



## SUBMISSION

**Prepared for:**

The Australian Energy Regulator (AER)

By email to [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au)

# The AER's proposal to delay final network decisions

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## **1. INTRODUCTION**

### **1.1. THE AER'S PROPOSAL TO DELAY FINAL DECISIONS**

The Australian Energy Regulator (AER) is proposing to delay final decisions for SA Power Networks, Energex, Ergon Energy, Directlink and Jemena Gas Networks.<sup>1</sup>

The Australian Energy Regulator (AER) is currently scheduled to provide its final 2020-25 network revenue determinations on 30 April 2020 for these businesses.

The AER has reported that it has completed its review of all the material it has received on these decisions and is ready to make its final decisions. However, the AER is proposing to delay the above final revenue determinations to late May so it can use short-term forecasts of inflation from the Reserve Bank expected on 8 May 2020. Usually, the AER would use the Reserve Bank forecasts from February in its final decisions. At the current time, the AER thinks it is desirable to wait for the May inflation forecasts, as, if available, they are likely to be a more accurate reflection of the economic circumstances going into the next regulatory control period.

Should the AER's final revenue determinations be delayed to late May, the AER would work closely and quickly with the impacted network and retail businesses to enable new retail prices to be in places for 1 July 2020.

In the event the Reserve Bank does not publish new forecasts on 8 May 2020, the AER proposes to publish its final decisions as soon as possible using the February short-term inflation forecasts to give certainty of prices over the five year regulatory period.

### **1.2. THE AER'S INVITATION FOR SUBMISSIONS**

The AER has stated that submissions on the proposal to delay the above final revenue determinations are welcome, and should be made by 27 April 2020.

### **1.3. BACKGROUND TO THE AER'S PROPOSAL**

An estimate of inflation is an important input for determining efficient revenue allowances. The AER uses use short-term inflation forecasts published by the Reserve Bank in its quarterly Statement on Monetary Policy. Efficient revenue allowances help promote efficient operation of, use of and investment in monopoly energy network infrastructure. They thereby contribute to achieving the National Electricity and National Gas Objectives.

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<sup>1</sup> The AER's proposal and request for submissions is to be found on the AER website at <https://www.aer.gov.au/communication/aer-invites-submissions-on-proposal-to-delay-final-decisions-for-sa-power-networks-energex-ergon-energy-directlink-and-jemena-gas-networks>

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SA Power Networks, Energex and Ergon Energy are required to produce separate annual pricing proposals for the 2020-21 year following our final revenue determinations. To develop these prices, the AER proposes to set the allowed revenue in the first year using the February forecast of inflation from the Reserve Bank. The AER proposes to publish the allowed revenue for the first year at the end of April. If the May forecast leads to different revenue outcomes, it would make adjustments to the revenue allowances in the following years so that the correct revenue is allowed over the five year the regulatory control period for these businesses.

#### **1.4. ABOUT THIS SUBMISSION AND ETROG CONSULTING**

This submission is a response from Etrog Consulting Pty Ltd (Etrog Consulting) to the AER's invitation for submissions on its proposal.

Etrog Consulting is a specialist consultancy in energy and utilities, focusing on regulatory policy and the interaction of regulation and competition in energy and water industries and markets. The director of Etrog Consulting, David Prins, who is the author of this submission, has 30 years consulting experience in this field.

This submission discusses some aspects of the AER's proposal, which we hope will be of interest and of value to the AER.

Etrog Consulting is advising the Queensland Council of Social Service (QCOSS) on various related regulatory matters, and the author of this report is a member of the AER's Consumer Challenge Panel (CCP).

The views put forward in this submission are the views of Etrog Consulting and its author, and are not intended to represent the views of QCOSS or the CCP, or of any other person or organisation.

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## 2. OUR HIGH-LEVEL THOUGHTS ON THE AER'S PROPOSAL

Our thinking for the content of this submission arises largely from the fact that while inviting submissions on the proposed delay, the AER has not set out any specific consultation questions or issues that the AER would like stakeholders to answer or otherwise address in their submissions.

We have therefore composed some questions of our own, which we seek to address in this submission.

The questions we have composed are as follows:

- Should the AER delay its final decisions?
- If the AER does delay its final decisions
  - What will be the effects of delay on other stakeholders and regulatory processes?
  - What other actions should the AER take as a result?

Each of these questions is addressed in the remainder of this submission.

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### 3. SHOULD THE AER DELAY ITS FINAL DECISIONS?

As stated above, the AER states that its reason for proposing to delay its final decisions is that the AER thinks it is desirable to wait for the May inflation forecasts, as, if available, they are likely to be a more accurate reflection of the economic circumstances going into the next regulatory control period.

#### 3.1. NORMALLY THE AER DOES NOT DELAY DECISIONS

Normally, the AER, like other regulatory bodies, does not delay final decisions pending new information that will be available at a later date. There is always more information available if one waits long enough to receive it. If the AER (and other regulatory bodies) were to continue to wait for new information, there would be no end to the matter. Regulatory decisions would be consistently delayed, perhaps indefinitely or for long periods of time.

Rather, all regulatory bodies, including the AER, necessarily always have to set deadlines after which no new forecasts will be taken into account in its draft and final decisions (though the rules under which the regulatory body operates may allow for later adjustments to take into account actual outcomes that differ from the forecasts used in the earlier decisions).

#### 3.2. RESPONSES OF THE AER TO THE EFFECTS OF COVID-19

This being the case, we need to understand why the AER is considering delaying final decisions now, when it does not usually contemplate such actions. The AER's invitation for submissions does not state explicitly what is different now. We expect that the AER's reference to basing its inflation forecast on "a more accurate reflection of the economic circumstances" is founded on the fact that the Australian economy, and the larger world economy, is currently in a state of flux due to the economic effects of COVID-19. In other words, the AER is reacting to COVID-19 in proposing delays here.

We have noted the AER's reactions to COVID-19, which include the following:

- The ACCC/AER has activated its Business Continuity Plan due to COVID-19;<sup>2</sup>
- The AER's Statement of Expectations of energy businesses: Protecting consumers and the energy market during COVID-19;<sup>3</sup>
- Initiatives in conjunction with AEMO and the AEMC in regard to prioritising implementation timeframes for key market reforms and rule changes;<sup>4</sup>

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<sup>2</sup> This is referenced at <https://www.aer.gov.au/freedom-of-information>

<sup>3</sup> See for example <https://www.aer.gov.au/publications/corporate-documents/aer-statement-of-expectations-of-energy-businesses-protecting-consumers-and-the-energy-market-during-covid-19> and <https://www.aer.gov.au/news-release/energy-businesses-must-go-above-and-beyond-to-support-customers-doing-it-tough> and <https://mailchi.mp/aer/energy-dispatch-edition-22>

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- Letter to retailers: New data reporting requirements relating to COVID-19;<sup>5</sup>
- Energy watchdogs ramp up monitoring to protect customers;<sup>6</sup>
- AER invites submissions on the implications of COVID-19 for the Default Market Offer (DMO) price determination for 2020-21;<sup>7</sup> and
- Recognition of impacts of COVID-19 on stakeholder engagement in regulatory processes.<sup>8</sup>

This is likely not an exhaustive list.

### 3.3. OUR OBSERVATIONS ON THE AER RESPONSES

Overall we are seeing many initiatives, but it is not obvious that there is an overall approach. The consultation on effects on the DMO, this consultation on the possible delay, and other initiatives, seem to an outside observer to be somewhat piecemeal.

There does not appear to be an overarching framework that sets out what the AER will take into account in its decision-making framework on network pricing, retail pricing and other matters as a result of COVID-19.

We have in mind matters such as affordability issues, changes in patterns of demand and new demand forecasts and how they might affect decisions on tariff structures and capital expenditure forecasts, changes in wholesale energy costs, and perhaps new definitions of vulnerability, and new assessments of who is vulnerable. There are many such effects of COVID-19, and more, that the AER may be considering, and are not yet in the public domain.

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4 See for example <https://www.aer.gov.au/publications/corporate-documents/letter-to-minister-for-energy-and-emissions-reduction-prioritising-implementation-timeframes-for-rule-changes-covid-19> and <https://www.aer.gov.au/communication/energy-market-bodies-covid-19-response> and <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-ring-fencing-guideline-review-august-2019>

5 See <https://www.aer.gov.au/publications/corporate-documents/letter-to-retailers-new-data-reporting-requirements-relating-to-covid-19>

6 See <https://www.aer.gov.au/news-release/energy-watchdogs-ramp-up-monitoring-to-protect-customers>

7 See <https://www.aer.gov.au/communication/aer-invites-submissions-on-the-implications-of-covid-19-for-the-dmo-price-determination-for-2020-21> in particular, and <https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices-2020-21> for information on the AER's determination of the DMO for 2020-21 more generally.

8 See for example <https://www.aer.gov.au/communication/online-public-forum-%E2%80%93-2021-26-victorian-electricity-determinations-%E2%80%93-stakeholder-presentations> and [https://www.aer.gov.au/system/files/AER%20-%20Initiation%20notice%20-%202020%20Inflation%20review%20-%207%20April%202020\\_0.pdf](https://www.aer.gov.au/system/files/AER%20-%20Initiation%20notice%20-%202020%20Inflation%20review%20-%207%20April%202020_0.pdf)

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Alongside these issues, the AER, alongside industry parties, customer representatives and other stakeholders would also need to consider which issues will have only short-term effects, and which will have longer-term effects. When will the Australian economy recover? How short-term or long-term are affordability issues for Australians in highly affected industries such as hospitality, travel and tourism, and food service? What are the effects on the employees in these industries and on the businesses themselves?

It may be that the AER is considering all these matters, but that again is not obvious to an outside observer. More importantly, we are not seeing stakeholders engaged on the overall AER response to COVID-19. Among the submissions to the consultation on effects of COVID-19 is a submission that comprises notes from a discussion on the implications of COVID-19 for the DMO in a meeting that the AER held with its Customer Consultative Group (CCG). The CCG is an excellent group with which to discuss such matters, but the CCG does not represent all stakeholders, and the discussion was on only one aspect of the effects COVID-19, i.e. the effects on the DMO.

One possible model that the AER might consider as a framework for stakeholder consultation on COVID-19 effects is the review of the Rate of Return Guideline which took place during 2017-18, where the AER deployed a sub-panel of the CCP and various Reference Groups.<sup>9</sup> That is one idea; other models would also be suited.

#### **3.4. OUR CONCLUSION ON WHETHER THE AER SHOULD DELAY ITS FINAL DECISIONS**

The AER obviously needs to make a very quick decision on this question, which it should make based on its own judgement and taking into account stakeholder input. More generally, we suggest that the AER should put in place an overall framework, including effective stakeholder consultation, to consider all aspects of effects of COVID-19.

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<sup>9</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-instrument-2018/consultation>

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#### **4. WHAT WILL BE THE EFFECTS OF DELAY ON OTHER STAKEHOLDERS AND REGULATORY PROCESSES?**

The AER has stated: “Should our final revenue determinations be delayed to late May, we would work closely and quickly with the impacted network and retail businesses to enable new retail prices to be in places for 1 July 2020.”

This is of course appreciated, because network businesses need to put in place network tariff structures and prices for 2020-21 at the earliest opportunity, which retailers need to take into account in setting retail prices for 2020-21.

We have also considered what might be the effects of delay on two other regulatory processes for determining retail prices for 2020-21: the AER determination of the DMO, and the Queensland Competition Authority (QCA) determination of notified prices in regional and rural Queensland. We are advising / have advised QCOSS on both these determinations of retail prices.

Our concern for both these processes is partly to ensure that any price reductions to consumers resulting from lower network charges from 1 July 2020 are passed on to those customers in full and without delay, particularly in regard to vulnerable customers and customers experiencing hardship and affordability issues which may be exacerbated by COVID-19.

##### **4.1. EFFECTS OF DELAY ON THE AER DETERMINATION OF THE DMO**

Network prices to apply from 1 July 2020 are key inputs into the AER’s determination of the DMO for 2020-21. Any delay in setting those network prices could materially affect the calculation of the DMO.

One of the submissions to the AER on the implications of COVID-19 for the DMO price determination for 2020-21 proposed that the AER should recommend to the Federal Government a delay in the final 2020-21 DMO from 30 April 2020 until 15 June 2020.

We are not aware of any action being taken to put that into fruition, if indeed it is a practical proposal. Therefore, we are basing our comments here on an assumption that the AER is still proposing to issue its DMO price determination for 2020-21 on or before 30 April 2020.

That being the case, it is important that the DMO team have access to the very best information to meet that timeframe. We take heart that the AER has stated:

SA Power Networks, Energex and Ergon Energy are required to produce separate annual pricing proposals for the 2020-21 year following our final revenue determinations. To develop these prices, we propose to set the allowed revenue in the first year using the February forecast of inflation from the Reserve Bank. We will publish the allowed revenue for the first year at the end of April. If the May forecast leads to different revenue outcomes, we would make adjustments to the revenue allowances in the following years so that the correct revenue is allowed over the five year the regulatory control period for these businesses.

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Normally, the AER includes in its final decision the parameters for the network to set tariffs, including the AER's decision on the tariff structures to apply each year. At the same time, the AER gives guidance to the network on how to set prices in the network's annual pricing proposals, so as to create a "glide path" over the regulatory period (and into the next regulatory period).

Publishing of the allowed revenue for the first year of the regulatory period at the end of April 2020, alongside the AER's tariff structure decisions for 2020-21, and basing that on the information available at that time, should mean that the AER's DMO team has the same information available to it for its end of April decision, whether or not there is a delay in the final network decisions.

Put another way, the content of information on allowed revenue, tariffs and tariff structures that is provided in regard to the year 2020-21 that is published in April 2020 should be the same whether or not the AER decides to delay the final decisions.

If this is the case, then delay of the final network decisions should not affect the DMO.

(This assumes also that the AER makes this information available in advance to the DMO team, which we would expect to be the case with or without delay to the final network decisions.)

#### **4.2. EFFECTS OF DELAY ON THE QCA DETERMINATION OF NOTIFIED PRICES**

The QCA's determination of notified prices for 2020-21<sup>10</sup> relies (inter alia) on information on both the DMO and on Energex network pricing for 2020-21.

We have covered above that the DMO should not be impacted by delay in the finalisation of network decisions for 2020-21, with the provisos set out above.

We note that there is a timetable for the network businesses to submit their annual pricing proposals to the AER after publication of the AER's final decision, and for the AER to respond and for the businesses to publish final network pricing for the coming year. We expect that for 2020-21 the businesses and the AER will follow that timetable commencing from the publication of the decisions for 2020-21 in April 2020, and not wait till the full decisions are published in the event they are delayed to May 2020.

Our analysis suggests that this should ensure that the QCA's determination is also not affected if there is delay in the AER's finalisation of network decisions till May 2020.<sup>11</sup>

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<sup>10</sup> See <https://www.qca.org.au/project/customers/electricity-prices/regulated-electricity-prices-for-regional-gld-2020-21>

<sup>11</sup> We caveat this by stating that we have not yet discussed this with the QCA, and intend to do that very shortly.

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## 5. WHAT OTHER ACTIONS SHOULD THE AER TAKE IF IT DELAYS ITS FINAL DECISIONS?

Beyond our suggestions in earlier sections of this report, we also ask the AER to be as transparent as possible in its publication of its decisions on network pricing, on the DMO, and other matters. As a general rule, in accord with the AER's confidential guideline, the redaction of confidential material should be kept to a minimum, and information that is not confidential that is provided to a subset of stakeholders and interested parties should be made available to all interested parties.

We also believe that it would be helpful for the AER to liaise with the QCA regarding how the QCA uses and interprets the DMO decision, given especially that this is the first year that the QCA is taking the DMO into account in setting notified prices, and that the QCA's draft determination on notified prices has not indicated in any detail how the DMO will be applied to the QCA's final determination or provided a worked example or similar.<sup>12</sup>

Issues that we have thought of to date include:

- The fact that the DMO determination includes an allowance for metering charges, but the notified prices determined by the QCA exclude any allowance for metering charges. Therefore an adjustment will need to be made to the DMO before application to notified prices by the QCA.
- Ensuring that when the DMO is compared to notified prices, a consistent approach is taken in regard to whether GST is included or excluded.

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<sup>12</sup> We again caveat this by stating that we have not yet discussed this with the QCA, and intend to do that very shortly. Nor are we aware whether any discussions on these matters have already been held between the AER and the QCA, which may already have covered the issues we raise here.