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Dear COAG Energy Council Secretariat

**AER submission to consultation paper on consumer engagement**

The Australian Energy Regulator (AER) welcomes the opportunity to provide this submission to the COAG Energy Council review of consumer participation in network revenue decision and associated regulatory processes. Please find attached the AER's submission to the consultation paper.

We would be pleased to provide further assistance to the COAG Energy Council Secretariat on this important matter. If you would like to discuss any aspect of this submission please contact Anthony Bell, Director, Network Regulation, on (03) 9290 6914.

Yours sincerely



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**November 2017**

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# 1 Summary

The decisions we make in performing our regulatory roles affect a wide range of individuals, businesses and organisations. Effective and meaningful engagement with stakeholders across all our functions is essential to fulfilling our role, and it provides stakeholders with an opportunity to inform and influence what we do. It helps us to make better decisions, enhances the transparency and predictability of our regulatory activities and processes, and builds stakeholders' trust and confidence in the regulatory regime.

We are committed to continually improving the quality of our engagement and communication, especially with consumers. We continue to explore ways to increase the capacity of consumers to engage effectively in our regulatory processes. Consumer engagement is fundamental to our regulatory roles and responsibilities. Better understanding of consumer views and preferences promotes the objectives of energy sector regulation, especially in the context of the ongoing transformation of the energy sector.

For network regulation, which is the focus of the COAG Energy Council's consultation paper and therefore of this submission, our experience is that there is a significant gap between the businesses and consumer representatives in terms of both their understanding of our regulatory processes and assessment approaches, and ability to provide substantive input into our decisions through oral and written submissions. Consumers have generally found it difficult to maintain the level of engagement required to make a major impact on all aspects of these regulatory decisions. This requires a significant investment of resources, and consumers have competing priorities and sometimes very limited resources. (It is noted that mentions of 'consumers' throughout this submission generally refer to consumer representatives/advocates. There are not many examples of 'household consumers' engaging with the AER in our network regulation processes, but there is increasing direct engagement of small consumers – both household and small business – with the businesses as part of the development of their regulatory proposals.)

Network regulation is complex, creating significant barriers to effective engagement particularly for consumers on the more technical aspects of our regulatory processes. Although we have seen improvement in recent years in consumer engagement and participation, especially since reforms pursued by governments and policy makers in late 2012, we consider there are opportunities to enable consumers to engage in regulatory debates in a more sophisticated manner. This includes through engagement on our network revenue decision processes and guideline development.

National consumer bodies, such as Energy Consumers Australia (ECA), have built capacity and expertise to engage in network revenue decision and guideline processes – especially on ‘high payoff’ issues common across the jurisdictions, such as rate of return. ECA is resourced and has a mandate to give consumers a voice in the energy market.

At a jurisdiction or community level, however, consumer bodies are less familiar with network regulation partly because they do not necessarily regularly engage on these processes. This is not surprising given revenue decisions are made once every five years or so for each network business. Plus, these consumer bodies generally have a wide remit covering a range of essential services, with competing priorities and sometimes very limited resources.

Of concern, these factors mean consumer representatives in a particular jurisdiction – which should have the best understanding of consumer views and preferences in their local area, and whose constituents are the most affected – have less capacity to participate and influence the outcomes of a regulatory process. There is a significant imbalance of views and arguments presented to the AER.

ECA supports consumer advocacy in the energy sector through its Grants Program. This allows consumer bodies to apply for a grant to engage with the networks in the development of their regulatory proposals, and with the AER in network revenue decision and guideline processes (among other things). However, ECA’s overall grants budget is limited, and needs to support a diverse range of advocacy and research work across Australia. Only a small proportion of ECA grant applications seek funding for consumer advocacy on AER network regulatory processes overall.

We consider there is a need to improve the resourcing available to consumer advocates at a jurisdiction level to allow them to contribute more effectively to our regulatory processes. This could include providing greater insights of local community views and/or creating a counterparty to the network businesses. We consider recent examples in Australia and overseas have shown such support gives consumers a greater voice in the process, allows for more constructive debate between all parties, and is likely to have a significant impact on our decisions.

We would welcome the opportunity to further develop the ideas in this submission with the COAG Energy Council Secretariat and broader sector.

## 2 How we engage with consumers in our processes

Effective consumer engagement is essential to build the Australian community's confidence in the energy market, its regulation and the outcomes it delivers. It is important for the AER to gain consumer perspectives and observations to help us make regulatory decisions which achieve the National Electricity or Gas Objectives. Consumer perspectives are critical if the regulatory regime is to be focused on promoting consumers' long term interests.

The focus of the COAG Energy Council's consultation paper is on the AER's revenue determinations and access arrangement decisions under the national electricity and gas laws and rules. This submission focusses on network regulation. The AER is responsible for the economic regulation of electricity networks in the National Electricity Market (covering eastern and southern Australia) and gas pipelines in jurisdictions other than Western Australia and Tasmania. We are also responsible for regulating wholesale and retail energy markets.

In engaging with consumers on our network regulation processes, here are some observations and principles we adhere to:

- We aim to ensure there is input from consumers at all key stages of our work, from setting high-level priorities and approaches to individual decision-making processes
- There is rarely a single consumer interest in a topic, which means input needs to both reflect consumer diversity and come from a range of sources
- While the AER draws on consumer research and other insight during the course of its work, regulated businesses have the primary responsibility for involving their consumers, both on an ongoing basis and in the course of business planning for revenue decision processes
- So far as possible, engaging consumers and their representatives should be done in a way that does not require them to become technical experts
- In those instances where consumer representatives do need to become more expert in order to engage effectively, the AER and businesses both need to help build their capacity and/or bring in expert resources on an ad hoc basis, which may require additional investment.

The AER has a variety of roles and functions, and we engage with consumers in different processes and forums. Our main consumer engagement approaches include:

- Input on our priorities, regulatory approaches and ‘cross-cutting’ themes, and identification of emerging issues for consumers, through our Consumer Consultative Group, regular bilateral discussions with consumer bodies such as Energy Consumers Australia, Public Interest Advocacy Centre, Consumer Action Law Centre, etc
- Consumer input to our revenue decision processes, through our Consumer Challenge Panel (CCP) and capacity building in consumer organisations
- Encouraging regulated businesses to improve the quality and extent of their consumer engagement, through the publication of our Consumer Engagement Guideline for Network Service Providers, assessment by the CCP of individual businesses’ engagement in reset processes, and involvement in the new Energy Consumers Australia (ECA)/Energy Networks Australia (ENA) Awards for engagement and innovation
- Input to individual programs and projects, through reference committees which typically involve both consumer and industry representatives
- Collaborative projects with industry and consumer bodies, such as the current joint AER, ENA and ECA project aimed at developing a new approach to engagement on revenue decision processes.

Some of this engagement is on more of an ongoing basis, while other forms of engagement are on a ‘stand-alone’ basis – and are usually on specific, sometimes one-off issues or processes. Our network revenue decisions for a jurisdiction are ‘one-in-five-year events’, so we generally engage with consumers on these processes irregularly – except to note electricity/gas, distribution/transmission processes are staggered over time in some jurisdictions. We observe consumers are most interested in our electricity distribution revenue determination processes. The irregular nature and geographic focus of revenue decision processes poses particular challenges for building and maintaining consumer capacity.

## 2.1 Recent initiatives to improve our engagement approaches

We have recently reviewed our Stakeholder Engagement Framework to make sure it remains relevant and effective. We heard that some stakeholder groups need assistance to understand the issues and their impact, and to participate in our processes. We will be flexible and consider tailored engagement approaches. We are committed to being proactive and inclusive to encourage participation, and we have said we will assist building the capacity of consumer stakeholders to allow them to make effective contributions.

We continue to explore ways of making our engagement with consumers more constructive. In particular, we are looking to engage with consumers and network businesses to identify key issues earlier, and work collaboratively to resolve them. We are similarly moving to create more open dialogue in areas such as guideline development, including wider use of industry and stakeholder workshops where contentious issues can be openly discussed. This approach offers opportunities to significantly reduce the regulatory costs borne by businesses and consumers alike.

We recently announced a new joint initiative with ENA and ECA to explore ways of improving sector engagement, and identify opportunities for regulatory innovation. The three organisations are exploring development of a pre-lodgement engagement process that facilitates 'mutually advantageous discovery' where the network business' proposal has been developed with critical input from – and been genuinely shaped by – consumer engagement.

We are exploring different consultation and engagement mechanisms. As part of the development of the AER's Rate of Return guideline, we are consulting on the following approaches: an independent panel review of our draft guideline; concurrent 'evidence sessions' where the AER can put questions to expert consultants and explore material issues of agreement and disagreement; a new consumer reference group to facilitate broader consumer participation and engagement; and advice from a sub-panel of our Consumer Challenge Panel. We will review which consultation mechanisms worked best, and begin to incorporate them into our engagement strategies going forward.

Finally, we are developing tools to support better regulation, including new performance monitoring and reporting to help consumers see how well network businesses are delivering the services they pay for. Such



initiatives will assist consumers to participate in and contribute to our regulatory processes, and support engagement between the network businesses and their customers.

## **2.2 Incentivising network businesses to engage with consumers**

The National Electricity Rules require us to take account of network businesses' consultation with their end-customers in considering their regulatory proposals. When determining capital and operating expenditure allowances, we must have regard to the extent to which the forecast includes expenditure to address the concerns of consumers, as identified by the distributor in the course of its engagement with consumers. This creates an important incentive for the businesses to engage with end users.

We have an established Consumer Engagement Guideline for Network Service Providers, which aims to assist the businesses to engage systematically and strategically with consumers on significant issues, so that the provision of their services is aligned with the long term interests of consumers. Although it is non-binding, we expect the networks to demonstrate they have listened to consumers, heard what has been said and reflect these views in their proposals. We expect the businesses to demonstrate a commitment to ongoing and genuine consumer engagement on a broad range of issues relevant to consumers. This includes integrating consumer engagement into their 'business-as-usual' operations.

We want to see, and have seen in some cases, businesses change their approach and become more accountable to their customers. To incentivise continual improvement in the sector, we look to identify examples of success and innovation, and call out examples of poor-quality or inadequate consumer engagement. This commentary can be found, for example, in our revenue decision overviews and speeches by the AER Chair. In some instances, a lack of meaningful consumer engagement by a network business has been a key factor in AER decisions to reject proposed expenditure programs.

We also encourage industry to 'self-regulate' and explore new ways to understand and meet the needs of consumers. We welcome the recent announcement by ECA and ENA of two inaugural energy network industry awards recognising leadership in consumer engagement and innovation. The AER Chair is on the judging panel for these awards, which we hope will help build knowledge of successful engagement approaches and demonstrate their value, as well as providing a reputational incentive for the businesses.

## 2.3 The Consumer Challenge Panel

The role of the CCP is to assist the AER to make better regulatory decisions. It accomplishes this by providing 'wise counsel', insights and ideas from the consumer perspective to challenge the AER, in order to improve decisions. Specifically, the objectives of the CCP are to advise the AER on:

- whether the network businesses' proposals are in the long term interests of consumers – which may be specific to a particular network revenue decision or common across other jurisdictions
- the effectiveness of network businesses' engagement activities with their customers and how this is reflected in the development of the network businesses' proposals.

We recently had the operations and effectiveness of the CCP independently reviewed. The review found that although there was broad support for the objectives and operation of the CCP, changes to the program would increase its effectiveness. The key themes of the recommendations included: improving consistency between sub-panels, working more collaboratively within CCP sub-panels and with AER staff, and clarifications around the roles and expectations of the CCP. The AER accepted the findings and recommendations and implemented them. The changes to the governance and structure of the CCP have made it more cohesive, and its engagements with network businesses, consumer groups and the AER are more effective and collaborative.

Within the CCP there is a mix of experience and skills including consumer advocacy, energy policy and economic regulation, technical and management skills and legal representation. The CCP uses this expertise to bring consumer perspectives to the AER to better balance the range of views considered as part of our decisions. In this sense the CCP is a conduit for consumer views to inform the AER. The CCP also serves to challenge the AER's thinking and 'inject' these consumer views – front and centre – into our decision making. The CCP provides a consumer voice in the AER's considerations, where consumer groups can find it difficult to engage due to the complexities involved.

The CCP provides a capacity building function for consumer groups. It is often able to bridge the gap between network business and consumer groups, breaking down complex and often technologically dense material so that it is accessible to consumers. The CCP also meets with consumers and stakeholder groups to understand jurisdictional issues.

There is however a risk that this could mean consumer groups are less involved in the AER's processes, instead allowing the CCP to act as a de facto for consumer involvement. This is not the intention of the CCP program. The CCP provides a consumer-centred challenge to network businesses and focuses on the consumer interest, but it does not negotiate or advocate on behalf of consumers in the way that a more traditional representative group might. We consider the CCP to be complementary to consumer groups, not a replacement.

### 3 Barriers to effective consumer engagement

It is widely acknowledged that there are significant barriers to effective consumer engagement in revenue determinations and access arrangement processes. We aim to equip consumers to participate in our consultation processes, make issues tangible to consumers and obtain a cross-section of consumer views. But in practice these are major challenges to overcome.

The regulatory framework is complex. For example, Chapter 6 of the National Electricity Rules, which covers the economic regulation of distribution services, is 124 pages long and comprises layers of objectives, including: the National Electricity Objective, Revenue and Pricing Principles, allowed rate of return objective, capital and operating expenditure objectives, capital and operating expenditure criteria, and capital and operating expenditure factors.

The building block model (required under the Rules) and AER's assessment approaches can be technical and complex. There are large amounts of material in regulatory proposals. The AER engages on a broad range of issues, from assessing large investment proposals that expand network capacity, to understanding complicated pricing mechanisms and incentive effects. To assess network revenue proposals, we rely on a wide range of skills internally, including economic, finance, engineering, modelling and legal skills. We also rely on external advisors, such as expert consultants and legal counsel. Assessments of the various building block components of a proposal rely on highly specialised knowledge.

The complexity of the regulatory regime and resource imbalance between consumers and the network businesses create challenges for the consumer voice to be adequately heard, considered and ultimately reflected in regulatory outcomes.

Finally, as discussed in the COAG Energy Council's consultation paper, consumer groups have limited resources to engage in regulatory processes – especially given the competing demands on consumer advocates' time to ensure their diverse priorities and needs are being considered and acted on by decision makers. On the one hand, the consultation paper acknowledges AER attempts to provide enhanced opportunities for consumers to participate effectively in our regulatory processes, and to explore innovative approaches to consultation. On the other hand, the paper justly highlights that 'the creation of such

opportunities puts further pressure on consumer groups to participate in the increasing number of processes and will require the engagement of expert support.' (p. 9) It is a challenge to get the right balance.

## 4 Opportunities for improvement and greater balance

There has been some good progress in the energy sector over the last five years to engage with consumers. Nevertheless, we consider there are opportunities to enable consumers to engage in regulatory debates in a more sophisticated manner.

This possibility is highlighted by a recent AER process where there was greater balance in the use of expert consultants between consumers and the businesses, which led to a more dynamic consultation process.

In our ongoing review of the regulatory treatment of inflation, the AER actively promoted consumer engagement that was supported by expert advice. This review was very technical, requiring an understanding of financial economics, modelling and the current rate of return framework. It was clear to us from the start that consumers could not meaningfully engage and be heard without an expert to assist them.

The AER funded and set up a sub-panel of the CCP, which consisted of members that had technical expertise to understand the complexities of the underlying financial concepts and their interaction with the current rate of return framework. The AER also set up a consumer reference group, which included ECA. Given the complexities, ECA also engaged two independent expert advisors to engage in our review.

This resulted in a better balance of material presented to the AER. We also observed that at the multiple public workshops we ran, we were better able to bring all stakeholders to a common understanding of the key underlying issues, which resulted in more balanced and constructive engagement between all parties.

There are international examples that tell a similar story. Independent, well-funded customer advocacy has been a feature of public utility regulation in the United States for several decades. Another interesting case study is Scottish Water. The regulator, the Water Industry Commission for Scotland (WICS), created a 'Customer Forum' to represent customers in negotiations with the monopoly business, Scottish Water. The Customer Forum receives substantial funding and support. Its purpose is to play a key role in the regulatory process by:

- undertaking a research program to establish customers' priorities for service level improvement and expectations in terms of the level of charges

- understanding and representing to WICS and Scottish Water the priorities and preferences of customers
- seeking to secure, through its participation in the regulatory process, the most appropriate outcome for customers on those priorities and preferences, in particular by seeking to establish an 'agreed business plan' (among other things).

## 4.1 Proposed dedicated grants program on network regulation processes

We consider the above examples in Australia and overseas show improving resourcing available to consumers to equip them to develop capacity, and potentially engage expert consultants for network regulation processes, allows for more balanced, positive engagement between all parties, and is likely to have a significant impact on our regulatory processes and decisions. Engaging expert consultants, for example, can be a cost-effective and practical approach to support consumer engagement at a deeper level in regulatory processes – particularly where different types of expertise may be required infrequently, rather than continuously. We consider additional funding should be targeted towards jurisdictional consumer representatives to increase the degree of genuinely local input to network revenue decision processes.

National consumer bodies, such as ECA, have an ongoing interest in network revenue decision and guideline processes. ECA is resourced and has a mandate to give consumers a voice in the energy market. It has built capacity and expertise to engage in regulatory processes – especially on 'high payoff' issues common across the jurisdictions, such as rate of return. However, ECA is a national voice for energy consumers, and is not resourced or structured to engage on local community issues in the decisions of more than 30 network businesses across six jurisdictions. It is important that there is sufficient resourcing for 'informed' consumer engagement at the jurisdictional level too.

Jurisdictional consumer representatives have the most relevant connections and insight, but are less likely to have expertise in regulatory processes or technical energy sector knowledge. This is not surprising given revenue decisions for a business or jurisdiction are generally made once every five years, so local groups do not necessarily regularly engage on these processes – except to note electricity/gas, distribution/transmission processes are staggered over time in some jurisdictions. Plus, these consumer organisations generally have a wide remit covering most essential services including energy markets – they have competing priorities and sometimes very limited resources. This means consumer representatives in a

particular jurisdiction, whose constituents are the most affected, may have less capacity to influence the outcomes of a revenue decision process.

ECA supports consumer advocacy through its Grants Program. This allows jurisdictional consumer representatives to apply for a grant to engage with the networks in the development of their regulatory proposal, and with the AER in network revenue decision and guideline processes (among other things). However, ECA has a limited overall grants budget, and a diverse range of projects that it funds across Australia for advocacy and research work. Only a small proportion of ECA's overall grants budget funds consumer advocacy on AER network regulatory processes.

However, we do not consider increasing the amount of funding available to the ECA's current Grants Program would be the best way to improve resourcing for consumer participation in network regulation processes. We consider dedicated funding for consumer engagement on these regulatory processes should be a separate grants program supported by a devoted secretariat. This additional support could provide 'strategic guidance' by, for example, facilitating coordinated action of local consumer advocacy groups. It could also assist with contracting for any external resources that may need to be engaged such as consultancy services and customer research.

We consider the resourcing would need to be sufficient to support engagement of technical experts and consultants with relevant expertise when necessary. This support could enable more effective consumer input by helping, for example, to aggregate consumer preferences and translate these views in the context of the regulatory framework. Such expertise can assist the design and delivery of consumer engagement work, which might range from deliberative or collaborative research approaches such as Citizen Juries, to analytical techniques such as willingness to pay, in order to produce new and current evidence that reflects and provides insight into community views.

We consider ECA is well-placed to provide secretariat support and manage the proposed dedicated grants program on regulatory processes – possibly with the oversight of a program board or steering committee, which could include members from other organisations including the AER. ECA will require sufficient additional funding to enable it to perform this role. Further, the AER could also help consumer advocates make the best use of their resources. For example, we could provide consumer training in collaboration with others, assist jurisdictional consumers to identify key issues, and offer more basic support such as access



to meeting room facilities. To better understand the value of this initiative, it could be first developed as a trial.

One challenge might be to identify suitable recipients of this funding as some areas may not have well-established organisations that would characterise themselves as consumer groups, although they are likely to have a range of local community organisations. ECA would need to have a role to identify and support the early development of local capacity, to enable more engagement from these jurisdictional consumer representatives.

We would welcome the opportunity to further develop the ideas in this submission, including the proposed dedicated grants program on network regulation processes, with the COAG Energy Council Secretariat and broader sector.