



# New Reg:AusNet Services Trial Insights Report I – Establishment and early operation

2 November 2018

Australian Energy Regulator

**FINAL REPORT**



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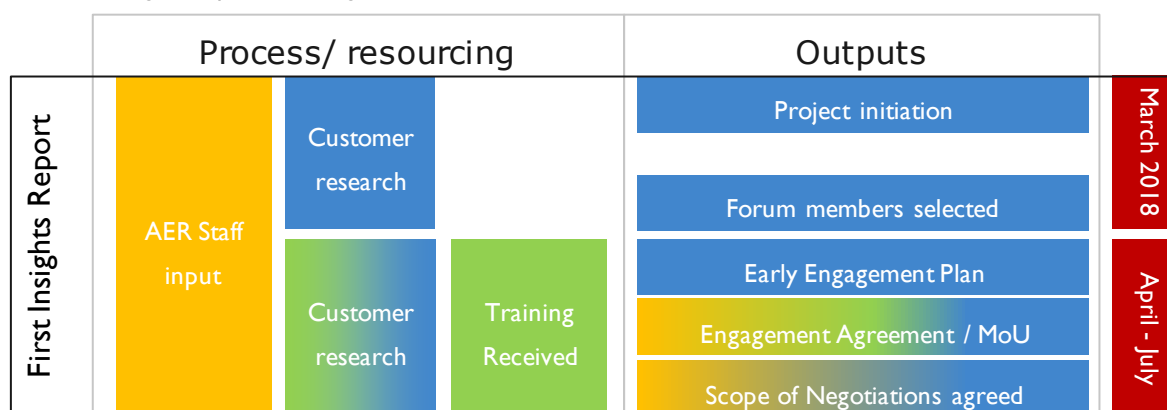


## I. INTRODUCTION

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

Our evaluation framework, dated 31 October 2018, provides further information on our overall approach to evaluating New Reg. This Insights Report is the first in a series of three before we provide the AER with both an Interim Evaluation Report and a Final Evaluation Report. This first Insights Report covers the establishment and early operations phase of the AusNet trial. The activities and deliverables in this phase are set out in the figure below.

Figure 1.1: First Insights Report's coverage



Source: CEPA

Note: We have used different colours to represent parties' involvement: The Customer Forum = Green; AER = Gold; AusNet = Blue.

This Insights Report relies on and should be read in conjunction with the First Monitoring Report prepared by Farrier Swier, dated 10 October 2018, as we extensively refer to the material contained within it.<sup>1</sup> The First Monitoring Report covered activities from project initiation to mid-June 2018. While there has been considerable progress since the First Monitoring Report – including the publication of AusNet's initial negotiating positions on a range of topics – the negotiations are still at an early stage and are out of scope of this Insights Report.

The views presented in this paper are those of CEPA alone. However, this paper has benefitted from an early review and comments by leading international regulatory expert Professor Stephen Littlechild and by regulation and consumer engagement expert Maxine Frerk.

### I.1. SUMMARY OF INSIGHTS

In the Table overleaf, we provide a summary of our insights against the relevant steps of the New Reg process set out in the Directions Paper.<sup>2</sup> We set out further detail on each of the insights in Section 2.

<sup>1</sup> Farrier Swier (2018), *New Reg: AusNet Services Trial: Monitoring report on establishment and early operation*, 10 October.

<sup>2</sup> Energy Consumers Australia, AER and Energy Networks Australia (2018), *New Reg: Towards Consumer-Centric Energy Network Regulation: Directions Paper*, March.

Table 1.1: 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.   | <b>Insight (1):</b> 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: | <b>Insights (2):</b> 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 (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   | <b>Insight (3):</b> 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. |

| New Reg process step  | Insights  |
|---|---|
| b. be fully independent of the network business   | <b>Insight (4):</b> AER Staff <sup>3</sup> 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. <sup>4</sup> 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.  |
| c. have the skills and expertise to serve the role of being a credible counterparty to the network business   | <b>Insight (5):</b> 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. |
| d. operate in an open and engaging way to establish and maintain its legitimacy with consumers and the wider community.   | <b>Insight (6):</b> 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.   |
| 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.                    | <b>Insight (7):</b> The MOU broadly reflects the Early Engagement Plan, indicating that the AER was broadly accepting of the Plan.  |
| a. This commitment is formalised through an 'Engagement Agreement' entered into by the business, the AER and the Customer Forum.  |   |
| 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. |   |

<sup>3</sup> Note, the MOU, Clause 6.3, makes a distinction between the AER and AER Staff. Clause 6.3(d) clarifies that the views of AER Staff do not reflect the views of the AER.

<sup>4</sup> We expect the AER to give due consideration to other stakeholders, such as customer advocates and customer representatives, views on the negotiated positions.

| New Reg process step  | Insights  |
|---|---|
| 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.   | <b>Insights (8):</b> 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.  |
| 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.  | <b>Insight (9):</b> 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 <sup>5</sup> 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.   |
| 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. | <b>Insight (10):</b> 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.<br><br><b>Insight (11):</b> 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 |

<sup>5</sup> Scope of Negotiation, as defined in the MOU, Schedule I, “means the matters which the Customer Forum and AusNet Services agree will be the subject of negotiation between them ...”.

| New Reg process step  | Insights   |
|---|--|
|   | 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.   |
| 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. | We believe that it is too early to comment on this step in detail. Insights will be set out in future reports.   |
| 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 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.  | <b>Insight (12):</b> 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 <i>"such information or resources necessary to analyse information provided to the Forum by AusNet Services."</i> <sup>6</sup> Notwithstanding our Insights in relation to Step 6, this appears a sensible extension of the AER's role. |
| 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.  | <b>Insights (13):</b> 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.  |

<sup>6</sup> MoU, Clause 6.3(a)(i)(2).



## 2. OUR INITIAL INSIGHTS

In this section we set out our initial insights on the New Reg process. Given this Insights Report covers the early stage of the AusNet trial we are not providing an evaluation against the Trial Assessment Factors. Instead we have focused on providing observations on specific aspects of the process and gathering information that will help with the evaluation towards the end of the project.

It is important that readers consider our observations in the context that the Forum and the New Reg process are at a formative stage. How the Forum, AusNet and the AER approach different parts of the process is likely to evolve, therefore our commentary in this report should not be considered as final.

### 2.1. PROJECT INITIATION

#### Insight 1: The incentive for the NSPs to elect to use the New Reg process

The 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.

The fact the Early Engagement Process is triggered (proposed) by the NSP is an interesting feature of New Reg. This is a formalised and transparent process that requires NSPs to adopt a different approach to the process typically followed to prepare a regulatory proposal. It is not an 'easy' option for an NSP. Therefore, why would the network choose to participate?

AusNet itself has stated that for this trial:

*"Beyond 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."*<sup>7</sup>

We cannot judge yet whether this objective will be achieved in practice. However, more broadly the New Reg trial appears to offer an opportunity for AusNet to:

- develop regulatory proposals that are demonstrably informed by consumer preferences, which includes the publication of the Forum's Engagement Report(s);
- 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;<sup>8</sup> and
- receive some relatively early views on its proposals from the AER.

The governance arrangements, and therefore status of the process, provides the incentive for networks like AusNet to use the New Reg process to negotiate matters and avoid/ lessen a (potentially) more adversarial and/or resource intensive process with the AER under a standard regulatory procedure. While the customer engagement aspects of the process are important, it is the *negotiated outcome* with the Forum,

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<sup>7</sup> <https://www.ausnetservices.com.au/Misc-Pages/Links/About-Us/Charges-and-revenues/Electricity-distribution-network/Customer-Forum>

<sup>8</sup> Directions Paper, page 4.

and the AER's involvement throughout the process, that will give the 'status' to AusNet's final regulatory proposal. If the regulatory proposal and the Engagement Report demonstrate they achieve the National Electricity Objective (NEO)<sup>9</sup>, then this may allow the AER to review more easily the negotiated matters in AusNet's proposal. If AusNet reaches a negotiated position with the Forum that is accepted by the AER without amendment, this should be considered a good outcome for the company as it was a suitably acceptable position for AusNet to be happy to submit to the AER.

It is interesting to contrast New Reg with the Fast Track / enhanced business plan process that Ofwat<sup>10</sup> and Ofgem<sup>11</sup> have adopted at recent price control reviews in the UK. In those cases, business plans that the regulators consider 'high quality' had financial incentives attached to them. Demonstrating that the plans reflect customer preferences (e.g. through evidence of extensive customer engagement) is a necessary but not sufficient condition for being Fast Tracked / receiving enhanced status. For companies receiving that status, the intention was that Ofgem and Ofwat would accept the plans as submitted.<sup>12</sup> However, within their broader regulatory determination process, both regulators had no obligation to have regard to the findings and outcomes of the customer engagement processes the companies followed.

Points to monitor / consider at later stages in the process:

- Will AusNet conclude that the process was worth the effort once the process is concluded? This may affect whether other networks choose to participate in New Reg, if the decision to participate is a voluntary one.
- How may the AER's actions towards the close of the price review process (i.e., its draft and final determinations) influence this? The AER may need to be conscious of the regulatory precedent it creates in New Reg trials, as this may influence networks' willingness to participate.

#### Insight 2: Development of the Early Engagement Plan

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 (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.

The development and agreement of this Early Engagement Plan has been an important first step in the formation of the Forum and agreement on the Scope of Negotiations (see discussion on Insight 9 below). The New Reg Directions paper appears to have helped AusNet to formulate an Early Engagement Plan that was acceptable to the AER given that AusNet's published plan follows closely the requirements within the Directions paper. This important first phase in the New Reg framework has helped to provide structure and clarity to the expected objectives, scope and process of the trial.

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<sup>9</sup> As stated in the National Electricity Law (NEL), Section 7.

<sup>10</sup> The England and Wales water regulator.

<sup>11</sup> The Great Britain energy sector regulator.

<sup>12</sup> Both regulators imposed some changes even on Fast Tracked / enhanced companies – e.g. lower return on equity for Western Power Distribution in RIIO-ED1 (see Ofgem, *Decision to fast-track Western Power Distribution*, letter dated 28 February 2014).

## 2.2. FORMATION AND ROLE OF THE FORUM

### Insight 3: Forum's ability to represent AusNet's current and future customers

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 trial negotiations.

We cannot comment on the entirety of this step at this stage of the project because the negotiations process may reveal additional insight on the Forum's ability to represent customers. However, the Forum's customer research experience, with one member being an experienced customer research consultant, has led to a meaningful change in AusNet's approach.<sup>13</sup> The Forum proposed an alternative focus group approach, which was adopted by AusNet. The Forum's proposals included guidance on the location of the focus group sessions, to ensure that regional customers were appropriately represented. The Forum also provided feedback on the focus group discussion guides and online content, including observations on the appropriateness of the language used and the impartiality of the materials presented.

At this stage, we consider that the reasoning for this change, provided by the Forum and AusNet, appears to be well-justified. For instance:

- The Forum has indicated to CEPA that the initial plan put forward by AusNet appeared to focus primarily on the engagement methodology, rather than necessarily setting out the purpose and desired outcomes of the engagement.
- The Forum also made suggestions on the type of engagement AusNet had initially planned to undertake a series of deliberative forums. The Forum felt that a wider scope of smaller workshops might better achieve the level of research that AusNet, and the Forum, required on customers' preferences. In particular, the Forum also considered that research of vulnerable customers and those in remote areas would be better under its proposed approach.

We do note that, at this stage, in our view AusNet could have likely procured similar customer research advice, such as strategy, questions and approach, through a separate process. However, there may have been less transparency on how this advice was received and AusNet's application of it. A point for future evaluation will be the impact the Forum's direction of customer research has on the eventual trial negotiation positions and whether similar outcomes could have been achieved absent of the Forum's early role in steering AusNet's customer research during the trial.

At this stage, we have insufficient information to comment on whether the revised engagement process has led to a different regulatory proposal than if AusNet had continued with its original plan (which may have included further research). We expect that the content of the regulatory proposal will provide further insights into how the outcomes of the engagement are used in practice. However, AusNet's responses to our follow up questions indicate that they found the Forum's expertise useful.

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<sup>13</sup> First Monitoring Report, page 23.

#### Insight 4: Forum ability to make decisions independently of AusNet and stakeholders' perception of this

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.

The Forum is not 'fully independent' of AusNet – AusNet selected the five members and pays the Forum members and its expenses – however we consider it more important that the Forum's decisions are made independently of AusNet, and are viewed as such by stakeholders. The Forum itself noted the risk of a perception that the Forum is not independent.<sup>14</sup> While we can only provide a qualified view on the Forum's independence at this stage of the project, our insights are:

- In our view the make-up, seniority, and experience of the Forum members has resulted in a body that is confident in conducting its role without being influenced by its employment arrangements. This is supported by the Forum's ability to influence AusNet's customer research programme. The responses from the Forum, and the changes in AusNet's consumer engagement approach, indicate that it is comfortable challenging AusNet's approaches and positions.<sup>15</sup>
- The mechanisms – which include publishing minutes of the meeting between the Forum and AusNet, the governance arrangements, and publishing both a draft and final engagement report – should enhance the view that the Forum is acting independently.
- To enhance transparency of the Forum's process/ impact, more material could have been made publicly available at earlier stages of the project, such as minutes from the initial meetings and clearer explanations of why AusNet's consumer engagement changed in the way it did.
- As noted in the Monitoring Report, there is also a risk of 'capture' of the Forum by AusNet. If AusNet is the main source of information this increases the risk of capture. The AER's input throughout the process may help to further alleviate this issue in addition to the transparency arrangements.

We agree that knowing research/ views are independent can help a regulator to take a view on elements of a regulatory proposal which may be more subjective in nature. The regulator will however still consider the supporting evidence and reasoning. Therefore, the ability of the Forum to set this out in its Engagement Report will be critical. The AER's previous decisions and guidance on customer engagement to inform regulatory proposals may provide a guide for the basic level of information it requires. We also expect the AER to give due consideration to the views of other stakeholders, such as customer advocates and customer representatives, on the negotiated positions.

We note that there are limited comparisons that we can make to other jurisdictions on the importance of independence for the regulator's assessment of the company's proposals. Independence was highlighted as a key aspect of the Water Industry Commission for Scotland (WICS) approach, however there were

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<sup>14</sup> First Monitoring Report, Section 6.4.

<sup>15</sup> First Monitoring Report, Appendix D.

differences in the selection process.<sup>16</sup> In that case, the selection of the Customer Forum involved the regulator, Consumer Focus Scotland and Scottish Water, while the interview for the Chairman was chaired by Consumer Focus Scotland.<sup>17</sup> Ofwat places weight on the views provided by the regulated companies' Customer Challenge Groups. However, the Customer Challenge Groups' role is only to provide Ofwat with assurance on the "quality of a company's customer engagement" and "the degree to which the results of this engagement are driving decision making and are reflected in the company's plan".<sup>18</sup> In RIIO-1 Ofgem involved a Customer Challenge Group, but this is similar to the AER's Consumer Challenge Panel (CCP) rather than the Forum.<sup>19</sup> The UK Civil Aviation Authority (CAA) runs a Constructive Engagement process for designated airports in the UK, with airports' airline customers given the opportunity to engage on the airports business plans. Different funding arrangements are used across the jurisdictions/ sectors:

- Scotland, Water. The Customer Forum in Scotland was funded by WICS. This funding included staff, programme running costs, and commission new research.
- England and Wales, Water. The regulated companies provide secretariat and administrative support and costs, as well as covering the salary of the Chair.
- Great Britain, Energy. Ofgem funds its Consumer Challenge Group. Companies are responsible for funding their own customer engagement activities.<sup>20</sup>
- UK, aviation. The airports are required to host meetings and provide venues at its own expense. Other costs, such as staff time, are borne by the different participants.

#### Insight 5: Forum's ability to be a credible (negotiating) counterparty to AusNet

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.

At this stage of the process, prior to viewing the negotiating minutes and positions, we can only provide a limited insight based on the CV summaries provided by AusNet on its website.

<sup>16</sup> The selection process is summarised in Attachment A of AusNet's Early Engagement Plan. AusNet (2018), *Early Engagement Plan: EDPR 2021-25 Customer Forum*.

<sup>17</sup> Stephen Littlechild (2014), *The Customer Forum: customer engagement in the Scottish water sector*, July, page 6.

<sup>18</sup> <https://www.ofwat.gov.uk/regulated-companies/price-review/2019-price-review-final-methodology/customer-challenge-groups/>

<sup>19</sup> For RIIO-2 Ofgem has proposed to introduce: Customer Engagement Groups for electricity and gas distribution that are modelled on the Ofwat approach; User Groups for electricity and gas transmission that would challenge companies' proposals; and a Challenge Group that would produce a public report on companies' business plans from the perspective of end consumers. See Ofgem (2018), *RIIO-2 Enhanced Stakeholder Engagement Guidance – Version 1*, March.

<sup>20</sup> For example, Scotia Gas Networks RIIO-2 customer engagement group (which is Chaired by Maxine Frerk).

#### Insight 6: The Forum should operate in an open and engaged way to have legitimacy with consumers

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.

Transparency arrangements include the Forum publishing both a draft engagement report and a final engagement report. The Forum also sought, and received, funding from AusNet for an independent minute taker and most of these minutes are being made available online. The Forum has been directly interacting with customers through AusNet's customer research process and we understand that it has also been engaging separately with customer advocates.<sup>21</sup> We also note that AusNet's Forum website allows customers to follow and observe the process, and also provides AusNet's contact details for them to participate in the process.<sup>22</sup>

We do note that minutes for all meetings are not available, and material published by AusNet and the AER are not available in a single location.<sup>23</sup>

It is too early in the process to provide a view on the sufficiency of the transparency arrangements the Forum has put in place. We would expect that the Forum would need to show the same attention to this as a regulator adopting best practice principles.

### 2.3. ENGAGEMENT AGREEMENT

#### Insight 7: Agreement of the Early Engagement Plan

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

Following from the Early Engagement Plan, the parties were able to enter into an agreement, in the form of the MOU, rather than an 'Engagement Agreement'. This set out at a high level the roles and responsibilities of each party.

In our view this document, in addition to the Directions Paper and Approach Paper<sup>24</sup>, has been useful in clarifying the high-level objectives of the trial and initial roles and responsibilities of the parties.<sup>25</sup> The

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<sup>21</sup> AusNet has undertaken wider engagement, which the Forum has been involved in, with customer advocates and customer representatives. The parties that AusNet has engaged with are listed on its website (<https://www.ausnetservices.com.au/Misc-Pages/Links/About-Us/Charges-and-revenues/Electricity-distribution-network/Customer-Forum/Stakeholder-engagement>).

<sup>22</sup> <https://www.ausnetservices.com.au/Misc-Pages/Links/About-Us/Charges-and-revenues/Electricity-distribution-network/Customer-Forum>

<sup>23</sup> AusNet's and the Forum's publicly available documents are located on AusNet's website (<https://www.ausnetservices.com.au/Misc-Pages/Links/About-Us/Charges-and-revenues/Electricity-distribution-network/Customer-Forum>), while the AER's publicly available documents are located on its website (<https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/regulatory-innovation>).

<sup>24</sup> Energy Consumers Australia, AER and Energy Networks Australia (2018), *New Reg: Towards Consumer-Centric Energy Network Regulation: Approach Paper*, March.

<sup>25</sup> While the Direction Paper and Approach Paper made clear the overall vision, they did not explicitly state the objectives of the New Reg trial.

Monitoring Report notes that, so far, the parties have not identified drawbacks from the use of an MOU rather than an Agreement.<sup>26</sup> The contractual nature of the early engagement process also potentially helps to create legitimacy for the process as an input to the regulatory determination (see discussion on Insight (1)).

## 2.4. THE FORUM'S TRAINING

### Insight 8: The training received by the Forum

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

The Forum received training from AusNet, with the AER being provided the opportunity to comment on the training material. The Monitoring Report, page 17, notes that the Chair “*thought the education provided was adequate for the Forum’s required role.*” The Forum is confident that it can ask questions of AusNet on the material it produces or provides to the Forum.

AusNet, with the AER’s input, appear to have developed an initial base of material that sets the basis for educating people who may not have industry or regulatory expertise. We have not reviewed the material presented by AusNet in detail, however the feedback from the three parties indicates that this may be a good template for this type of education.

We understand that the Forum will receive further education from additional material provided by the AER and AusNet as the process progresses. However, as we discuss further on, we are not yet clear on what the negotiations will cover or the extent of the positions each party will reach. We may find that more specific education in certain areas may be required.

## 2.5. SCOPE OF NEGOTIATIONS

### Insight 9: Use of criteria for agreeing the Scope of Negotiations

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<sup>27</sup> 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.

AusNet’s Early Engagement Plan set out a series of criteria it proposed should be used for determining the scope of the expenditure proposal and associated inputs/issues that could be subject to negotiation with the Forum.<sup>28</sup> These were reflected in the agreed MOU. The AER, in setting out its view on the Scope of Negotiation also used these criteria and added an additional one “*the extent to which the matter is a policy or*

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<sup>26</sup> First Monitoring Report, page 14.

<sup>27</sup> Scope of Negotiation, as defined in the MoU, Schedule 1, “*means the matters which the Customer Forum and AusNet Services agree will be the subject of negotiation between them ...*”.

<sup>28</sup> AusNet, *Early Engagement Plan: EDPR 2021-25 Customer Forum*, June 2018, page 9.



wider issue better dealt with through a different and more expansive consultative process than the Forum's negotiation with AusNet.”<sup>29</sup> This additional criterion was consistent with Clause 3(d) in the MOU which stated that the Forum “is not expected to be involved in policy decisions”.

Given the AER and AusNet were able to agree on the criteria that should be used to define the Scope of Negotiation, this showed at an early stage a willingness by both parties to establish key principles to guide the matters that the Forum will be asked to deliberate on.

We note that the New Reg Directions Paper states that the Early Engagement Plan should provide a high-level indication of the matters proposed to be considered in scope, including whether the network business intended to engage with the Forum on the whole proposal and whether the network business considers some matters should be taken out of scope at the outset. AusNet's proposed criteria meant that it was able to state in its Early Engagement Plan that “while the whole proposal and total revenues and prices will remain a reference point throughout the negotiations, the range of issues for negotiation will be considerably narrower owing to the criteria set out above.”<sup>30</sup> However, the specific matters to be included in the negotiations were not stated in the Early Engagement Plan.<sup>31</sup>

A point to consider is whether a criteria-based approach should be used in future or whether other networks may instead choose to directly propose a set of negotiation items in the Early Engagement Plan. We note that one of the benefits of a criteria-based approach is that it provides a consistent logic/justification for what is and is not included in the Scope of Negotiation.

#### Insight 10: Approach to agreeing the Scope of Negotiations

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.

AusNet and the AER agreed the Scope for Negotiations, which set out the topics that the AER considered to be in the official Scope for Negotiations and the boundaries for these topics. It was noted that AusNet could, and has, presented topics to the Forum that are ‘out of scope’ of the defined Scope for Negotiations. We understand that at the start of the discussion on the Scope for Negotiations AusNet sought a broader scope than what was eventually set out in Scope of Negotiations.<sup>32</sup>

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<sup>29</sup> AER, *AusNet Trial – AER Staff Guidance Note 2: Scope of Negotiation*, July 2018, page 3.

<sup>30</sup> AusNet, *Early Engagement Plan: EDPR 2021-25 Customer Forum*, 2018, page 10.

<sup>31</sup> Note there is a minor inconsistency in the Directions paper on this issue. Section 2.1 – what should be included in the Early Engagement Plan – requires a high-level indication of the matters proposed to be considered in scope, while Section 3.5 (page 13) – states that the Early Engagement Plan must adequately demonstrate “the scope of the matters to be covered, or the process by which the scope will be decided among the NSP, the AER and the Customer Forum.” In this case, AusNet set out the proposed process by which the Scope of Negotiation would be agreed, rather than proposals for the scope itself.

<sup>32</sup> AER, *AusNet Trial – AER Staff Guidance Note 2: Scope of Negotiation*, July 2018.



The AER Staff highlighted in their guidance note on the Scope of Negotiations, that it had concerns that the Forum and AusNet may agree a position that the AER subsequently determines to be inconsistent with the regulatory framework.<sup>33</sup>

The Forum Chair noted that it may have been more efficient if the AER and AusNet had agreed the scope, and that this had become part of the Forum's brief before the Forum was convened.<sup>34</sup>

#### Insight 11: Resourcing implications of the scope of the negotiations

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.

At this stage of the project, given the available information, we note the following insights:

- One of the objectives of the New Reg process is that it creates a pathway for consumers' preferences to be recognised and represented in regulatory proposals and the regulatory determination. Consumers' preferences may drive different outcomes than what AusNet and the AER anticipated. Therefore constraints, or perceived constraints, placed on the Forum's scope to raise and/ or negotiate matters may restrict its ability to represent consumers' preferences. Even if preferences and the Forum's positions are outside what is allowable by the current NER/NEL, these views may still provide valuable information for how the regulatory framework might need to change in future.
- Having a flexible scope of negotiation can impact the resourcing requirements of all parties. While we understand the New Reg Trial process is well resourced, if there are additional demands on, for example, the AER's time, this may impact on the process and the perceived legitimacy of the negotiated positions. As noted in the Monitoring Report, even though it is well resourced, the AER noted that it *"has been challenging to mobilise appropriate AER staff to comment on relevant AusNet Services material, because only limited time has been provided to review that material in advance of Forum meetings."*<sup>35</sup> Separately, the AER have commented to us that if the process became too resource intensive then the AER would only focus on Scope of Negotiation matters. The extent of the AER's involvement will also depend on the amount and quality of the information the NSP provides to the Forum.
- A key question for the trial evaluation will be whether the observed level of the AER's involvement would be required for future New Reg processes, potentially across multiple NSPs, and whether this is reasonable given the overall net costs/benefits. The key determinants of the AER's required resources for subsequent New Reg processes would be: the level of engagement and quality of material provided by the DNSP, the membership and expertise of the Forum, and the Scope of

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<sup>33</sup> AER, *AusNet Trial – AER Staff Guidance Note 2: Scope of Negotiation*, July 2018, page 2.

<sup>34</sup> First Monitoring Report, Section 6.5.

<sup>35</sup> First Monitoring Report, Section 6.5, page 16.

Negotiations. The AER may be able to influence each of the above depending on how future New Reg processes structured.

In relation to the last point, it is our view that the involvement of AER staff in assisting the New Reg process (in relation to the consumer engagement of a single company) is greater than what we have observed in other customer-centric / outcomes-focused regulatory regimes that involve multiple regulated companies – for example, the Victorian Essential Services Commission’s (ESC) PREMO process, Ofgem’s RIIO-1 and Ofwat’s PR14. The regulators in these other regimes engage with consumers and consumer representatives but this is not necessarily directly to support the regulated companies in producing their regulatory proposals or reaching an ‘agreed position’.<sup>36, 37</sup> As we mention in Section 2.1, those processes did not involve formal negotiations between the regulated company and customer representatives, but they share the New Reg ambition that the regulator would be able to expend less effort on aspects of the company’s proposal that are endorsed by customers. While the involvement of the Water Industry Commission of Scotland (WICS) in the customer engagement (negotiation) process for Scottish Water was high, it is the only company that WICS regulates. In other words, WICS did not need to duplicate/ adjust its advice and analysis for other regulated companies at the same time.

As part of the Evaluation Reports, we will consider the cost and resource requirements of the New Reg process. A key question for the evaluation will be whether the observed level of the AER’s involvement would be required for future New Reg processes, potentially across multiple NSPs, and whether this was reasonable given the overall net costs/benefits.

## 2.6. THE ‘DYNAMIC CONVERSATION’

### Insight 12: AER Staff’s advice to the Forum

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.”<sup>38</sup> Notwithstanding our Insights in relation to Step 6, this appears a sensible extension of the AER’s role.

We understand that since the Monitoring Report was published, the AER has, on its own prerogative, provided additional information to the Forum in relation to AusNet’s initial negotiating positions. This will be addressed in the next Insights Report.

### Insight 13: Forum’s resourcing and ability to communicate with customers

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.

<sup>36</sup> Rather the regulators’ involvement with consumers is to assist in developing guidance for the regulated companies and/ or to assist the regulators in assessing the regulatory proposals.

<sup>37</sup> Ofgem’s RIIO-2 Stakeholder Engagement Guidelines set out Ofgem’s role in supporting with NSPs’ customer engagement (see Ofgem (2018), page 17). While it is proposing to actively engage, the extent of its engagements at this stage appears more limited than AER Staff’s role in New Reg as set out in Clause 6.3 of the MOU.

<sup>38</sup> MoU, Clause 6.3(a)(i)(2).

See our discussion in Section 2.2.

The Forum appears to be well resourced. The Forum had significant input into AusNet's research program, and we understand its members have been very hands-on in directing the research that needs to be undertaken (which is different to the Forum's expectations at the beginning of the process). This broadly indicates that the Forum has sufficient ability to undertake the research it requires at this stage. However, we understand the Forum's work has taken more time than anticipated. We also note that AusNet believes that it has been very open during the process and has aired issues and questions on topics where it may not have decided internally. In its view this differs from what it may have done in the past.<sup>39</sup>

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<sup>39</sup> First Monitoring Report, Box 8.



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