to the Early Engagement process, it may be worth considering retaining the key role that the AER played in AusNet Services' trial in helping to establish the engagement plan and the expected scope of negotiations.

6. INTERACTIONS WITH THE NEL AND NER

In addition to the broad requirement to issue a determination that achieves the NEO, the NER prescribe certain specific aspects of the regulatory determination process that the AER must follow. In the third Monitoring Report, AusNet Services and the Customer Forum noted instances where, based on their experience during the trial, in their view these requirements (or the AER's interpretation of these) created a degree of inflexibility that could prevent the acceptance of proposals that customers support.⁹¹ In their joint submission to the AEMC's 2020 electricity network economic regulatory framework review, the AER, Energy Networks Australia and ECA have also identified some areas of the framework that may, in their view, be overly restrictive.⁹²

Our initial observations on the key issues identified by the trial participants are set out in this section. These observations are not intended to present a definitive position at this stage, but rather to highlight questions that we intend to explore in the Final Evaluation Report. The Final Evaluation Report will also include a more comprehensive discussion of the costs and challenges of implementing the New Reg process more widely (should the final evaluation indicate that this is desirable), including any constraints in the NEL and NER.

6.1. ACCOMMODATING NEGOTIATED POSITIONS

Outcomes from the trial

In the third Monitoring Report, AusNet Services and the Customer Forum noted instances where, during the negotiations, AER staff provided guidance indicating that the direction of negotiations might not produce an outcome that could be accepted within the boundaries of the NEL and the NER.

For example, in relation to innovation funding AusNet Services observed that:

"The AER indicated that under the NER, they were unable to approve a funding bucket for innovation, but needed to assess and approve individual projects. This impacted the negotiation with the forum as we focussed on the detail of specific innovation projects, whereas the Forum had previously been comfortable with an innovation allowance, with projects to be determined via a customer-centric governance mechanism.

...

Regardless of the interpretation of the existing Rules, the idea of the innovation allowance was supported by customers and the Customer Forum (with appropriate governance and sharing of learnings across the industry). If an agreement such as this can be shown to be supported by customers and is in customers' long-term interests, then there should be scope for the Rules to allow for the agreement to be upheld."⁹³

Similarly, in relation to the revenue path, AusNet Services considered that:

"A similar constraint [to innovation] applied when agreeing the preferred price path with the Customer Forum. The Customer Forum based on their understanding of customer concerns about affordability are adamant that they want to deliver the greatest possible price cut at the start of the regulatory period. The AER staff are concerned about a potential breach of the [...] NER. [...] Again, there should

⁹¹ Farrierswier, Stage 3 Monitoring Report, page 41-42.

⁹² AER / Energy Networks Australia / ECA, Joint submission to approach paper, July 2020.

⁹³ Farrierswier, Stage 3 Monitoring Report, page 41.

*be scope for the AER to accept agreements supported by customers and that are aligned with the long term interests of customers.*⁹⁴

The Customer Forum's perspective on this issue was that:

*"We felt that for some time at least there was questionable value in the inclusion of Price Path [in our scope] because the AER staff's position seemed for some months to be that rules prevented it from allowing too big a price decrease in the first year. While we appreciate that the process for setting prices has rules it struck us as unproductive to be encouraging us, on behalf of customers, to be looking at an outcome that would, at least in the period under review, fall short of their expectations (i.e. the bigger the price decrease in first year the better)."*⁹⁵

In addition to the issues raised by AusNet Services and the Customer Forum, in seeking to implement the CSIS agreed between the parties, the AER identified that the NER could potentially accommodate this position under the small scale incentive scheme provisions.⁹⁶ However, the AER noted that to apply these provisions, the NER require it to undertake a national consultation (as opposed to, for example, consulting only within AusNet Service's region). Ultimately, we note the AER was able to implement a flexible CSIS that provides a framework for other networks to adapt to their context. Nonetheless, AER staff have indicated to us that the requirements of the NER, as interpreted by the AER, may have resulted in a relatively onerous process that could have hindered the AER from giving effect, in a timely manner, to an agreed position that the AER considered to be in the interests of consumers.

Initial reflections

As noted in section 2.1, the New Reg Directions Paper envisaged that the Early Engagement Process would inform and complement, but not replace, the regulatory assessment of the networks' business plans. Accordingly, while as part of the process the AER will have regard to the positions reached, agreements between the parties will not be binding on the AER. We note that this is an important element of the process, that is intended to maintain appropriate discipline on the parties to not only reach agreement, but to do so in a way that is well-evidenced and demonstrably in the best interests of consumers.

Consequently, while it is possible that the AER, the Customer Forum, the network business and indeed other stakeholders may have different perspectives on what outcomes are in the long-term interest of consumers, and what is possible under the current framework, under the framework envisaged by New Reg the decision ultimately rests with the AER.

Accordingly, we consider that the appropriate question in evaluating the success of the trial is not whether the AER did or did not accept particular positions, but rather whether there is appropriate flexibility within the existing regulatory framework for the AER to implement proposals that it considers to be consistent with consumers' long-term interests. At this stage of the trial process, considering the views put forward by trial participants, our reading of the evidence suggests that:

- In making its Draft Decision following an Early Engagement Process, the AER appears to have faced some constraints in accepting positions that the Customer Forum considered to reflect the preferences of AusNet Services' customers. For example, based on its interpretation of the NER, the AER was not able to adopt the revenue path agreed between the Customer Forum and AusNet Services, which maximised the reduction in allowed revenue in the first year of the price control. Based on our reading of the Draft Decision, it is not necessarily clear that the AER would have accepted the negotiated revenue path as being in the long term interest of consumers, had the NER provided it with the freedom to do so.

⁹⁴ Farrierswier, Stage 3 Monitoring Report, page 42.

⁹⁵ Farrierswier, Stage 3 Monitoring Report, page 42.

⁹⁶ AER, Staff Guidance Note 3.

- Nonetheless, there may be scope to consider how the regulatory framework could better facilitate the implementation of proposals that are tailored to a particular network and its customers following a process of Early Engagement. We will consider this question further at the Final Evaluation phase, based on the full evidence from the Final Decision.

6.2. BUILDING BLOCKS STRUCTURE

Outcomes from the trial

The New Reg Directions Paper envisaged that:

“Maximising flexibility for the Consumer Forum and the business to think across different elements of a building block proposal could allow more space for creative trade-offs and ‘win-win’ outcomes. It is acknowledged that there may be, as a result of external policy decisions, matters that automatically fall outside the scope, such as Rate of Return under a future binding guideline, or reliability standards where these are state-based. There may also be matters that the network otherwise feels it will not be able to ‘negotiate’ or ‘trade-off’ (such as mandated safety and universal service obligations).”⁹⁷

However, for this trial the structure of the negotiations largely followed the building blocks approach. Further, the Interim Engagement Report was, to a large extent, laid out like a negotiation on each building block, i.e. assessing items under the operating expenditure (opex) block, the augmentation expenditure (augex) block, the major replacement expenditure (repep) block, etc. Effectively, this led to a more ‘bottom up’ discussion on AusNet Services’ regulatory proposal. There appear to have been both advantages and disadvantages to this approach:

- The Customer Forum noted that it was challenging to agree proposals on all building blocks items at the time of the Interim Engagement Report, given uncertainties around cost proposals for some items. Accordingly, requiring the Customer Forum to structure its findings in this way may not have been helpful at that stage of the process.
- As noted in section 4.4, on some building blocks components, the agreed positions were quite general, with the Customer Forum providing ‘in principle’ agreement subject to the AER’s efficiency assessment. Accordingly, it is worth considering whether requiring the Customer Forum to express its positions in this way added value to the process.
- At the same time, the structure of the Engagement Report appears to have helped the AER to use the evidence provided by the Customer Forum in making its decision. For example, the AER’s Draft Decision has noted that the report assisted it to readily identify areas of agreement.

Initial reflections

More broadly, we note that the Customer Forum and AusNet Services were not constrained to discussing elements of the building blocks model. In particular, the parties agreed to consider customer service levels, reflecting the Customer Forum’s view that this issue was not adequately captured by the determination process. Indeed, the consideration of these issues by the Customer Forum may indicate a need to re-evaluate how the outcomes that customers want to see are identified through the regulatory framework.

Overall, this may suggest that:

- It is appropriate that future Customer Forums’ have the ability to consider non-building blocks issues that relate to the provision of regulated services, as this may allow for the identification of potential improvements to the regulatory framework.

⁹⁷ Directions Paper, page 11.

- There is a need to consider whether a separate and/or additional process in the regulatory framework is required to ensure that service levels are appropriately identified and reflected in companies' business plans.

6.3. ASSESSMENT PROCESS

Outcomes from the trial

As noted above, the ability of the AER to reject agreed positions is an important feature of the New Reg process, as it maintains appropriate discipline and focus of both parties on reaching an agreement on a proposal that is in the long term interest of consumers, rather than simply agreement. This point notwithstanding, an objective of the New Reg Trial is to reduce the time and cost associated with the regulatory assessment process. With this objective in mind, it may be appropriate to consider whether there is scope within the regulatory framework to appropriately 'reward' a network that has worked with its customers to produce a high-quality business plan.

The New Reg process envisaged the AER could adopt an expedited process to the Final Decision, if it considered that this was justified. Further, the Directions Paper noted that:

"Going forward, as confidence grows in the robustness of the Early Engagement Process, the AER may, where it considers appropriate, shorten its determination process—although some limitations exist under the Rules. It is acknowledged that the prospect of a shortened and less costly revenue determination process is one important incentive for a business to undertake a trial of the Early Engagement Process".⁹⁸

Initial reflections

It is too early to assess whether the AER will decide that the evidence from this trial is sufficient for it to adopt a lighter touch review as part of the Final Decision process and what might be required from the outcomes of the Early Engagement Process in order for the AER to decide – as part of future regulatory determinations – to adopt an expedited process at an early stage – e.g. in reaching a draft determination.

However, more broadly, we note that the existing regulatory framework may place some constraints on the extent to which the AER is able to adopt an expedited process. For example, the NER contain a number of specific requirements in relation to the type of consultation the AER must undertake as part of its determination process, and the timing of this consultation. These may reduce flexibility in terms of the timeframes for the AER to make its decisions. Accordingly, it may be appropriate to consider whether it is appropriate for the AER to have greater discretion in this area in future. We note that this question is not solely related to the New Reg process. As noted in section 4.5, it is possible that different approaches could also perform well against the factors the AER has considered in assessing approaches to customer engagement.

In considering what type, or degree of flexibility is appropriate, it is interesting to contrast New Reg with the approaches that regulators in other jurisdictions have adopted to incentivise companies to 'put their best foot forward' in developing proposals that incorporate consumers priorities and perspectives. A summary of the evolution of 'fast track' assessments used by Ofgem and Ofwat in the UK, and Ofgem's subsequent shift to a financial incentive-based mechanism, is provided in Appendix C. The experiences of these regulators provide learnings that would need to be considered, should a similar approach be considered in Australia. For example, if a fast-tracking approach were taken, a key question is how to deal with material changes in circumstances following a fast-tracked determination (the COVID pandemic being one such example).

We will revisit this issue in the Final Evaluation Report, which will be informed by AusNet Services' revised regulatory proposal, the process the AER follows to establish its Final Decision, and trial participants' estimated costs. In particular, we think that it will be relevant to consider the following issues:

⁹⁸ Directions Paper, page 12.

- How the evidence provided by the Engagement Report informs the AER's decision on the Final Decision process, in combination with the other evidence before the AER.
- Whether the AER considers that the evidence provided could support an expedited review for both the Draft and Final Decision, in future applications of the New Reg process.

Appendix A TRIAL EVALUATION FRAMEWORK

In our 2018 Trial Evaluation Framework, we set out our trial assessment factors.⁹⁹ We have reproduced these in the table below. The purpose of the evaluation framework, using the Trial Assessment Factors, is to evaluate whether the outcomes of the AusNet Services trial met, or partially met, the various objectives set out above for the trial and the New Reg process more generally.

Table App A.1: Trial Assessment Factors (sub-factors in no particular order)

Factor	Sub-factors
Process	
Engagement and representation - Did the Forum provide improved information to AusNet on its customers' perspectives and preferences?	Did the different parties understand their roles and responsibilities?
	Was the Forum an effective representative of a wider consumer group?
	Did the engagement process provide the parties with sufficient time to undertake their roles and responsibilities?
Scope and negotiations - Did the Forum adequately and appropriately represent customers' perspectives and preferences during the negotiations?	Was the 'Scope of Negotiations' appropriate?
	Did the Forum understand, and did they have the ability to negotiate, the topic/ issues?
	Were the negotiations conducted in an appropriate manner?
Outcomes	
Impact on the content of regulatory proceedings – What customer priorities and preferences did the New Reg process identify?	What customer priorities and preferences were identified and negotiated during the trial process? Did these priorities and preferences reflect all or a subset of AusNet's customers? Did these represent the long-term interests of consumers?
	Did early engagement influence the focus areas for the regulatory review? To what extent did customer engagement, and therefore customers' priorities and preferences, drive the focus of the Forum and AusNet's negotiations?
	Did the negotiation between the Forum and AusNet lead to any new and/or innovative issues, driven by stated preferences of customers, forming part of the regulatory outcomes of the proceedings?
Impact on the AusNet proposal – How did the Forum's negotiations impact AusNet's final regulatory proposals?	Did AusNet adopt all or only parts of the negotiated positions set out in the Forum's Engagement Report(s)? Where AusNet did not adopt the same position as the Forum, what was the rationale for this?
	How did AusNet reflect the negotiated positions of the Forum and customers' priorities and stated preferences in the presentation and content of its final regulatory proposal?

⁹⁹ CEPA (2018). Available here: <https://www.aer.gov.au/system/files/D18-177714%20New%20Reg%20AusNet%20Trial%20-%20Trial%20Assessment%20Factors.PDF>

Factor	Sub-factors
Impact on the determination(s) - Did the AER's determinations benefit from the Forum's negotiations (the Engagement Reports)?	To what extent did AER's draft and final determination(s) reflect the engagement and negotiations between AusNet and the Forum? <hr/> Where the AER adopted a different position to the negotiated positions and outcomes of the early engagement process, what was the reason for this? <hr/> To what extent did the AER consider the negotiated positions in the Forum's Engagement Report provided an effective evidence base for its determinations and were in the best interests of AusNet's customers? <hr/> Did the AER consider that AusNet's final regulatory proposal 'better' reflected and presented the customer perspectives and preferences?
Learnings	
Overall - Did the New Reg process lead to the achievement of the NEO? If so was this achieved in an efficient way? Does the current NER allow AER to consider properly the outcomes of the New Reg process?	Is the New Reg process likely to achieve its objective? (Drawing on the assessment of the 'Process' and 'Outcomes' factors). <hr/> Were there any secondary benefits? <hr/> Were the overall regulatory outcomes from the process considered to be in the interest of AusNet's customers? <hr/> Are there amendments to the process, such as the removal of barriers, that could be made to better achieve the Project Objective? <hr/> Were there improvements in the engagement between the AER and AusNet? Did this lead to a 'better' and/or more efficient process, and therefore outcome? <hr/> Are there findings that could improve the AER's process and/ or Rules changes? <hr/> What are the costs and challenges (including any constraints in the NEL/NER) of implementing the New Reg process, therefore the overall net benefit/cost?

There are a number of factors and limitations that impact on our evaluation of New Reg.

We do not think that the outcome of the AusNet Services trial could be meaningfully compared to the outcomes of other determinations the AER is making at a similar time. This is because different network companies face different circumstances, and their customers may have different expectations. As such, differences in outcome may not necessarily reflect differences in process. Similarly, we do not think that the outcome of the New Reg Trial can be meaningfully compared to the outcome of AusNet Service's determination for 2016-20. This is because the two determinations would have taken place amid different circumstances for the network (e.g. in terms of utilisation), for customers and for the AER (e.g. the removal of the tribunal appeals process).

We instead proposed, in part, to assess the outcomes of the trial based on the views of AusNet Service and the Customer Forum as to what the counterfactual might have been if the Customer Forum did not exist. We will also give regard to best practice regulatory principles and other international precedent of economic regulation of network utilities. Our assessment will be largely qualitative. It relies on our judgement, and the stakeholders' views on the process and outcomes, and the AER's decisions.

Since the AER is responsible for ensuring that the NEO is met and the NEL is followed, we are not evaluating the AER's Draft and Final Decisions. Instead, we are evaluating the impact of the New Reg process on the AER's determinations.

Appendix B SUMMARY OF INSIGHTS REPORTS

In the table below, we have reproduced our insights from each of the three Insights Reports. The first number of each insight indicates the report it came from.

Table_App B.1: Summary of insights

New Reg process step	Insights
1. A network business may propose to the AER to undertake an Early Engagement Process to develop its regulatory proposal.	Insight 1.1. The Network Service Provider (NSP) elects to follow the New Reg process. The status of New Reg and AER's role in the process is likely to be critical to its current and future success and for the NSP to elect to participate.
2. If a network business decides to pursue the Early Engagement Process, it would submit an Early Engagement Plan to the AER. This would draw on informal discussions and consultation with the AER, the network business' existing consumer relationships and Energy Consumers Australia (ECA). The Plan outlines the process the business intends to undertake to develop its regulatory proposal, including:	Insight 1.2. AusNet prepared an Early Engagement Plan that covered the required issues. We note that AusNet followed relatively closely the guidance in the Directions Paper in its Early Engagement Plan. As set out in Insight 1.7, AusNet, the Customer Forum ('Forum') and AER were able to agree a Memorandum of Understanding (MOU) that reflected the majority of the directions laid out in the Plan, indicating that the Plan was well thought out.
a. establishment of a consumer representative group (Customer Forum) which the network would resource and fund	
b. high-level scope of matters proposed to be considered within the Early Engagement Process	
c. process of dialogue and engagement that will be followed by the network business and Customer Forum	
d. role and expectations of the AER to support the Early Engagement Process.	
3. The Customer Forum should:	
a. represent, 'bring' the perspectives of, and act on behalf of all consumer voices (large and small), having regard to the long-term interests of current and future consumers	Insight 1.3. The Forum's involvement has led to a meaningful change in AusNet's planned customer research programme. We consider that the reasons provided for this change - namely to gain a better understanding of a wider range of residential customers' perspectives and to ensure specific business customer research is undertaken - indicate that the Forum has the influence to affect AusNet's strategy for engaging with consumers and understanding their perspectives. Later stages of the trial will demonstrate how the Forum's impact on the customer research programme will influence the negotiations. Insight 2.1. The Customer Forum appears to be providing a good conduit for consumers' perspectives. The Customer Forum has had a positive impact on AusNet Services' customer engagement and

identified areas/ processes where AusNet Services could improve its services. The Customer Forum has achieved this by working with AusNet Services to engage with a range of different types of customers in different locations.

Insight 3.1. While the Customer Forum has sought to balance the interests of current and future consumers (e.g. reviewing net present value estimates of capital expenditure projects), guidance might be improved on how the Customer Forum should evidence how it takes account of the longer-term interests of consumers

- b. be fully independent of the network business

Insight 1.4. AER Staff have indicated to us that the negotiated positions are likely to be more persuasive if, in addition to being evidence based, stakeholders view the Forum as making its decisions independently from AusNet. At this early stage of the process, in our opinion, the make-up of the Forum and the arrangements put in place should assist stakeholders in forming their views on the Forum's ability to reach negotiated positions independently.

Insight 2.2. The Customer Forum continues to appear to be acting independently of AusNet Services, and AER Staff are comfortable with the Customer Forum's independence. This is supported by the Customer Forum and AusNet Services commitment to publish material from and minutes of their meetings, and the Customer Forum and AusNet Services publishing their initial positions/ considerations for consultation.

Insight 3.2. The Customer Forum continues to appear to be acting independently of AusNet Services, and AER staff are comfortable with the Customer Forum's independence. The perception of this independence has been assisted by the Customer Forum's open engagement with customers and advocates, and through the publication of the interim engagement report.

- c. have the skills and expertise to serve the role of being a credible counterparty to the network business

Insight 1.5. Criteria for selecting the Forum were set out in the Early Engagement Plan, which was agreed by the AER and ECA. The AER and ECA also received and commented on a shortlist of candidates. The CVs of the Forum members indicate that they should have the skills to negotiate on behalf of customers. We note, no members have a background in electrical engineering or regulation. Therefore, for technical matters the Forum reaches a position on, it may need to demonstrate a clear link to external analysis to build confidence in any negotiated positions reached with AusNet.

Insight 2.3. The Customer Forum has focused its engagement (to date) on identifying and seeking commitments from AusNet Services on customer experience outcomes. It has also challenged AusNet Services to set out its works program better to demonstrate customer benefits. The Forum has utilised the skill set of its members to form these positions and influence AusNet Services Regulatory Proposal.

Insight 2.4. The Customer Forum has relied on AER Staff for a technical view on the efficiency of some of AusNet Services' proposed expenditure (in addition to requesting that AusNet Services engage technical support to provide it with an opinion on specific areas of AusNet Services' proposal). Given Insight 2.3, this has meant the Customer Forum's negotiated positions in the Initial Engagement Report have tended to focus on customer needs and desired outcomes rather than on the efficient level of expenditure the network operator should be allowed to deliver on these customer preferences and requirements.

Insight 2.5. Where the balance of focus and skill set of the Customer Forum should be in future New Reg processes may be an issue that

stakeholders wish to consider when initially defining the scope of the negotiations and membership of the Customer Forum.

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- d. operate in an open and engaging way to establish and maintain its legitimacy with consumers and the wider community.

Insight 1.6. The arrangements put in place provide a satisfactory level of transparency of the Forum’s deliberations during the New Reg process. At this stage in the process, in our view, transparency could be enhanced by making all minutes for meetings publicly available and having documents from all parties available in a single location.

Insight 2.6. The wider community in AusNet Services’ distribution area provided a mix of views in response to a survey. While there was no specific question in the survey on whether the Customer Forum was operating in an open and engaging way, both customers, one of the three advocates, and one (of one) community group considered that the Customer Forum was able to understand customers’ expectations, preferences and concerns. Also supporting an open and transparent process, as noted in Insight 2.2, is the publication of Customer Forum and AusNet Services meeting minutes and the Interim Engagement Report/ Draft Regulatory Proposal document for consultation.

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- 4. The AER will decide whether or not it accepts the proposed Early Engagement Plan. The AER may propose amendments to the Plan. If the AER accepts the Plan, it commits itself to be deeply involved in the Early Engagement Process.

Insight 1.7. The MOU broadly reflects the Early Engagement Plan, indicating that the AER was broadly accepting of the Plan.

Insight 3.3. Greater clarity is required on the close out procedures and the role of the Customer Forum post submission of the regulatory proposal.

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- a. This commitment is formalised through an ‘Engagement Agreement’ entered into by the business, the AER and the Customer Forum.

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- b. The Engagement Agreement sets out the roles and expectations of each of the parties, including the scope, funding arrangements, anticipated timelines, ‘off-ramps’ or termination conditions, and arrangements for a jointly conducted ex post review.

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- 5. It is anticipated that the early phases of engagement between the network business and Customer Forum will involve induction, training, and information sharing. The AER will be closely involved in providing background information including on network performance comparisons and previous related decisions, and guidance on AER assessment approaches and its statutory roles and responsibilities in revenue determination processes. Both the business and the Forum will do this in a way that does not require Forum members to have energy industry or regulatory expertise.

Insight 1.8. The extent of the training delivered by AusNet and AER Staff appears sufficient for the Forum at this stage. However, a flexible scope means that further training and information sharing may be required.

Insight 3.4. At the conclusion of the negotiation, the Customer Forum has indicated that it received adequate support from both AusNet Services and AER staff to allow it to fulfil its role and responsibilities. However, the Customer Forum has indicated that some areas of the training process (for example, revisiting some training during the negotiation period) and the ongoing level of administrative support could be improved, which will be taken into account during the evaluation.

6. The next step involves the business and Customer Forum scoping in detail the matters to be considered in the Early Engagement Process. This should also set out how the parties intend to collect information on the perspectives of customers (for example, through customer research or direct engagement) to inform their consideration of these matters. The scope of matters to be considered must be agreed between the business and Customer Forum, and accepted by the AER—although the AER may be more closely involved in the scoping phase for the purpose of a trial.

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- a. Ideally the business and Customer Forum can agree to the proposal as a whole—and that it fully reflects consumer perspectives and preferences wherever relevant. It is envisaged that the Early Engagement Process will, in principle, deal with any matter that may arise in a network business’ regulatory proposal. However, for reasons of practicality or due to regulatory constraints, certain matters may be taken ‘off the table’. For example, at least for a trial, some aspects of the proposal may be out of the business’ control due to government regulations or reliability standards, or are subject to a binding AER guideline.

Insight 1.9 In its Early Engagement Plan, AusNet proposed a set of criteria for determining the scope of the negotiations. This provided a flexible route to agree the scope of the matters to be covered. The Scope of Negotiation was agreed without significant input from the Forum and before customers’ perspectives or priorities were researched. The AER also appears to have used the criteria more to direct, based on AusNet’s proposals, what should be in the Scope of Negotiation rather than to agree them with AusNet. Therefore, while the criteria provided flexibility, this may have not been utilised to its fullest potential, particularly considering the timing of when the Scope of Negotiation was agreed.

Insight 1.10. The Scope of Negotiation is intended to help ensure that negotiations are kept to those matters within the boundaries of the NER/NEL, to help with the efficiency of the process, and to ensure sufficient resourcing. We agree that while providing guidance for the Scope of Negotiation is appropriate, a balance needs to be found between the boundaries placed on the parties and the ability for customers’ preferences to be raised during the process. We note that AusNet is negotiating with the Forum on matters that are outside of the Scope of Negotiations.

Insight 1.11. The AER is assigning sufficient resources to make the New Reg process work. AER Staff have indicated that while the AER has allocated sufficient resources, they have found it challenging to mobilise appropriate staff to comment on relevant AusNet material, because limited time had been provided to review that material in advance of Forum meetings. This process is for a single NSP. The AER may find it difficult to resource, and be responsive in a timely manner, if New Reg was undertaken by multiple NSPs, which may be in addition to the AER’s typical price determination process. The scalability of the process given benefits/ costs will be a key evaluation question.

Insight 2.7. The Customer Forum and AusNet Services consider that the scope of matters they are negotiating is appropriate. However, AER Staff noted that the monitoring/ evaluation should consider whether the expanded scope of matters (to those AER Staff considered were out of scope) was appropriate given the timelines of the trial.

Insight 2.8. While the Customer Forum has been able to rely on AER Staff for guidance on what is or isn’t consistent with how the regulatory framework currently functions, the Customer Forum set out a few positions in the Interim Engagement Report that AER Staff consider are potentially inconsistent with the framework (e.g. in relation to innovation and the CRM proposal). The positions were not wrong per se; however, it appeared that the Customer Forum, in forming these positions, either did not appreciate the technical interactions between different elements of the framework or what is feasible under the current regulatory framework. (We note that some of these issues relate to out of scope matters, please also refer to Insight 2.12.) The former could indicate that more (or more timely) regulatory technical support needs to be provided to the Customer Forum, and/ or additional experience/ skill set be incorporated in the Customer Forum’s membership, in future New Reg processes. The latter may provide an interesting insight into the appropriateness of the regulatory framework given new information on customer preferences, and will be considered in our evaluation.

Insight 3.5. In future applications of the New Reg process, there could be benefits from retaining the Memorandum of Understanding (MOU) provisions that allow changes to the Scope of Negotiations, and also allow the Customer Forum and AusNet Services to agree to negotiate on matters outside this scope. This provides flexibility for the

negotiations to evolve as the Customer Forum gains familiarity with the material and forms a clearer understanding of where customers' perspectives can add value to the regulatory process. To support this flexibility, the MOU could clarify how scope changes can be agreed and how scope changes affect the roles of different parties. This will need to be balanced against the practical implications of a dynamic scope in terms of the support required from AER staff and the DNSP.

Insight 3.6. The Customer Forum has used its experience not just to negotiate outcomes on behalf of customers for the upcoming regulatory period, but also to provide advice to the business on its operations and policies. This broader role undertaken by the Customer Forum, and the associated costs, will be considered as part of our trial evaluation.

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7. The Early Engagement Plan will specify how the Early Engagement Process will be carried out. Central to the Early Engagement Process is the idea of creating a 'dynamic conversation' between the network business and Customer Forum, supported by the AER, to achieve outcomes in the long term interests of consumers. These discussions should be structured with the aim of reaching agreements in a timely way. The AER needs to be assured that it has sufficient visibility during the Early Engagement Process that it can indicate that something will not be acceptable before it is submitted.

Insight 2.9. The Customer Forum noted that agreeing expenditure levels was difficult given the moving nature of AusNet Services' forecasts. The Customer Forum indicated that it may have left numbers out of its Interim Engagement Report if it had to do it again. AusNet Services noted that estimates will move around as the network is trying to establish expenditure estimates 18 months or more before they are due to be incurred, and some estimates will not be finalised until close to the submission of its Regulatory Proposal. This raises questions to explore on whether the phasing of the New Reg process as laid out in the MOU is appropriate.

Insight 2.10. The Customer Forum and AusNet Services originally envisaged that the Draft Engagement Report and Draft Regulatory Proposal would set out both parties' initial positions, and this was specified in the MOU. However, the Customer Forum has decided to treat the Draft Engagement Report as an interim one for consultative purposes. This indicates that the MOU could have provided greater flexibility for what the Draft Engagement Report needed to cover.

Insight 2.11. While bearing in mind that this is the first trial of New Reg and therefore no precedent has been established for what AER Staff are seeking in terms of justification for the positions reached, the publications of the reports have been important for AER Staff to provide their views on how the Customer Forum and AusNet Services have set out their positions and associated justification.

Insight 3.7. The Customer Forum considered that negotiations on expenditure levels were difficult, given that AusNet Services' expenditure forecasts were only able to be firmed up towards the end of the negotiating period. As noted in the second Insights Report, this raises questions to explore on whether the phasing of the New Reg process as laid out in the MOU is appropriate.

Insight 3.8. The overall (downward) price trajectory may have supported the ability of AusNet Services and the Customer Forum to reach agreed positions. Reaching agreed positions between both parties, including on quality of service improvements, may have been more difficult if AusNet Services' proposed price path was increasing. The overall context of the negotiations therefore needs to be considered when evaluating the ability of the New Reg process to support the parties in reaching agreed positions.

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- a. Throughout the engagement process, the AER will contribute to the process of reaching agreement by providing information and explaining issues through 'advice notes' and/or presentations that

Insight 1.12. At this stage in the process we cannot comment completely on this point. We do note that as of mid-June, the Forum and AusNet were satisfied with the advice provided by the AER. We note that the MOU appears to expand the AER's role slightly beyond the scope set out in the Directions paper, with the Forum being able to request "such information or resources necessary to analyse information provided to the Forum by AusNet Services."

communicate the ‘boundaries’ of the rules, and what it may consider as an acceptable regulatory outcome—consistent with AER guideline approaches. The AER may also identify aspects of a proposal that in its view would most benefit from consumer perspectives, including through customer research and wider stakeholder consultation.

Notwithstanding our Insights in relation to Step 6, this appears a sensible extension of the AER’s role.

Insight 2.12. The Customer Forum and AusNet Services are satisfied with the advice AER Staff have been providing. However, related to Insight 2.8, AER Staff noted that a number of the issues it has raised during the course of the negotiation process were related to matters outside the agreed Scope of Negotiation. AER Staff had not provided guidance notes for these matters. AER Staff have provided the Customer Forum with their views on the Interim Engagement Report and Draft Regulatory Proposal in Guidance Note 9 and continue to work with the Customer Forum on these points.

Insight 3.9. The Customer Forum were satisfied with the level of support provided by AER staff. However, AER staff provided support on topics they had originally considered to be out of scope (and therefore not originally budgeted for). The need for additional technical guidance on out of scope topics, and the resourcing implications of this, are an important consideration for the design of future New Reg processes.

- b. The Customer Forum should be resourced to communicate directly with end-customers, customer representatives, and other engagement channels and forums the network uses for its business-as-usual engagement, to elicit and understand their preferences, to carry out customer research (or help shape the business’ research program), and to communicate issues and trade-offs back to customers.

Insights 1.13. The Forum has provided meaningful strategic advice to AusNet on its customer research programme. By being heavily involved in directing AusNet research this provides comfort that the Forum has sufficient ability to communicate with customers. However, we have not yet canvassed the views of customer advocates and other customer representatives on the sufficiency of the Forum’s resources for customer research.

Insight 2.13. The Customer Forum has had sufficient resourcing to carry out its scope of work. However, it has noted that more administrative support may have made its role easier. Securing this type of support during the early stages of a New Reg process may be something that needs to be considered in future.

- 8. At the conclusion of the Early Engagement Process the parties submit an Engagement Report setting out the process followed and outcomes from the engagement. The Engagement Report is a critical input to the AER’s subsequent assessment of the regulatory proposal submitted by the network business, contributes to learning and improvement for future applications of the New Reg process, and supports accountability of the Customer Forum to the end-use consumers.

Insight 2.14. Based on the Interim Engagement Report, we consider that the Customer Forum provided justification to support some but not all of the initial positions it reached/ did not reach. We also note that it was not clear for some matters what position the Customer Forum had reached. To help achieve the objectives set out in the MOU, the Customer Forum, in justifying its final positions, needs to provide further linkages between its positions, customers’ preferences it has gathered during the negotiation process, and the achievement of the NEO. This will assist the AER in making its determination on whether the positions adopted by the Customer Forum contribute to the achievement of the NEO.

Insight 2.15. Interim Engagement Report was, to a large extent, structured like a negotiation on each building block, i.e., assessing items under the operating expenditure (opex) block, the augmentation expenditure (augex) block, the replacement expenditure (repex) block, etc. However, the Customer Forum, as noted in Insights 2.3, 2.4 and 2.5, has focused more on determining appropriate customer experience and outputs/ outcomes which don’t necessarily correspond neatly with individual building blocks.

We consider that more flexibility in terms of the structure of the report might be appropriate given how the Customer Forum approached its role (and how future Customer Forum may approach their roles). For example, the Customer Forum could set out the service outcomes required (in line with customer preferences), while leaving the assessment of the prudence and efficiency of specific expenditure

items to the AER. We will consider this issue further in future evaluation reports.

Insight 2.16. When read independently, we do not consider that the Draft Regulatory Proposal and the Interim Engagement Report always give the same impression of the positions reached by each party. Alternative procedural or other mechanisms for documenting agreements may be worth consideration to ensure that discrepancies, or perceived discrepancies, are dealt with.

sight 3.10. The feedback provided by AER staff on the structure of the Interim Engagement Report appears to have been helpful in shaping the format of the Final Engagement Report so that it more clearly evidences the rationale for the Customer Forum's positions. AER staff have noted that changes to the report structure have more clearly linked the Customer Forum's position to the requirements of the MOU. The MOU could in future include specific guidance on how both parties should set out which topics were agreed and which were not, to provide greater clarity to stakeholders.

Appendix C **FAST TRACKING IN UK REGULATION**

'Fast-tracking' is a term used by UK regulators for the procedure of allowing a regulated company to have their price control settlement agreed at an earlier stage than would otherwise be the case. Earlier settlement is achieved by submitting the company's proposed business plan to less scrutiny, following an assessment that this plan is well-justified and of high quality. The benefits of being fast-tracked for the company can (depending on the precise nature of the process) include:

- earlier certainty on the outcome of the upcoming price control – meaning companies can “spend less time on the price control review and more time on running their business”;¹⁰⁰
- outcomes and parameters (e.g. cost allowances, cost of capital rates) more in line with those proposed by the company;
- explicit financial rewards (for example, an additional component of return of regulated equity dependent on fast-tracking assessment); and
- reputational benefits of being signalled as providing a higher quality business plan relative to their peers.

These benefits are offered by the regulator in order to incentivise all the companies to submit higher quality business plans, including costs more reflective of the company's actual expectations of the price control period and plans that are underpinned by research of customer preferences and needs.

In this way, fast-tracking can be described as an 'information-revealing device' with the potential to drive down costs and lead to better outcomes for customers as companies compete with each other for the “best” plan. With higher quality company submissions, the regulator would then be able to apply reduce scrutiny with greater confidence, meaning a reduced regulatory burden during the price control process for both the company and the regulator. Higher quality submissions should also mean that companies are better tailoring their business plans and proposed outputs to meet their customers' needs.

Evolution of fast-tracking

With these benefits in mind, fast-tracking was first introduced in the UK as part of the 'proportionate assessment' approach in Ofgem's RIIO-1 price control in the energy sector. For RIIO-T1 and RIIO-GD1 – price controls running from 2013 to 2021 for (electricity and gas) transmission and gas distribution respectively – the two smaller Scottish electricity transmission companies were awarded fast-tracking. No gas distribution network was considered to have a sufficiently well-justified plan, and so all GDNs were subject to additional scrutiny.¹⁰¹ For RIIO-ED1, running from 2015 to 2023, one electricity DNO, Western Power Distribution (WPD), was fast-tracked.

Emulating the change to the price review process undertaken by Ofgem, Ofwat – the economic regulator for the UK water sector – adopted many of the elements of the RIIO framework. In particular, the PR14 price control, determining water and sewerage bills for 2015 to 2020 identified two companies that qualified for 'enhanced' status.¹⁰² Ofwat first 'pre-qualified' these companies, requiring them to accept Ofwat's proposals on aspects such as cost of capital to gain the advantages of enhanced status, including fast-tracking. For PR19, covering 2020 to 2025, Ofwat continued to apply fast-tracking, which three companies achieved.

¹⁰⁰ Ofgem (2010), *'Handbook for implementing the RIIO model'*, pg. 57, available here: <https://www.ofgem.gov.uk/ofgem-publications/51871/riiohandbookpdf>

¹⁰¹ Ofgem (2012), *'RIIO-GD1: Decision on fast-track process'*, available here: <https://www.ofgem.gov.uk/ofgem-publications/48232/120203fasttrackdecisionletter-pdf>

¹⁰² Ofwat (2013), *'Outcomes of the risk-based review and next steps'*, available here: <https://www.ofwat.gov.uk/regulated-companies/price-review/price-review-2014/risk-based-review/outcomes-of-the-risk-based-review-and-next-steps/>

However, Ofgem has recently moved away from early settlement as an information revealing device. During the consultation on RIIO-2, some companies argued it should be retained while others favoured amending or removing it. Ofgem decided to rule out early settlement in transmission and gas distribution, citing concentrated ownership structures, a lack of comparability between network companies and a risk of limiting the time available for stakeholders to engage with the companies over their business plans.¹⁰³

Ofgem's own analysis also suggested that WPD's allowances were £600m higher (around 10% of totex) than what they would have been if they weren't fast-tracked.¹⁰⁴ Once the (less tangible) benefits are taken into account, it was estimated fast-tracking had a net benefit for consumers in RIIO-ED1¹⁰⁵ – although to what extent is difficult to measure with certainty. A clear challenge with early settlement is that, by locking in assessment at an early stage, it is procedurally not possible to update analysis if modelling improves. For example, following its decision to fast-track WPD as having “the most efficient cost package of all the DNOs”, Ofgem's (more developed) slow-track benchmarking later found this company was no longer the most efficient company.¹⁰⁶

While comparability is greater and ownership less concentrated in the electricity distribution sector, Ofgem decided there were no compelling reasons to reach a different conclusion in ED compared to T or GD. In particular, a significant majority of consultation respondents were in favour of removing early settlement, and there were concerns fast-tracking would not be compatible with the enhanced engagement programme developed for RIIO-2. As such fast-tracking will not be used in RIIO-ED2.¹⁰⁷

Alternative approaches

As suggested by Ofgem's reasoning for removing fast tracking for RIIO-2, the current approach now places a greater focus of enhanced engagement with stakeholders to ensure high quality business plans. Instead of early settlement, the Business Plan Incentive (BPI) is used. This is meant to reward companies for plans that offer consumers additional benefits and value for money, with companies bidding for rewards on the quality aspects of its plan as revealed by a 'consumer value proposition' (CVP).

There are four stages of assessment under the BPI assessment, as illustrated in the figure below.

¹⁰³ Ofgem (2018), *RIIO-2 Framework Decision*, available here: https://www.ofgem.gov.uk/system/files/docs/2018/07/riio-2_july_decision_document_final_300718.pdf

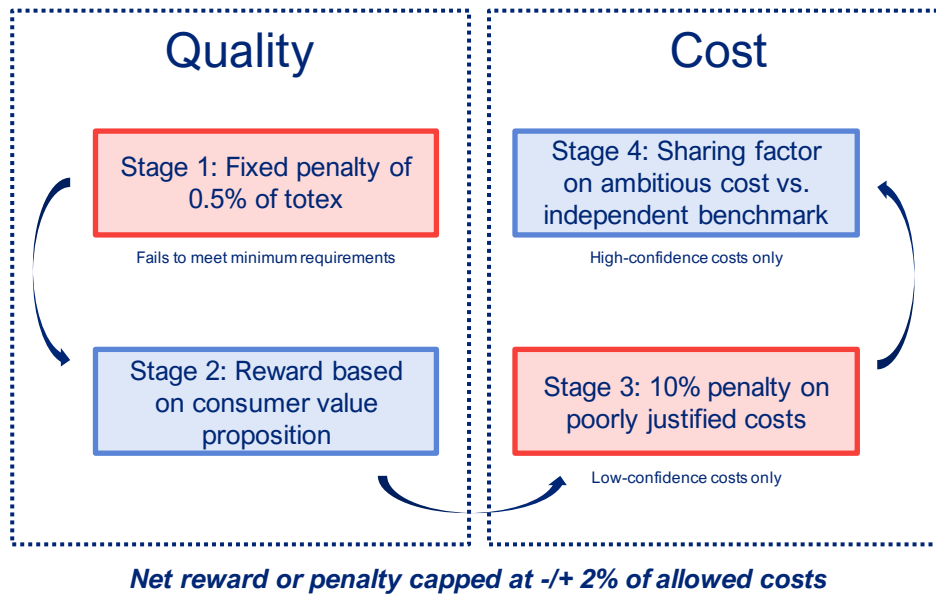
¹⁰⁴ Ofgem (2014), *RIIO-ED1: Final determinations for the slow track electricity distribution companies: Business plan expenditure assessment*, table 2.5, available here: https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1_final_determination_expenditure_assessment_0.pdf

¹⁰⁵ CEPA (2018), *Review of the RIIO framework and RIIO-1 performance*, available here: https://www.ofgem.gov.uk/system/files/docs/2018/03/cepa_review_of_the_riio_framework_and_riio-1_performance.pdf

¹⁰⁶ Ofgem (2014)

¹⁰⁷ Ofgem (2020), *RIIO-ED2 Framework Decision*, available here: https://www.ofgem.gov.uk/system/files/docs/2020/01/riio-ed2_framework_decision_jan_2020.pdf

Figure C.1: Ofgem BPI assessment process



Source: Ofgem, RIIO-2 Draft Determinations - Core Document, page 124.

The key components of each assessment stage are summarised below, with a focus on the CVP element.¹⁰⁸

- Stage 1:** The purpose of Stage 1 is to ensure that the business plans meet Ofgem’s minimum information requirements. Where a company fails an initial qualitative assessment of their business plan against a set of completeness and quality criteria, Ofgem can penalise them by up to 0.5% of allowed baseline totex.
- Stage 2:** The Stage 2 assessment considers evidence that the companies provide in relation to their CVPs (that is, the extent to which their business plan offers additional value beyond the ‘business as usual’ functions typically undertaken by an energy network). For example, a CVP could relate to the provision of service quality levels that are above existing levels, delivered at the same or lower cost. At this stage of the BPI assessment, there is the potential for an incentive reward linked to the assessed monetised value delivered to consumers through the proposed CVP. Ofgem has set out a range of factors that it will consider in assessing CVP proposals, including evidence of consumer support and the strength of links to consumer expectations and priorities. Companies must pass the Stage 1 assessment in order to be eligible for Stage 2 rewards.
- Stage 3:** Under Stage 3, Ofgem will consider the application of a penalty associated with poorly justified ‘low-confidence’ costs that are removed by Ofgem from the business plans.
- Stage 4:** Under Stage 4, rewards may be available if companies submit cost forecasts that are lower than the efficient cost benchmark that Ofgem would otherwise have used in setting the allowance.

Another addition to help link companies’ business plans to their customers’ demands is the introduction of the RIIO-2 Challenge Group. The purpose of this group, made up of independent members representing consumers (for example a Citizens Advice representative), is to provide an independent challenge to, and scrutiny of, all proposed network company business plans, participate in public hearings run by Ofgem, and review the initial determinations published by Ofgem.¹⁰⁹

¹⁰⁸ Ofgem (2019), *RIIO-2 Business Plans Guidance*, available here: https://www.ofgem.gov.uk/system/files/docs/2019/10/riio-2_business_plans_guidance_october_2019.pdf

¹⁰⁹ Ofgem (2018), *RIIO-2 challenge group Terms of Reference*, available here: https://www.ofgem.gov.uk/system/files/docs/2018/11/riio-2_challenge_group_terms_of_reference.pdf

Similarly, in recent price controls, Ofwat have also placed increasing emphasis on the role of customer engagement. As with Ofgem, each company has a Customer Challenge Group (CCG), to provide independent challenge to companies as they develop business plans, and to provide additional assurance to the regulator that customers' views are reflected in business plans.¹¹⁰

¹¹⁰ Ofwat (2016), '*Ofwat's customer engagement policy statement and expectations for PR19*', available here: https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap_pos20160525w2020cust.pdf



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