

**Network of
Illawarra
Consumers of
Energy**

**Network of Illawarra Consumers of Energy
Submission on the AER's Better Resets
Handbook
October 2021**

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Introduction

The Network of Illawarra Consumers of Energy (NICE) is a recently formed informal network advocating for the energy transition to a net-zero carbon future to be managed with the interests of consumers at heart.¹ This necessary transition needs to occur at least cost to consumers while maintaining reliability and security of energy services, appropriate consumer protections for essential services and a just transition for affected workforces.

We believe there is a role for regionally based advocacy within the context of nationally consistent energy policy. The choice and options for energy supply differ by geographic region because different climatic conditions affect demand and supply options, and different risk factors impact resilience planning. This submission has been prepared by David Havyatt, who is the sole author.²

The AER is to be congratulated on publishing the *Draft Better Resets Handbook* of September 2021 and revoking the 2013 *Better Regulation: Consumer Engagement Guideline for Network Service Providers*. We welcome the opportunity to comment on the Draft Handbook. However, we note that a 'targeted briefing for invited stakeholders' is a strange way to commence consultation on the subject of consumer engagement. While the AER encourages networks to develop their proposals alongside consumers, it is developing the handbook in the traditional way of deciding on a model and then consulting.

This submission has three substantive sections following this introduction. The first section provides some background on economic regulation and why there is interest in consumer engagement in economic regulation. This section introduces the distinction between consumer engagement and consumer negotiation. The fundamental difference is that the latter explicitly includes an objective of reaching an agreement with consumers, that is the meaning of 'negotiation.' Both the NewReg process and the process followed by Powerlink in its most recent reset reach the standard of negotiation.

While we understand the currently favoured position is to describe NewReg as just an example of an enhanced engagement program among others, the essential difference remains that NewReg rested on reaching an agreement. At the project team's urging, AusNet formed its Consumer Forum entirely from individuals not otherwise involved as consumer advocates in energy. This choice has led to what the author believes is a distorted view of the process.³

The second section provides some comments on the sections of the Draft Handbook. These comments draw out the similarity between the AER's proposed 'targeted review stream' and the

¹ The network has not yet started actively recruiting participants.

² Mr Havyatt was employed as Senior Economist at Energy Consumers Australia from October 2015 to August 2020. In that capacity he was a member of the NewReg Project Team. For the avoidance of doubt, nothing in this submission is the position of Energy Consumers Australia.

³ The author contends that the choice of an entirely independent forum, which was modelled on the Scottish Water approach, was the right decision. The members of the forum attached the task from a blank slate rather than with attendant prior baggage, yet the process did not reduce the ability of consumer advocates to be heard by AusNet and the forum.

NewReg process as described in that project's Approach Paper. Consequently, we highlight three elements that should be included in the targeted stream.

1. The network business should be required to lodge an Engagement Plan with the indication of intent to use the targeted review stream,
2. The Engagement Plan must identify the process and/or entity that will provide the independent consumer report in the Engagement Plan, and
3. The AER should provide more detail on its expectations on the content of the independent consumer report, specifically that the report must identify those aspects of the proposal that consumers support (i.e. agree with or are capable of acceptance) and any areas where consumers want particular AER attention.

This section also suggests that the AER is misinterpreting the objectives of the national energy laws. This is a view the author has previously shared with the AER concerning its interpretation of the objectives in the context of the review of the Rate of Return Instrument.⁴

The third substantive section responds to the consultation questions posed by the AER. A short conclusion follows this.

Nothing in the submission is confidential, and the AER may publish it on its website.

⁴ The letter should appear on the AER's website here shortly <https://www.aer.gov.au/publications/guidelines-schemes-models/rate-of-return-instrument-2022/preparation#step-76610>

Background

The purpose, form and goals of economic regulation of networks

Before we discuss how effective the Draft Handbook is at ensuring networks regulatory proposals reflect genuine consumer engagement and that the AER will regulate accordingly, it is worthwhile to ask how consumer engagement fits with the task of economic regulation.

All Australian energy policy and regulatory decisions are designed to promote economic efficiency for the long-term interests with respect to price and 'quality' (where quality is a vector including supply quality, safety, asset reliability, system security and resource adequacy).⁵ As part of the over-arching goal, the industry was restructured to separate potentially competitive elements (generation and retail) from the networks that are natural monopolies (defined as one producer can provide all the output at a lower cost than two or more).

In this framework, the networks are subject to economic regulation. Among a host of potential reasons economic theory offers up, there are two normative reasons by comparison to competitive markets. Orthodox theory tells us that all firms in a competitive market price at (short-run marginal) cost (efficient prices), and all firms produce at the lowest possible cost (efficient costs.) The first normative reason is that, compared to a competitive market, a monopolist has the opportunity and incentive to price above cost and earn an economic rent (resulting in allocative inefficiency.) The second is that a monopolist has the opportunity and sometimes the incentive to incur more cost than necessary or to reduce product quality (resulting in productive inefficiency.)

US-style rate of return regulation is designed to set prices equal to costs. Pure price caps will provide a maximum incentive to reduce costs, but none of the benefits is passed on to consumers. The idea that regulators can compute the efficient costs and then use these to set prices and thus achieve efficient costs ignores the requirement for the business to exert effort to reduce costs and that additional effort could further reduce costs.

The work of Laffont and Tirole compiled in their *A Theory of Incentives in Procurement and Regulation* is instructive. This work is most commonly identified with the focus on using a menu of contracts as a means to get the regulated business to reveal their cost type. However, its first conclusion is that economic rent is the price the regulator must pay to elicit cost-reducing effort. That is, the regulator cannot achieve simultaneously efficient prices and efficient costs. It further concludes that eliciting the optimal amount of effort involves a differential in the strength of the incentives for each firm depending on their cost type.

⁵ The paper written by the author for Energy Consumers Australia explains that the concept of efficiency and the concept of the long-term interests of consumers are not alternative descriptions; each implies the other. See <https://energyconsumersaustralia.com.au/publications/interpreting-the-long-term-interests-of-consumers-2>

An alternative conception of regulation is as a form of incomplete long-term contract between networks and consumers, both of whom make sunk fixed cost investments. This necessitates the direct consideration of the interests of consumers. As Biggar noted:⁶

If (as argued here) the primary objective of public utility regulation is the re-creation of the long-term contract the parties would have negotiated if they could have negotiated costlessly ex ante, then who better to negotiate and agree key regulatory outcomes than the parties themselves? Customers of service providers should be directly involved in negotiating regulatory outcomes.

The need to focus on 'regulatory outcomes' rather than just the allowed input costs also reflects the changing nature of the function of distribution networks and the increased focus on explicit outcome incentives as developed under Performance-Based Regulation.⁷

The evolution of consumer engagement

The AER's Draft Handbook comes nine years after the rule change that instituted a requirement for network service providers to include details of their engagement with consumers in their regulatory proposals. The long history of the journey is, we believe, relevant to the discussion of the content of the Draft Handbook.

The obligation for consumer engagement by network service providers before lodging their regulatory proposals was introduced by the *Economic Regulation of Network Service Providers* rule changes in 2012.⁸ Those rule changes followed proposals from the AER and a collection of businesses called 'Energy Users Rule Change Committee.' Neither proposal included anything on pre-lodgement consumer engagement.

The desirability of better-resourced consumer engagement was a feature of the submission from Energy Networks Australia, which called for the establishment of what eventually became Energy Consumers Australia.

Several consumer organisations cited a speech by then IPART Chair Rod Sims to a June 2011 PIAC conference in which he advocated for pre-lodgement consumer engagement. This appears to be the first public call for an explicit requirement for pre-lodgement engagement. IPART had already commissioned and published a report from CEPA on engagement practices before the rule change proposals were lodged. IPART published its *Customer engagement on prices for monopoly services: Final Report* in August 2012.⁹

We consider that customer engagement can provide regulated businesses with valuable information about what service levels and service offerings their customers prefer, which they may not otherwise obtain due to

⁶ Biggar, D 2011, 'Public utility regulation in Australia: Where have we got to? Where should we be going?', in prepared for the Utility Regulators' Forum.

⁷ For a good discussion of PBR in this context see Lowry, MN & Woolf, T 2016, *Performance-Based Regulation In A High Distributed Energy Resources Future*.

⁸ <https://www.aemc.gov.au/rule-changes/economic-regulation-of-network-service-providers>

⁹ https://www.ipart.nsw.gov.au/sites/default/files/documents/final_report_-_customer_engagement_on_prices_for_monopoly_services_-_august_2012-%5Bw162380%5D.pdf Interestingly by the time the report was produced, Peter Boxall had taken over as Chair of IPART and the other participating member was Mr James Cox PSM.

4the absence of competitive pressure. Therefore, it is good practice for such businesses to use customer engagement to inform the development of their pricing proposals to the regulator – particularly, their proposals on discretionary operating and capital expenditure (which can affect their discretionary service levels), and to a lesser extent, their proposals on changes to their price structure (which can affect their service offerings).

We restate our established position that the water businesses should be encouraged to accompany discretionary expenditure proposals with evidence of the customer engagement they have undertaken... We also encourage water businesses to accompany their price structure proposals with customer engagement evidence.

The requirement for networks to engage in and report on consumer engagement was incorporated into the NER Chapter 6¹⁰ as a new subsection in rule 6.8.2

(c1) The regulatory proposal must be accompanied by an overview paper which includes each of the following matters:

- (1) a summary of the regulatory proposal the purpose of which is to explain the regulatory proposal in reasonably plain language to electricity consumers;*
- (2) a description of how the Distribution Network Service Provider has engaged with electricity consumers and has sought to address any relevant concerns identified as a result of that engagement;*
- (3) a description of the key risks and benefits of the regulatory proposal for electricity consumers; and*
- (4) a comparison of the Distribution Network Service Provider's proposed total revenue requirement with its total revenue requirement for the current regulatory control period and an explanation for any material differences between the two amounts.*

The Rule changes also inserted new sub-sections 6.5.6(e)(5A) and 6.5.7(e)(5A):

6.5.6 Forecast operating expenditure...

(e) In deciding whether or not the AER is satisfied as referred to in paragraph (c), the AER must have regard to the following (the operating expenditure factors):...

(5A) the extent to which the operating expenditure forecast includes expenditure to address the concerns of any electricity consumers to the extent those concerns have been identified by the Distribution Network Service Provider in the course of its engagement with electricity consumers;

6.5.7 Forecast capital expenditure...

(e) In deciding whether or not the AER is satisfied as referred to in paragraph (c), the AER must have regard to the following (the capital expenditure factors):...

¹⁰ For simplicity only the references to electricity distribution economic regulation are included.

(5A) the extent to which the capital expenditure forecast includes expenditure to address the concerns of any electricity consumers to the extent those concerns have been identified by the Distribution Network Service Provider in the course of its engagement with electricity consumers;

Following the *Access, pricing and incentive arrangements for distributed energy resources rule change* sub-sub-clause 6.8.2(c1)(2) has now been amended to read:

(c1) The regulatory proposal must be accompanied by an overview paper in reasonably plain language which includes each of the following matters:...

(2) a description of:

(i) how the Distribution Network Service Provider has engaged with relevant stakeholders including distribution service end users or groups representing them and (in relation to the tariff structure statement) retailers and Market Small Generation Aggregators in developing the regulatory proposal and the proposed tariff structure statement including the export tariff transition strategy;

(ii) the relevant concerns identified as a result of that engagement; and

(iii) how the Distribution Network Service Provider has sought to address those concerns;

Following the 2012 rule change, the AER undertook a series of consultations on Guidelines under the general banner of *Better Regulation*¹¹, one of which was the *Consumer Engagement Guideline for Network Service Providers*. However, the related *Better Regulation: Expenditure Forecast Assessment Guideline for Electricity Distribution*¹² did not refer to network engagement with consumers.

Despite the title, the Guideline provided little guidance. The AER also made minimal commitments on how it would consider the network's consumer engagement when assessing the regulatory proposal.

When we review regulatory proposals, revenue proposals and access arrangements (expenditure proposals), we will have regard, on a case by case basis, to how a service provider engaged with its consumers and accounted for the long term interests of those consumers.

The Guideline provided little practical guidance to NSPs on engagement. Instead, it enunciated four overarching principles: clear, accurate and timely communication; accessible and inclusive; transparent; and measurable. Otherwise, the guideline merely expected a sequential process of setting priorities for engagement, delivering engagement, articulating the outcomes, and regularly reviewing engagement.

¹¹ <https://www.aer.gov.au/networks-pipelines/better-regulation>

¹²

<https://www.aer.gov.au/system/files/AER%20Overview%20of%20the%20Better%20Regulation%20reform%20package.pdf>

The 2012 reforms also saw the creation of the Consumer Challenge Panel (CCP). In December 2013, the AER wrote to the (then) Energy Networks Association (ENA) attaching a short note from the CCP¹³, and effectively summarised the position:

The CCP has raised with the AER the importance of effective consumer engagement. Briefly, the CCP has noted that NSPs' regulatory proposals need to reflect consumers' preferences and consider quality of supply and services versus low or stable prices. In any consumer engagement, NSPs should communicate clearly to consumers the cost and price implications of options put to them.

The CCP was quick to criticise networks for their consumer engagement, writing letters to the AER on 16 July 2014¹⁴ and 30 October 2014¹⁵. ENA responded by, in conjunction with the CSIRO, publishing a *Customer Engagement Handbook* in 2016.¹⁶

To promote good engagement practices, ENA partnered with Energy Consumers Australia to institute the annual Consumer Engagement Award in 2017.¹⁷ As reflected in the published summaries of nominations for the award, Networks progressively have developed their engagement practices since.¹⁸

Beyond engagement to negotiation

Also in 2017, New Reg commenced. The project eventually had the secondary title *Towards Consumer-Centric Energy Network Regulation*. Quoting from the NewReg Directions Paper:

The Australian Energy Regulator (AER), Energy Networks Australia and Energy Consumers Australia agreed to establish a project aimed at improving engagement on network revenue proposals, and to identify opportunities for regulatory innovation.

The overall vision for the project is that energy consumers' priorities and stated preferences should drive, and be seen to drive, energy network businesses proposals and regulatory outcomes. We believe there are significant opportunities to better incorporate consumer preferences in revenue determination processes, and to improve consumer trust and confidence in network regulation. Further, there is scope to improve the efficiency and effectiveness of the regulatory process.

The project is proposing a new dialogue and a better process to align interests so that revenue proposals and AER determinations reflect the interests of consumers. This will also provide consumers with confidence that the network revenue is no more than necessary. Other regulatory processes associated with

¹³

<https://www.aer.gov.au/system/files/AER%20letter%20to%20the%20ENA%20regarding%20the%20consumer%20engagement%20advice%20%E2%80%93%20December%202013.pdf>

¹⁴ https://www.aer.gov.au/system/files/Consumer%20engagement%20advice_140707.pdf

¹⁵ https://www.aer.gov.au/system/files/Consumer%20engagement%20advice_141030.pdf

¹⁶ https://www.energynetworks.com.au/assets/uploads/customer_engagement_handbook_july_2016.pdf

¹⁷ <https://www.energynetworks.com.au/news/media-releases/consumer-engagement-and-innovation-recognised-in-new-energy-awards/>

¹⁸ See <https://www.energynetworks.com.au/resources/reports/2020-reports-and-publications/consumer-engagement-report-2020/> and <https://www.energynetworks.com.au/resources/reports/2021-reports-and-publications/consumer-engagement-report-2021/>

revenue determinations, such as tariff structures, can also benefit from an innovative approach to consultation.

Consumers need to be partners in regulatory processes – respected, recognised and “rewarded” with outcomes about which they can be absolutely confident provide the services they want at an efficient cost (lowest cost that delivers the services consumers want).

A process that puts consumers at the centre of the regulatory process will benefit network businesses and the regulator.

Upfront agreement that the network business revenue proposal reflects consumer interests provides greater certainty than lengthy and detailed regulatory processes about what the long term interests of consumers are.

A new regulatory process also needs to support the transformations occurring in the energy sector. Consumers now have additional choices they can exercise to express their preferences through investments in generation and storage technologies.

The core concepts inherent in the design of the process were:

1. Reaching Agreement: The core outcome of the process was the extent to which the consumers agreed that the network's revenue proposal reflected consumer preferences and priorities.
2. The Counterparty. To reach an agreement, the network business needs a counterparty to that agreement, called the Consumer Forum in the Approach Paper.¹⁹
3. Early Engagement. To ensure the Consumer Forum didn't agree to proposals that the AER would not be able to accept, the AER would provide support to the Consumer Forum.
4. The Engagement Plan. To enable the AER to commit the resource, the business was required to submit an engagement plan that the regulator would need to agree to before committing to supporting the process.
5. Governance and Support. The Consumer Forum needed to be seen as independent and receive support from the business and the regulator.
6. The Consumer Perspective. The Consumer Forum was not constructed to ‘represent’ consumers; the onus for discovering consumer preferences fell squarely on the shoulders of the network business. The Consumer Forum needed to satisfy itself that it, and the network business, were properly researching consumer preferences and that this information was adequately incorporated in the development of the revenue proposal.
7. Documenting Agreement. The core outcome of the process was the extent to which the Consumer Forum agreed to the network's revenue proposal. The extent of that agreement (or disagreement) needed to be formally reported to the AER (and all other stakeholders) together with the basis for reaching that agreement.

¹⁹ The importance of a formal counterparty was also an issue raised by a consumer advocate at one of the steering committee meetings.

AusNet Services trialled the NewReg process for its electricity distribution revenue reset. Evaluating the AusNet proposal alongside the other Victorian distribution businesses prompted the AER to develop its Framework for considering consumer engagement which appeared as Table 7 in the draft decision overviews.²⁰

Consumer engagement after NewReg

Other innovations have occurred since, including Powerlink's regulatory proposal, which the AER has substantially approved in its Draft Decision. Powerlink used an engagement process focussed on developing a proposal 'capable of acceptance by the business, consumers and the regulator' with a Revenue Proposal Reference Group made up of members of its Customer Panel. This differs from the NewReg approach in choosing a group of advocates and some big customers rather than an independent group; however, the task of the small group was still to represent a broader constituency of consumers. In practice, the 'capable of acceptance test' requires the network to reach an agreement with consumers because they wouldn't regard it as capable of acceptance if they didn't agree.

The NSW electricity distribution businesses, which are currently establishing their consumer engagement processes and (I am advised) will be publishing details shortly on their website. Ausgrid advertised for an independent chair for a Reset Customer Panel, with other members drawn from its Consumer Consultative Committee. The RCP was stated to be responsible for representing the long-term perspectives of our customers and helping ensure customer views are reflected within the Ausgrid 2024-29 Regulatory Proposal. The RCP will also be responsible for developing and publishing independent reports on Ausgrid's draft regulatory proposal, regulatory proposal, and revised regulatory proposal.

²⁰ <https://www.aer.gov.au/system/files/AER%20-%20Draft%20decision%20-%20AusNet%20Services%20distribution%20determination%202021-26%20-%20Overview%20-%20September%202020.pdf>

The AER's Proposals

Objective of the Proposal

NICE strongly supports the objective of incentivising networks to develop high-quality proposals with consumers so that regulatory outcomes better reflect the long-term interests of consumers.

In the Draft Handbook, the AER has outlined a process it refers to as the 'targeted review stream', which the AER contrasts with the 'current approach.' The targeted stream includes a comment at the Regulatory Proposal stage that requires the network to 'show how consumer feedback on the draft proposal has been accounted for.' However, this statement is in the wrong column – all network businesses have to do this (e.g. see NER 6.8.2(c1)(2).)

We note that the elements of the targeted stream are similar to the core elements of the NewReg approach. It starts with the network business notifying the AER of its intent and the AER staff then being available to support consumers. Its indicator of success is the 'independent consumer report' that is provided to the AER. The AER then gives weight to the elements of the proposal supported by consumers.

The differences between the targeted stream and NewReg are that the AER apparently puts no criteria on the content of the notification, and the AER makes no prescription in the process description about what it means for there to be an independent consumer report.

Disappointingly, the AER has not proposed any Rule changes to empower it to give any greater weight to the outcomes agreed with consumers than was the case in NewReg. Nevertheless, the NewReg project always assumed that a proposal agreed by the network and consumers developed within the guidance provided by AER staff would be a better quality proposal and more capable of acceptance.

Expectations on consumer engagement

This section generally repeats with additional detail the criteria laid out in the table developed for the Victorian electricity distribution resets. This consistency and further detail are welcome. However, we take issue with the statement that introduces this section. The AER says:

The networks we regulate are natural monopolies that supply an essential service. High quality consumer engagement is essential for ensuring that networks provide the services that meet the needs of their consumers, at a price that is affordable and efficient.

Whether the networks provide an 'essential service' is irrelevant to the task of regulation, which is necessitated by their natural monopoly characteristic. Further, in a regulatory context, an 'essential service' is ambiguous; as an economic concept, it is equivalent to a 'bottleneck facility' while, in energy, it is used as a social concept of a service essential for life. This ambiguity is an issue because retailers acquire the essential service under the economic concept, not consumers.

We further argue that consumer engagement is necessary to ensure the service reflects consumers' 'preferences and priorities rather than 'needs.' The former captures that the issues involved are primarily the subjective views of consumers.

We also find the phrase 'at a price that is affordable and efficient' to be confused. Firstly, we avoid the use of 'affordable' in our advocacy. It has no place in the objectives of the Australian Energy Market Agreement nor the energy laws. Affordability depends on two parameters, the price of the good and the income of the purchaser. The AER regulatory decisions only have an impact on part of the price of the good. In setting that part of the price, the AER only contributes to affordability by ensuring that current and future consumers pay no more than they need to for the quality of service they are prepared to pay for.

As described above, an 'efficient' price is one that is equal to costs, no matter the cost level. The purpose of the incentive regime is to give networks an incentive to reduce costs, to be productively efficient, but in the process, the reward to the network is economic rent through inefficient prices.

We note that at 4.3.1, the AER states that it is important that network businesses 'transparently set out their engagement plans.' The AER proposal varies from the NewReg requirement for the network business to submit its engagement plan as the trigger for the AER considering committing resources to support consumers through engagement. We believe the transparency of the engagement plan and the understanding of both parties of the expectations of AER support will be facilitated by starting the process with the network business publicly lodging its engagement plan with the AER.

Expectations on capital expenditure proposals

Once again, we take issue with the AER's description of its task. The AER is not seeking to ensure that 'consumers are provided with safe, reliable and good quality services that meet their needs at an efficient price.' Firstly, we repeat our comments about the concept of 'efficient price.' Secondly, we note that the construct of the objectives of the national energy laws is the achievement of efficiency for the long-term interests of consumers. Efficiency *per se* is **not** the goal. The goal is efficiency as a means to deliver the long-term interests of consumers on a vector of parameters that can be simplified to a price-quality trade-off.

Within the parameters of the existing Rules, the AER has two functions in assessing capital expenditure proposals. The first is determining whether the forecast expenditure is a productively efficient delivery of the asset proposed. The second is whether, at that cost, the investment is required – that is, how does it fit in the price/quality trade-off, including the trade-off between operating and capital expenditure²¹. Many consumer advocates argued through the

²¹ Note, it is a feature of the determination of the allowed rate of return that it determines the rate of efficient marginal substitution between capex and opex. An investment that could be prudent in a low WACC environment may not be prudent in a higher WACC environment.

NewReg process that consumer negotiation was not a substitute for the AER's conduct of the first of these tasks²². Consumer preferences are, however, highly relevant to the second.

Irrespective of these concerns, it is reasonable to expect the regulated business to seek the agreement of consumers that the capex proposals reflect consumers' preferences. To do so, the expenditure has to be linked to the expected outcome. It is also reasonable to expect consumers to highlight for the AER any expenditure proposals where consumers have particular concerns around prudence or efficiency.

Expectations on operating expenditure proposals

The AER states its view that the Rules require the AER to decide:

whether or not we are satisfied that the operating expenditure forecast proposed reasonably reflects prudent and efficient costs required by a network business to deliver the current levels of service to customers.

Thankfully the focus is now on the efficiency of the costs. Without analysing whether this is an accurate description of the Rules, consumers should ask why it is not reasonable to expect a higher level of service. Consumers could reasonably desire to take the benefits of greater efficiency as paying the same amount for a better quality of service.

This is particularly relevant in a world affected by climate change, where network assets are exposed to greater levels of risk. One response to higher risk levels would be to reverse the trend to centralising maintenance resources and instead have them dispersed to be able to respond faster. As an alternative case, Endeavour Energy has instructed the tree services to prune trees so that they need only to be pruned every second year rather than every year. However, this has a consequential loss of visual amenity.

Just as for capital expenditure, it is reasonable to expect the regulated business to seek the agreement of consumers that the opex proposals reflect consumers' preferences. Similarly, the proposals must be linked to outcomes, and consumers should be able to request specific AER reviews.

Regulatory depreciation

Regulatory depreciation is one area where the views of current consumers may inadequately represent the interests of future consumers. Technically, so long as the RAB roll-forward model works, any depreciation schedule has a zero NPV effect on the firm. However, the AER states that it generally employs an approach where 'regulatory depreciation is recovered evenly over an asset's useful life.'

This is an accurate statement of the purpose of RAB indexation, but it gives the false impression that consumers across time pay the same for the use of the asset. While consumers pay the same

²² The author believes that the incentive regime should be harnessed to do more of the heavy lifting on attaining productive efficiency. To put it simply the regulator is constrained to seeing how cheaply something can be done using existing technology and processes, management can consider the opportunities of new processes and technologies to further reduce costs.

real amount as the return of capital in each period, consumers in the near term pay significantly more in return to capital than future consumers.

In an environment where there has been a relatively constant level of capex, this discrepancy has not been material. However, following the ISP, there are significant new large-scale transmission projects, and these assets will not be fully utilised in the earlier periods. In this case, the traditional approach results in current consumers paying not only the highest financing cost but also an unwarranted share of the depreciation cost.

Similarly, where assets have the real prospect of having a shorter useful life than the currently provided life, there is benefit in accelerating depreciation. However, this should be achieved by explicitly reducing the asset life remaining.

Finally, in all cases, depreciation is more accurately provided for if each asset is accounted for separately. This equates to the so-called year-by-year approach, where all the assets of a single class are aggregated as a single asset acquired in that year. The AER should encourage moving to the year by year approach even though its short-term effect is to increase depreciation allowances.²³

The AER summarises its position on depreciation as 'we have not accepted broad changes to the depreciation approach that would bring forward costs to consumers.' While noting the concern that consumer engagement may preference the interest of current consumers over future consumers, we encourage the AER to give strong weight to any proposals by networks for revised depreciation approaches that are agreed to by consumers. We support the AER's proposition that detailed spreadsheets should accompany proposals to change depreciation approaches to show current and future depreciation under the existing and proposed approaches.

In considering targeted reviews of regulatory depreciation, we note that the AER's depreciation tracking module now supports year-by-year depreciation rather than only a weighted average life remaining.²⁴

Tariff structure statements

In our submission to the AEMC's review of metering, we noted that the development of 'cost reflective' network tariffs has been impeded by an expectation that a connection with a cost-reflective tariff (charges from network to retailer) has to have a time or demand dependent price (charge from retailer to consumer).²⁵ This assumption of a necessary connection was

²³ An extensive discussion of depreciation issues is included in the paper *Economic Regulation of Electricity Distribution: Theory and Practice* available at https://www.researchgate.net/publication/352800071_Economic_Regulation_of_Electricity_Distribution_Theory_and_Practice_in_Australia

²⁴ https://www.aer.gov.au/system/files/AER%20-%20Explanatory%20statement%20-%20Proposed%20amendments%20to%20electricity%20roll%20forward%20models%20-%20December%202019_0.pdf

²⁵

https://d3n8a8pro7vhm.cloudfront.net/nice/pages/21/attachments/original/1623628208/NICE_Submission_-_AEMC_Metering_Review.pdf?1623628208 We also made this position in our response to the ESB Post 2025

compounded in 2015 when the Victorian Government mandated that a cost-reflective tariff should only be applied if a consumer had accepted a time or demand varying price.²⁶

It is appropriate for networks to consider consumer preferences in developing their Tariff Structure Statements. Still, it is equally essential that the consideration of the statements focus only on the likely response of retailers to these tariffs when they develop their price structures. The simplest best way of managing potential customer impacts is to require retailers to offer at least one flat rate price in their offers.²⁷

Cost reflective network tariffs are in the long-term interests of consumers so long as the consumer can manage their impact by either the ability to choose a flat rate price or the ability to respond to time or demand varying prices. Therefore, the AER, distribution networks and consumer advocates should focus on rectifying the Rules so that implementation of cost-reflective tariffs can be accelerated.

Options Paper

https://d3n8a8pro7vhmx.cloudfront.net/nice/pages/21/attachments/original/1623628013/NICE_Response_to_P2025_Market_Design_Options_Paper.pdf?1623628013

²⁶ This position was made by Energy Consumers Australia in its 2016 submission on Victorian distribution businesses Tariff Structure Statements – see

https://www.aer.gov.au/system/files/Energy%20Consumers%20Australia%20-%20Submission%20-%20AER%20Issues%20paper%20Tariff%20structure%20statement%20proposals%20-%202020%20January%202016_8.pdf

²⁷ We believe the retail market should be more extensively reformed with the right and obligation to be the 'default' retailer applying to only one retailer for a DNSP, and that right being auctioned every three years to the provider offering the lowest margin between the sum of (unhedged) energy costs and network charges. Only the default retailer would be required to make a 'standing offer.'

Response to Consultation Questions

1. Do you consider the Handbook as set out will achieve the AER's aim of incentivising proposals that reflect consumer preferences and are capable of acceptance

a) If yes to 1, what do you see as the main benefits of the Handbook? Are they the same as those set out in this document or do you consider there additional [sic] benefits which are not listed?

b) If no to 1, what are your reasons for this? Further, what changes do you consider could be made to the Handbook to achieve the aim of incentivising proposals that reflect consumer preferences and are capable of acceptance?

The changes will incentivise proposals that reflect consumer preferences and are capable of acceptance. It will be more successful if the 'capable of acceptance' standard is interpreted to mean 'capable of acceptance by the network, consumers and the AER.' This amounts to an effective agreement between the network and consumers on the proposal, and the agreed proposal is capable of being accepted by the AER within the Rules.

The benefits of proposals that reflect consumer preferences and are capable of acceptance will be consumer-centric regulatory outcomes. The benefits will be cumulative and facilitate the adaptation by networks of their new role as the platform for transactive energy rather than mere delivery drivers for power from transmission terminal stations to consumer connection points. The benefits of that adaptation will be increased efficiency, resilience, and optimal utilisation of distributed energy resources.

2. Do you agree with the proposed targeted review stream and that this a positive change to how we regulate networks? Please include reasons for your views in the answer provided.

The targeted review stream does not appear to vary significantly from the approach already applied to AusNet and Powerlink, though that is a relatively uninformed external view. The networks will need confidence in the AER applying the targeted stream appropriately.

3. Do you consider the Handbook will improve the level of consumer engagement undertaken by network businesses and result in consumer preferences being better reflected in proposals? Please include reasons for your views in the answer provided.

We submit that the correct objective is to improve the quality of consumer engagement rather than the level; the latter could be interpreted as relating more to quantity (or belts and braces the level and quality). The approach will result in proposals reflecting consumer preferences better; however, we believe three changes to the targeted stream process could increase the impact.

The first is to require the network business to publicly submit an Engagement Plan with the notification of intention to access the targeted review stream. This is not an onerous

requirement, given it is a step already taken by network businesses paying particular attention to consumer preferences.

The second is to require that the Engagement Plan specifies what entity and/or process will generate the 'independent consumer report.'

The final change is to add more requirements around the content of the 'independent consumer report.' These should specify that the report must identify those aspects of the proposal with which consumers agree (or that consumers believe the proposals are capable of acceptance.) The report must also identify aspects of the proposal that consumers believe warrant detailed review by the AER.

4. Are the incentives offered by the Handbook sufficient for network businesses to seek access to the targeted review stream process? If you do not consider the incentives are sufficient, then what additional incentives do you think could be provided within the current regulatory framework?

This is a question to which only networks can meaningfully respond. However, the evidence from AusNet and Powerlink is there are significant benefits from pursuing the targeted review stream process. The AER could increase the incentive by clearly flagging that experience of success in the targeted review stream under the proposed process will result in the AER proposing Rule changes to enable the AER to give greater weight to proposals that clearly reflect consumer preferences.

5. The targeted review stream is a new process which we expect to refine and improve as we learn from each iterative application. Therefore our preference would be to first apply the targeted review stream process to a limited number of network businesses. This approach would allow us to better manage the risks of introducing a new process, maximise learnings and manage resourcing constraints. What approach or criteria should we use to determine which network businesses should be selected?

The idea that the AER should 'refine and improve' the approach as it 'learns from each iterative application' is not new. The NewReg Approach Paper stated that the project was 'learning by doing.' The learning from the NewReg trial was in part the table included in the Victorian electricity distribution determinations. We would argue that the learning from both AusNet and Powerlink is that consumer engagement only means something if it results in a positive statement by consumers that the proposal reflects consumer preferences.

The AER should not limit the number of businesses to which it will apply the targeted review stream by arbitrary processes. If there is concern about the volume of companies utilising it, then ration by inserting additional constraints on the content of the Engagement Plan. A well-developed Engagement Plan (including details of the resources to be provided to whatever process is identified for generating the independent consumer report) will result in the AER being required to commit fewer resources to support the consumers in the engagement.

6. Do you agree with the approach to commence the full application of the targeted review stream process to the revenue proposals due in January 2023?

Yes

a) We would be open to considering applying of the targeted review stream process partially to a proposal which is submitted before January 2023. This would allow us to test the process before it is fully applied. Would you be supportive of this approach? Please include reasons for your views in the answer provided.

Yes

b) For stakeholders that answered yes to 6(a), what approach or criteria should we use to determine which network business' proposal should be considered for a partial application?

Retrospective submission of an Engagement Plan and identification of the entity/process to develop an independent report.

7. Do you agree with the expectations for the topics set out in sections 4 to 8 of this document? If not, what changes do you consider need to be made to the expectations? Please include your reasons for any proposed changes.

See commentary on each of the sections above.

8. Is there any further clarification or issues which the Handbook should set out?

Yes, as previously advised, the requirement for lodgement of an Engagement Plan, the need for the Plan to identify the entity/process to provide the independent consumer report, and an indication of the expectations of the content of the independent report.

Conclusion

The Draft Handbook builds on the experience of NewReg, yet it doesn't fully incorporate all the lessons that the AusNet trial delivered nor the additional lessons of the Powerlink approach.

For the AER to give weight to consumer engagement requires more than just the record of engagement activities that meet the AER requirements for sincere, broad and deep engagement with well-equipped consumers treated as partners. It requires clearly evidenced impact of the engagement on the proposal and independent consumer support for the proposal. Whether this is framed as 'agreement' or 'capable of acceptance' is sophistry.²⁸

To ensure that independent consumer support for the proposal can be relied on, the AER needs to examine the Engagement Plan at the outset. The Engagement Plan needs to specify the process/entity that will generate the independent consumer report. In addition, the independent consumer report needs to be explicit about the extent of the consumer support for the proposal.

²⁸ That is, it is sophistry when 'capable of acceptance' means capable of acceptance by all parties, not just the AER.