11 March 2022

Sebastian Roberts
General Manager
Network Expenditure
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Email: incentivereview@aer.gov.au

Dear Mr Roberts

REVIEW OF INCENTIVE SCHEMES FOR NETWORKS

Energy Queensland Limited (Energy Queensland), on behalf of its distribution businesses, Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy), appreciates the opportunity to comment on the Australian Energy Regulator's (AER's) consultation on the review of incentive schemes.

The incentive schemes set out in the National Electricity Rules are an essential part of the overall incentive regulatory framework outlined in the National Electricity Law. Energy Queensland continues to support the application of the current incentive schemes developed by the AER as we consider that they promote the long-term interests of customers by strengthening the incentives for networks operate efficiently and improve service performance for customers. These incentive schemes include the:

- expenditure efficiency schemes: the efficiency benefit sharing scheme (EBSS) and capital expenditure sharing scheme (CESS)
- service performance schemes: service target performance incentive scheme (STPIS) and customer service incentive scheme (CSIS)
- demand management schemes: demand management incentive scheme (DMIS) and demand management innovation allowance mechanism (DMIAM).

Energy Queensland acknowledges the concerns about the costs and benefits of the incentives schemes that have been raised by customer groups and prompted this review. In particular, customers have queried the magnitude of the incentive scheme payments to network businesses and the key drivers of the incentive payments.

While Energy Queensland notes that the incentive scheme payments may appear to be significant, we consider that the benefits that flow to customers, as a consequence of the incentive scheme arrangements, far outweigh the costs. For example, the EBSS and STPIS, which have been in place since the AER commenced the economic regulation of electricity distribution networks have, to date, delivered substantial benefits for customers. The 2019 Energy Networks Association (ENA) report on how customers benefit from incentive based regulation, demonstrated that these two schemes, in particular, had delivered billions of dollars of benefits to customers.[1]

Energy Queensland considers that part of the issue is that when discussing incentive schemes there is typically a focus on the incentive schemes payments to networks (when they increase network revenues) without considering the associated benefits that flow to customers. The AER's consultation paper clearly demonstrates that, over the last decade, network expenditure levels have progressively declined while service performance has improved over time. It is important to note that the incentive schemes are designed such that most of the benefits from improving efficiency or service performance are retained by customers.

Our preliminary view is that it is premature to make material changes to any of the current incentive schemes. We agree with the AER that EBSS remains broadly fit-for-purpose. While the sharing of efficiencies between networks and customers has changed from 30:70 to approximately 15:85, with the decline in interest rates, we consider that these ratios will continue to evolve as interest rates evolve. Therefore, changes to the EBSS are not necessary at this stage. However, we consider there is merit in the AER reviewing the impact of making 'efficiency adjustments' to base opex on the EBSS. Our view is that when the AER moves away from the revealed costs of a network, it distorts the operation of the EBSS.

Energy Queensland notes that the AER only recently reviewed the STPIS in 2017, and consequently, we support the AER's proposal to not focus on the STPIS in this review. The same applies to the DMIAM. Furthermore, given the DMIS and CSIS are relatively new schemes, we consider it is too early to review those schemes.

We note that the AER's consultation paper identifies the CESS as a key focus area. However, noting that the scheme has only applied for one round of regulatory periods, we consider that significant changes to the scheme are not necessary. While stakeholders have raised concerns about over-forecasting of capex, this issue is not addressed by amending the CESS but by improving capex forecasting. To this end, the AER has, in recent years, significantly enhanced its capex forecasting tools and techniques as well as most recently publishing the Better Resets Handbook on the AER's expectations in relation to customer engagement and capex proposals. Energy Queensland considers that these measures and continued improvement in the AER's network performance reporting will alleviate over-forecasting concerns.

Should you wish to discuss any aspect of this matter further, please contact me on [redacted].

Yours sincerely

Trudy Fraser

[1] Energy Networks Australia, Rewarding Behaviour: How Customers Benefit from Incentive-Based Regulation, 31 July 2019. https://www.energynetworks.com.au/news/media-releases/incentives-deliver-more-than-6-billion-in-benefits-to-customers

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