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1 March 2023

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

Submitted via email: incentivereview@aer.gov.au

Dear Sebastian

Review of incentives schemes for networks - draft decision

Essential Energy appreciates the opportunity to respond to the Australian Energy Regulator (AER) on its *Review of incentive schemes for networks – draft decision (draft decision)*. Whilst we have prepared our own submission, we also support the submission made by Energy Networks Australia (ENA). We welcome the draft decision to retain the Efficiency Benefit Sharing Scheme (EBSS) and the distribution Service Target Performance Incentive Scheme (STPIS) in their current form. We also support the proposal to extend the application of the Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance (DMIA) to export services.

In relation to draft adjustments to the Capital Expenditure Sharing Scheme (CESS), such that there is a tiered methodology for underspends only, we have some concerns with the lack of symmetry - on principle. In addition, whilst we understand and support the need for transparency, it will be important that any proposed new data requirements will be of demonstrable value to stakeholders and be fully consulted on with network businesses. This will help ensure that any additional data requirements are feasible, and that there is a consistent basis of preparation between businesses. These points are further discussed below.

Proposed CESS design

Essential Energy agrees that, of the options previously discussed in the position paper for changing the current design of the CESS, the Bright-Line Tiered Test represents the more preferable option. It is more transparent and less prone to producing unintended consequences than the other options considered. However, the proposal is that it operates on an asymmetrical basis, whereby the tiered percentage sharing ratios of 30 per cent apply for underspends of up to 10 per cent of the forecast capital expenditure, and 20 percent for underspends above 10 per cent, do not match the single tier of 30 per cent for any overspends against forecast.

From a principles point of view, we would favour a symmetrical approach to CESS rewards and penalties. This is consistent with the importance of symmetry within the regulatory framework, which was emphasised in the AER's final position paper on the *Regulatory treatment of inflation*, which noted "The approach we are proposing is symmetric and enduring" [1]

The rigorous review processes carried out by the AER at the time regulatory allowances are set (to ensure that capital expenditure is efficient and prudent), as well as the depth of stakeholder

[1] AER, Final position paper – Regulatory treatment of inflation, December 2020, p.7

engagement carried out by distribution businesses, should reduce the risk of unrealistic capex forecasts being approved. Any overspends are likely to reflect a necessary response to a change in circumstances, especially in the context of the fast evolving energy landscape and weather extremes. Taking these factors into account, we consider that there should be a symmetrical approach to rewards and penalties in the design of the CESS, so a balanced incentives framework is maintained.

Proposed Transparency Measures

The draft decision proposes to improve transparency about variations between operating and capital expenditure outcomes and forecasts, and notes that there is a clear case for network businesses to be more transparent about the reasons for any variations. The draft decision also notes that measures to increase transparency will form part of the Network Information Requirements review. Essential Energy is in favour of transparency and would welcome a thorough consultation process to ensure that the provision of data is practical and achieves its intended outcomes. This consultation process will also provide network businesses with the opportunity to provide input on the potential impact of the requirements and to suggest alternative solutions that may better achieve the regulatory objectives.

As noted in the draft decision there are already network regulation measures in place, such as the Better Resets Handbook to promote transparency. The depth of consumer engagement expected of network businesses is clearly set out in the Handbook and should help mitigate the risk of developing operating and capital expenditure forecasts which do not align with consumer preferences. A key objective of the Better Resets Handbook is to create a more efficient regulatory process for all stakeholders. This is an important point to consider when developing new information requirements for network businesses.

Commencement of new CESS provisions

The draft decision seeks feedback on when the provisions of the revised Capex Incentive Guideline should commence and specifically whether these should apply to the upcoming NSW, ACT, NT and Tasmanian resets. Essential Energy is comfortable with the application of any CESS change being reflected in the upcoming resets, however, is cognisant that this may not be the case for all networks, given the long lead times generally required for significant incentive changes to be factored into regulatory plans and customer engagement programs.

Essential Energy would appreciate confirmation that the new CESS provisions won't apply to the current regulatory period.

If you have any queries regarding this submission, please contact our Network Regulation Manager, [redacted] on [redacted] or via [redacted]

Yours sincerely

[redacted]

Natalie Lindsay
Head of Regulatory Affairs