
CCP subpanel

Advice to the AER on the Draft Better Resets Handbook: Towards Consumer Centric Network Proposals

AER Consumer Challenge Panel CCP SOEN subpanel

(SOEN refers to Statement of Expectations for Networks, a language replaced by Better Resets Handbook)

Bev Hughson

David Prins

Mark Henley

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Confidentiality

We wish to advise that to the best of our knowledge this Advice neither presents any confidential information nor relies on confidential information for the comments.

The Consumer Challenge Panel subpanel Statement of Expectations for Networks (SOEN)

The AER established the Consumer Challenge Panel (CCP) in July 2013 as part of its Better Regulation reforms. These reforms aimed to deliver an improved regulatory framework focused on the long-term interests of consumers.

The CCP assists the AER to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to the AER to better balance the range of views considered as part of the AER's decisions.

This subpanel was asked for response to the draft better resets Handbook, which came from a process that has previously been referred to as Statement of Expectations for Networks (SOEN).

Acknowledgement of Country

We recognise the traditional owners of the lands on which AusNet Services operates. We respect the elders of these nations, past and present along with the emerging leaders.

1 Context & Summary Response to Consultation Questions

1.1 Context and Background

The Consumer Challenge Panel members who have prepared this submission commence by commending the AER on developing and releasing for comment the Better Resets Handbook.¹ We highlight that all CCP subpanels have contributed actively to the application and assessment of consumer engagement in the development of high quality, effective and efficient consumer engagement. We think that the path to the development of this paper is instructive and reflects that this paper is part of a process that has been of rapid (over about 5 years) cultural and practice change. We commend the Australian energy network businesses, the consumer groups and consumers and the AER for the substantial progress that has been made over the past 4-5 years that provides a base from which this paper can consolidate progress and look forward.

The purpose of the Better Resets Handbook, hereafter generally referred to as the Handbook is important too. The Handbook states:

“This document, the Better Resets Handbook – Towards Consumer Centric Network Proposals (the Handbook) seeks to encourage networks to better engage and have consumer preferences drive the development of regulatory proposals and create a more efficient regulatory process. This gives effect to one of our ‘tilt’ priorities in our Strategic Plan for 2020–25, to achieve our objective of delivering efficient network regulation while incentivising networks to become platforms for energy services.”

The purpose reflects both the long term aspirations of the National Energy Objective, to achieve the long term, best interests of consumers and the shorter term pragmatic goal of encouraging improving practice in consumer engagement, both goals are laudable.

1.1.1 Importance of Consumer Engagement

Consumer engagement is crucial in the economic regulation of natural monopolies as a proxy for the ongoing feedback that competitive businesses receive from customers through ongoing trading and competing. As such, consumer engagement is a most appropriate means for assessing consumer preferences in economic regulation practice.

1.1.2 Recent History and CCP experience

The CCP was established as one of a set of reform measures in 2013 that responded to widespread belief that energy businesses in Australia were failing to respond to consumer interests, with the Productivity Commission and Government Ministers among those promoting better engagement with consumers as necessary to achieve the long term interest of consumers.

The first CCP report was titled “Jam Tomorrow” by inaugural member Dr Gill Owen, as a reflection of consumer frustration at the time, 2014, that there was the regular promise that more network spending today would lead to better long term outcomes, that were perennially just beyond consumer reach. Energy prices continued to rise at a much greater rate than CPI.

¹ <https://www.aer.gov.au/system/files/Draft%20Better%20Resets%20Handbook%20-%20Towards%20Consumer%20Centric%20Network%20Proposals.pdf>

In August 2017, CCP10² responded to the draft Framework and Approach for NSW and ACT distribution business regulation in a paper titled “AER Signals to Encourage High Calibre Consumer Engagement by Energy Network Businesses”.

The CCP10 subpanel presented this paper as part of their response to a Framework and Approach process at a time where network businesses regularly appealed regulator decisions to the Australian Appeals Tribunal through Limited Merits review, processes that consumer groups believe shut them out.

The purpose of the paper was given as being:

“... to provide a range of options to the AER Board that would give signals to network service providers to encourage a continuous improvement approach to consumer engagement. The signals would also be relevant to consumer groups. The assumption being that a culture built on open, authentic and robust consumer engagement will lead to efficient network business operations and consumers paying no more than is necessary for appropriately reliable energy from energy network businesses.”

The summary of the paper commenced with:

“In considering the Framework and Approach (F&A) for NSW and ACT distribution business regulation 2019-24, CCP10 considers that all parties should be seeking an end goal of ensuring:

- 1. regulatory proposals lodged by network businesses where there are “no surprises” for stakeholders, including consumers, and*
- 2. processes for the development, submission and review of proposals are transparent, provide stakeholders with the opportunity to participate, and ensure that the views expressed are considered.*

This can be achieved through consultation that achieves agreement wherever possible.

(Note that ‘no surprises’ does not mean agreement, nor is consensus assumed, though it is desired.)

The proposed end goal is that regulatory proposals lodged by network businesses contain no surprises for stakeholders, including consumers, by applying transparent and informed processes that are not appealed (recognising that removal of Limited Merits Review contributes to this). This being achieved through consultation that achieves agreement wherever possible.

We suggest that the AER can provide a range of ‘signals’ to network businesses about many aspects of consumer engagement to enhance certainty for NSPs in developing ‘no surprises’ regulatory proposals.”

The recommendations from this paper are attached as Appendix 1.

The release of the “handbook” paper by the AER further builds on the ideas that were raised by CCP10, and reflects recent progress too:

- “No surprises” has evolved to NSPs seeking proposals “capable of acceptance” by consumers and regulator.
- The AER’s assessment table (Table 7 in the Victorian distribution Draft Decisions and Table 3 for Powerlink and AusNet Services Transmission Draft Determinations).
- A diversity of engagement methodologies have been effectively applied by network businesses.

² <https://www.aer.gov.au/system/files/Sub-panel%2010%20-%20AER%20signals%20to%20encourage%20high%20calibre%20consumer%20engagement.pdf>

Each CCP subpanel has described effective engagement practice and added to the thinking of the time. We do not describe these various CCP observations in this paper, but note that there is a solid record of the progress of consumer engagement embedded on the collective CCP subpanel reports.

1.2 Summary response to Consultation Questions

The AER is guided by the National Energy Objectives for electricity and gas (the NEO and the NGO): “to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.

Specific questions from the Consultation Paper:

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 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?*

We understand this question to be about improved outcomes from consumer engagement as outlines in the Handbook. With this interpretation, CCP considers that the Handbook will improve the consumer engagement undertaken by network businesses, particularly because the Handbook:

- a. Sends a clear signal from the regulator that they expect continuously improving engagement from NSPs and will recognise effective engagement.
- b. Encourages consumers to participate, knowing that they will be taken seriously
- c. Builds on current and emerging practice in engagement.
- d. Provides a basis for further developments in engagement
- e. Signals directions and purpose for engagement, so improves certainty, without being prescriptive in methodology of approach to engagement
- f. Fosters further discussion and debate

Importantly, the Handbook is directional and principle based, not prescriptive. This is crucial to its application to a diversity of network and reset circumstances.

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 provides a framework for the AER to assess if a business is eligible to have the benefit of a targeted review. The framework is built around the four components of the proposal that will have the most significant impacts on network costs to consumers. These include three major expenditure categories (capital and operating expenditures and depreciation) and network tariffs.

For each of these categories, the AER has set out its ‘expectations’, which include expectations about the technical aspects of the particular expenditure or tariff category and the quality of the engagement with consumers. If a network is judged as submitting a proposal for each category that meets these expectations for that category, then the AER will progress to the next step the targeted review.

For example, the AER set out five ‘expectations’ for the capital expenditure component of the proposal. Assuming the proposal is consistent with these expectations, the AER will target its review on a narrower range of more specific factors for example, important drivers of the forecast, any changes from business-as-usual (BAU) practices, and any new category or program of works.

CCP considers this is a positive change and provides incentives to the networks to ‘get it right’ at the proposal stage, and to genuinely engage their customers in this process. We are particularly pleased to see that the AER is not walking back from its responsibility to ensure expenditure proposals are prudent and efficient. The CCP observed that customers expect, and want, the AER to be playing this role. Customers recognise they do not have the same detailed knowledge, models and overall experience as the AER to ‘accept’ a proposal, although they may indicate they support the process and key elements of the proposal in principle.

CCP has one reservation, which is largely with the capital expenditure section of the draft Handbook. CCP has long expressed its concerns with the long-term trend of declining capital productivity (as measured by the AER’s annual benchmarking reports) and with the limitations of the CESS to incentivise improved capital productivity. We also note there is no in-built mechanism for capital expenditure that is equivalent to the productivity factor that applies to the operating expenditure proposals.

Given this, the current draft Handbook appears to place too much reliance on a capital expenditure proposal showing consistency with BAU processes, and with comparing previous capital expenditure with proposed capital expenditure. The Handbook does not appear to provide incentives for continual improvement in productivity outcomes.

We recommend that the Handbook include a stronger incentive to improve BAU processes and drive improvements in capital productivity, particularly in the face of the pending expansion of network investment as a result of the ISP/REZ programs.

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 understand this question to be about the intended improved process of consumer engagement with ‘level’ referring to IAP2 spectrum type progression to improved consumer impact on reset proposals from lower levels of engagement, e.g. “inform”, to higher levels of engagement described as “collaborate” and “empower”.

With this understanding to recognise that considerable progress has been made by regulated energy networks over the past 4-5 years with a diversity of engagement methods successfully applied. The Handbook provides the encouragement and imprimatur for continuous improvement in engagement practice. This will result in better reflection of a range of consumer views, including disparate opinions being carefully considered and reflected in regulatory proposals, this will lead to improving reflection of consumer preferences.

We also hope that in seeking ongoing improvement in engagement practice that there will be recognition by the AER as well as consumer groups and NSPs that some engagement attempts will not achieve the hoped-for outcomes and that this will be appreciated as constructive. Shared reflection and evaluation of processes that don’t ‘work’ as anticipated are an important aspect of continuous improvement, a key intent of the Handbook.

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 largely a question for network businesses to assess. We have seen to date a desire from several network businesses to provide proposals that are “capable of acceptance”, and for customer representatives to state also that the proposal is “capable of acceptance” (subject to AER assessment), or perhaps better put as “capable of support”. We therefore expect businesses to want to seek access to the targeted review stream process, but different businesses will have different agendas and may seek different incentives. Variations can be accepted provided they are in the long term interests of consumers.

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?*

We agree with the AER’s stated preference first to apply the targeted review stream process to a limited number of network businesses, for the reasons stated by the AER. The businesses should be selected based on where they are up to in the regulatory process when the Handbook is ready for implementation, taking into account the businesses’ early plans and engagement activities that may lead to successful qualification for the targeted review stream process.

Consequently, starting with businesses due to lodge regulatory proposals in or after January 2023 means that the transition timing cannot ready apply to ElectraNet, Transgrid, Murraylink and Victorian gas distribution businesses, all of which lodge during 2022 and are well advanced already in their consumer engagement.

The objective should be that all businesses should have the option of utilising the targeted review stream process, with a suggested timing of all reset proposals lodged in and from 2025.

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?*
 - 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.*
 - 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?*

We agree that the full application of the targeted review stream process should be applied to revenue proposals from electricity and gas regulated networks due in January 2023. This date would allow the relevant networks to review and adjust (as appropriate) their customer engagement processes and to complete a draft proposal with sufficient time to incorporate consumer feedback into the proposals due in January 2023.

It would also ensure that the new CCP (appointed in October 2021) would be able to observe the early consumer engagement activity of the relevant networks.

Q6(a)

With respect to proposals due prior to January 2023, it might be useful to use the opportunity to test the processes in the Handbook, conditional on agreement with the network and with any consumer panels that have been appointed by the network prior to the application of the trial process.

It is likely that the relevant network would have already appointed a customer panel for their reset. For the trial to be worthwhile, it would therefore require the AER to fully participate in the process as early as possible including explaining their role, and that of the CCP in their trial. Decisions would need to be made about the extent to which the AER or the CCP should intervene in an established Panel and customer engagement process (particularly if this has already been agreed between the network and the customer panel), even if the AER or CCP had some concerns about the process.

In order to ensure that lessons are learnt, interim public reports on the strengths and weaknesses of the process should be prepared independently by the network, the AER, the CCP and the network's consumer panel(s) by the third quarter of 2022, in order that lessons could be incorporated into any revised Handbook to apply from 2023.

The AER would need to confirm to all stakeholders that this is a trial process and that any issues would not impact on the AER's final assessment of the network's proposal. It is important that parties to the trial should be able to take 'risks' in their approach and not feel exposed to adverse consequences in the AER's final assessment.

Q6(b)

The fundamental criteria are that the process should be undertaken with the informed consent of the network's Board, senior and operational network staff and the relevant consumer panel(s). There should be evidence provided by the network of agreement to the process by the network's senior management and Board (if applicable).

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.

The expectations put consumers and their needs at the centre of the decision-making. This does not necessarily mean that the consumers' role is to critically assess the details of the 'technical areas' (sections 4-8 of the Handbook) proposal. Consumers are not always in a position to understand the detail nor should they be expected to do so. They can understand and contribute to challenges for the networks, change and larger spending proposals as well as local and consumer impacts.

We acknowledge that the AER's targeted review process recognises this limitation. It does so by signalling to the networks its expectations regarding the 'technical' evidence that the network should provide to demonstrate its capex, opex, depreciation and tariff proposals are prudent and efficient and that the proposal aligns, with asset management and risk management industry standards and controls the growth in the RAB and base opex.

We therefore support the AER's objective for the assessment of a network's proposals for the topics covered by sections 4-8.

The AER's approach also builds on its existing processes, guidelines and models. For example, these processes and models, such as the repex model and the RIT guidelines for capex have been progressively enhanced over many years to address the gaps in the networks' capex proposals.

It is also worth asking whether incentives will in the future rank as a technical aspect of resets and so warrant a place of its own in future iterations of the Handbook. We suspect that the role and application of incentives will be increasingly important for customers in changing and uncertain energy markets.

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

We agree that the Handbook should not be prescriptive. However, we suggest that the following comments would serve as useful "directions" for networks. We emphasise that spending by networks on consumer engagement needs to be prudent and efficient, as with all other expenditure. A consumer

engagement 'arms race' of spending would not be in the best interests of consumers, just as underspending is also not in longer term consumer interests.

Expenditure on engagement needs to be adequate to appropriately resource and support consumers who agree to participate in ongoing engagement and to meet the costs of implementing an agreed engagement strategy and to ensure adequate breadth in the characteristics of consumer interests that are engaged.

As a rule of thumb, we suggest that NSPs are better served in trying to implement as much of a consumer engagement program as possible, in house, rather than outsourcing to external consultants. In house engagement is more likely to permeate the various functions of a business and enhance a consumer-focused culture than outsourcing.

“Process Considerations”

2 Objective for the Handbook

2.1 General Comments

As set out in the AER’s draft, the Handbook aims to incentivise networks to develop high quality proposals through genuine engagement with consumers. This will lead to regulatory outcomes that better reflect the long-term interests of consumers.

Proposals which are developed through genuine engagement with consumers are more likely to be largely or wholly accepted at the draft decision stage, creating a more efficient regulatory process for all stakeholders. The AER considers that this will also lead to many other benefits, including:

- Improved relationships and understanding between networks and consumers;
- Greater faith from all parties in regulatory processes; and
- The generation of new ideas and regulatory approaches that benefit both consumers and networks.

We support the objective of achieving those benefits. The draft Handbook envisages that the benefits will be achieved through a targeted review rather than the AER’s standard assessment approach, where a proposal meets the AER’s expectations for any of the topics covered in sections 4 to 8 of the Handbook – these also being the topics discussed in later sections of this submission.

The Handbook, including the targeted review stream, will operate within the regulatory framework set up by the Rules and Law. The AER’s expectations are not in addition to these requirements, but rather are the AER’s views on how a proposal can be better substantiated to meet the Rules requirements for key topics. The AER’s role as the economic regulator for energy networks means that the AER must satisfy itself that a proposal meets the Rules requirements before the AER can accept it. Where the AER’s expectations are met, it will allow the AER to undertake a more efficient process to determine whether it can accept the relevant parts of a proposal – a targeted review.

For electricity proposals, the AER would provide an early signal and indicate its intention to undertake a targeted and proportionate review at the issues paper stage.

For gas proposals, the Gas Rules do not include a prescribed issues paper stage. The AER considers, however, that the Gas Rules contain sufficient flexibility to allow an early signal to occur at a similar time.

If a network misses out on the early signal, it might still qualify for a top-down/bottom up “targeted review”.

The distinction is important between the early signal stream (which includes a targeted review) and a high-quality process where a proposal is submitted that also qualifies for a more targeted review – e.g. a predominantly top-down/bottom up process where the proposal could be accepted in part or whole at the draft decision stage. This can be further explored in the next iteration of the Handbook, perhaps diagrammatically presenting, in parallel, the key elements and regulatory decision.

2.2 Role of AER and CCP

Figure 1 in the draft Handbook compares a proposed targeted review stream to the current AER assessment approach. Table 1 below advances from that figure, and includes some further ideas on roles

of the CCP. The right-hand column – potential CCP role – is exploratory, and intended as an input for further discussion.

Table 1: Potential CCP functions under Targeted Review Stream approach

	Current	Proposed: Targeted Review Stream	Potential CCP role with Targeted Review Stream approach
Start Pre-lodgement engagement	(Emerging) NSP appoints reset reference group NSPs commence engagement up to 2 years pre-lodgement, some with co-design. AER and CCP observe where time and appointment permits. CCP provides support / confidence to engaging consumers and informal feedback to all parties.	NSP commences engagement up to 2 years pre-lodgement. AER notified of intention to access targeted review stream. AER staff support customers in engagement and provide feedback to NSPs. CCP may observe and engage where necessary.	CCP can provide AER support for engaging customers, and feedback to NSPs and AER, including what others are doing well, and flag concerns early. Provide input to F&A process about engagement expectations and rewards.
Draft proposal	NSP may publish draft proposal.	NSP publishes draft proposal for consultation and updates proposal based on feedback.	CCP meets with interested consumer reps to share observations about key themes and assist in linking consumers with relevant AER expertise CCP responds to draft proposal, via the AER.
Reg Proposal	NSP submits regulatory proposal. Emerging trend is for a draft proposal to precede the actual regulatory proposal.	NSP shows how consumer input has been heard and applied. AER may commission CCP to provide an assurance report.	CCP prepares an assurance report regarding engagement process and outcomes for all revenue proposals. CCP reports on other relevant content aspects of the revenue proposal.
Early signalling		Assurance report details proposal aspects meeting expectations. Topics for targeted review. Topics for standard assessment.	CCP provides assurance report.
Forum and submissions	Seek stakeholder feedback on proposal, issues paper highlights AER view on key themes and issues raised by the proposal.	Seek stakeholder feedback on proposal and AER issues paper positions.	CCP presents at forum and seeks to further explore any issues of concern raised by consumers. CCP likely to lodge submission in response to NSP proposal, AER issues paper and assurance report, including observations of progress.

	Current	Proposed: Targeted Review Stream	Potential CCP role with Targeted Review Stream approach
AER draft determination	AER uses discretion on determining extent of assessment required to publish draft determination on individual components of the proposal.	Additionally, draft determination will highlight the parts of the proposal subject to targeted review and accepted from the review. AER to also highlight if proposal has been exemplary and has been accepted in its entirety.	CCP presents at pre-determination conference.
Revised revenue proposal	Standard assessment process using established regulatory tools, including new issues from revised proposal.	Highly targeted review of any outstanding decisions.	CCP submission responds to draft determination and revised proposal, where there remain live issues potentially updating assurance report, and significant engagement may occur post initial lodgement.
Final decision and BAU engagement	Final Decision published and reset process ends.	AER encourages BAU engagement and potentially indicates issues for further consideration or even resolution.	Potential for AER and CCP to explore post lodgement observation and update to AER.

Source: AER Handbook, figure 1 and CCP analysis

At the public forum about the Handbook process, there was discussion about the role of the AER's CCP and network consumer groups, including challenge functions. (Note that SA Power Networks currently refers to one of their consumer reference groups as a Consumer Consultative Panel, so the same acronym is used.) A question was whether the AER's CCP was duplicating NSP consumer reference groups, particularly where an NSP establishes as reset specific consumer reference / challenge groups.

This is an important question, and our view is that the accountabilities of the AER CCP is to the AER, while NSP consumer groups are accountable in individual networks, so the groups are not duplicates, serving sometimes similar roles but for different 'masters.' (A single CCP accountable to both AER and an NSP would likely be conflicted on occasions as a 'servant of two masters.)

3 Consumer Engagement

3.1 Expectations of consumer engagement

3.1.1 Coping with uncertainty – BAU engagement

The Handbook discussion paper states that part of the expectation that is being applied to NSPs is that:

“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.”

We agree with this overarching statement and add that consumer engagement can be expected to increasingly cover more than core affordability and efficiency questions. Recent CCP subpanels have reflected on the uncertainty confronting energy markets globally, including in Australia.

CCP has been clear that in wrestling with the dilemmas of planning for long term network assets in a more uncertain environment than has historically been the case, that more detailed and more regular engagement with consumers is essential; be it about integration of DER (distributed energy resources) through renewable energy sources, the future of gas in a decarbonised future or impacts of the Integrated System Plan (ISP) produced by AEMO for transmission businesses.

While the focus of this paper is on reset processes, consumer engagement in reset processes is going to be most effective for NSPs for whom ongoing engagement focusing on shared problem solving is businesses as usual (BAU). For example, consumer groups are increasingly asking energy (and other) businesses about the businesses’ medium and longer terms objectives and directions. This can be evident in business narrative, business plan or directions documents that provide basis for a regulatory proposal and build on BAU engagement and relationships.

We expect that assessment of consumer engagement will increasingly need to focus on BAU engagement as well as reset specific engagement. This can be an evolving aspect of application of handbook approaches.

3.1.2 Coping with Uncertainty – Engagement beyond resets

Another aspect of how NSPs cope with uncertainty is to use cost pass throughs, contingent projects and RIT-T / RIT-D (regulatory impact test, transmission or distribution) processes that occur outside of regulatory reset timeframes.

These processes are well described and provide appropriate mechanisms for expenditure decisions outside of the five-year reset process. Yet there is a risk for consumers that significant costs that ultimately consumers pay can be approved with less consumer scrutiny than applies to reset processes. It is important that there are no incentives for NSPs to minimise expenditure proposals in a regulatory proposal, which are then sought through less scrutinised practices.

The AER needs to also consider the consumer engagement expectation for no reset processes to require comparable levels of engagement to those proposed for resets through the handbook process.

3.2 Nature of Engagement

The Handbook appropriately builds on recent and current experience, including utilising the AER’s Table 7 (from the Victorina DNSP resets) and three of the four categories of assessment: “Nature of Engagement”, “Breadth and Depth” and “Clearly Evidenced Impact”, noting that the fourth category, “Proof Point” relates more to AER roles. The handbook’s utilisation of these categories is appropriate.

How far can customer groups and advocates go in making comments about the extent to which a proposal is Capable of acceptance, before it is lodged with the regulator?

The timing is important here, because consumer representatives are increasingly confident in commenting as the regulatory process approaches finalisation.

Before lodgement, we have said at the public forum, that there is an element of “who blinks first” at play. In part, this is because there is an interplay between consumer engagement and capability of acceptance and because the regulator gives consumer engagement due attention in its regulatory decision making, and consumer representatives look to the regulator’s technical expertise in helping to consolidate their thinking.

3.2.1 Basis for considering engagement: IAP2


All parties to engagement benefit from having a basis for engagement and we observe that the International Association for Public Participation (IAP2) spectrum provides a useful base.

This spectrum, developed by IAP2 is already widely applied by NSPs with some engaging directly with the Australasian chapter of the International Association, which we think is appropriate.

The spectrum recognises that the impact of consumer engagement increases as the engagement methodologies more from ‘informing’ through ‘consult’, ‘involve,’ ‘collaborate’ and ‘empower’. The goal of each category of engagement is provided in the figure below, as is the corresponding “promise to the public”, which we think provides the best way to focus on the tangible methodologies to be applied.

We suggest that the Handbook can better reflect the usefulness of the IAP2 spectrum and encourage the ENA, maybe with AER support, to consider exploring a more direct relationship with the IAP2 Association for Australian energy network businesses.

The International Association for Public Participation (IAP2) spectrum

INCREASING IMPACT ON THE DECISION 					
	INFORM	CONSULT	INVOLVE	COLLABORATE	EMPOWER
PUBLIC PARTICIPATION GOAL	To provide the public with balanced and objective information to assist them in understanding the problem, alternatives, opportunities and/or solutions.	To obtain public feedback on analysis, alternatives and/or decisions.	To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered.	To partner with the public in each aspect of the decision including the development of alternatives and the identification of the preferred solution.	To place final decision making in the hands of the public.
PROMISE TO THE PUBLIC	We will keep you informed.	We will keep you informed, listen to and acknowledge concerns and aspirations, and provide feedback on how public input influenced the decision.	We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision.	We will look to you for advice and innovation in formulating solutions and incorporate your advice and recommendations into the decisions to the maximum extent possible.	We will implement what you decide.

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Note that there is some debate about whether an NSP can ever move to “Empower” and maintain the fiduciary responsibilities of the Board. We respond with the view that “empower” engagement

approaches can be effectively and responsibly applied to aspects of a reset, but not to the entirety of a revenue proposal.

CCP strongly supports the application of all levels of the IAP2 spectrum to resets with “Involve” and “collaborate” levels being sought as the focus of a majority of engagement practice.

3.2.2 Who blinks first?

An important consideration of the nature of engagement is the interdependent of the parties: NSP, Consumers and AER on each other and in particular who takes the lead?

The question was explored by CCP23 in its considerations of the Powerlink³ revenue proposal lodged in 2021 that sought from the outset to be “capable of acceptance.” CCP23 wrote:

“An NSP asking whether a proposal is capable of acceptance is reasonable, but it is awkward to be the first to say so, because:

- *“Weight” of representing broad consumer base.*
- *Concern about what may have been missed?*
- *Good vs Perfect proposal for consumers – No proposal is ever perfect, and individual consumers can’t necessarily be certain about whether a proposal is “good enough”.*
- *What if the regulator finds inefficient proposal elements?*
- *Fear of “No going back” for an extended period of time.*
- *Trust levels are crucial.*

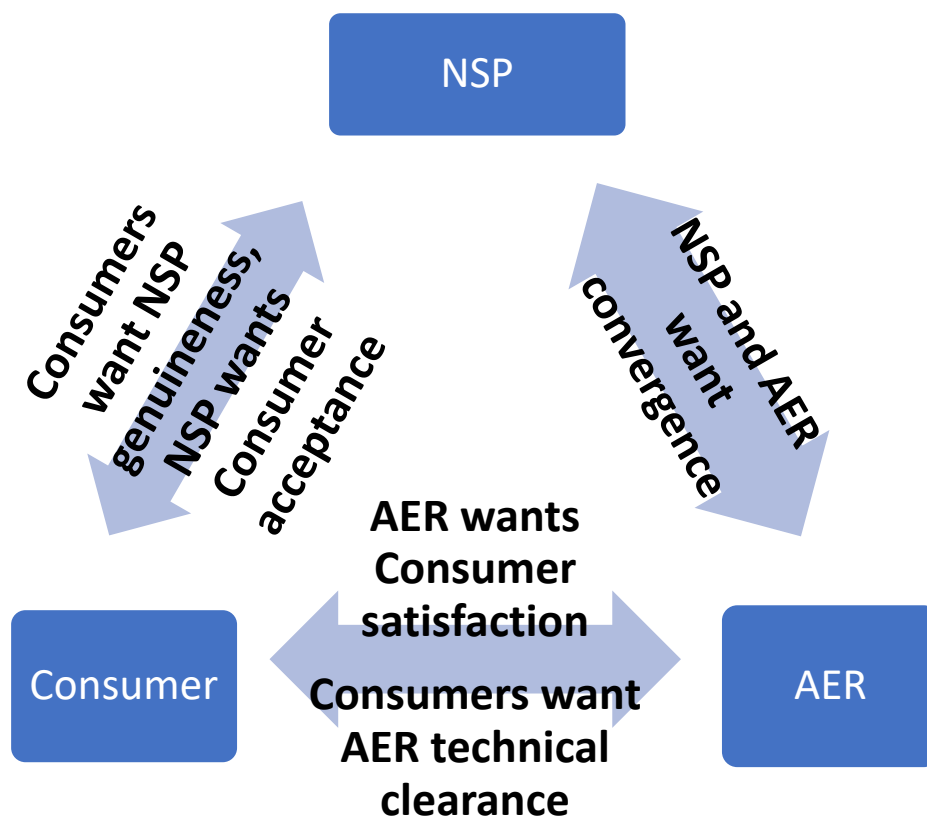
From a customer representative perspective, if they ‘blink first’ and say that they consider a proposal to be Capable of acceptance, and subsequent regulator analysis finds significant expenditure proposals that the regulator does not consider to be fully in the best interests of customers (in aggregate), then the customer representatives can feel caught out, embarrassed or even a little trapped. Customer representatives do not want to feel like “rabbits in the spotlight” (to change the metaphor).

Members of an advisory or reference group are mainly drawn from organisations, government departments or other businesses. As individuals, they bring the perspective of the organisation base / constituency to the proposal formation process but are unlikely to be able to formally ratify a regulatory proposal from an NSP on behalf of their organisation.”

The interdependence of expectations of the three parties is summarised in the diagram below.

³<https://www.aer.gov.au/system/files/CCP23%20-%20Submission%20on%20Powerlink%20Proposal%20and%20AER%27s%20Issues%20Paper%20-%2024%20May%202021.pdf>

The interdependence of expectations of the three parties – NSP, consumer and AER



The reality is that each party would really like the other party to be the first to commit, e.g. in saying that a proposal is acceptable (capable of support is an alternative form of words). In particular in assessment of an NSP regulatory proposal, the AER would like consumers engaged by the NSP to be able to say that they support the proposal while consumers look for reassurance from the AER that a revenue proposal meets the regulator's tests.

We suggest that the Handbook process will need to allow scope for 'soft' signals, particularly between the AER and engaged consumers, so that there are "no-commitment" discussions between the AER and consumers to check thinking about the extent to which an engagement process is genuine, on track and dealing with the issues most important to consumers. These 'soft' signals will also need to be relayed to the NSP, which will ideally also be a party to 'soft' signals.

Good engagement is generally non-linear and can involve various parallel discussions and musings, the Handbook is therefore reflective of a simplification of the nuanced reality of engagement, which is perfectly reasonable, as long as there is room for the nuance and capacity for AER (and CCP) assessment of engagement to reflect the feel of the consumer network relationships as well as the assessment of more tangible elements of engagement. Effective consumer engagement is part art, part process and part measurement, all aspects are important and cannot all be specified in the Handbook. We hope that all parties recognise this, and resist efforts to be too prescriptive with this Handbook and any future iterations of the Handbook.

3.2.3 Application of AER Assessment – Table 3/7

The AER’s assessment framework is copied below and has been applied by recent CCP subpanels as a means for considering the consumer engagement that has been observed as well as for providing some informal feedback to NSPs.

The AER’s assessment framework

Element	Examples of how this could be assessed
Nature of engagement	<ul style="list-style-type: none"> • Consumers partner in forming the proposal rather than asked for feedback on service provider’s proposal • Relevant skills and experience of the consumers, representatives, and advocates • Consumers provided with impartial support to engage with energy sector issues • Sincerity of engagement with consumers • Independence of consumers and their funding • Multiple channels used to engage with a range of consumers across a service provider’s consumer base
Breadth and depth	<ul style="list-style-type: none"> • Clear identification of topics for engagement and how these will feed into the regulatory proposal • Consumers consulted on broad range of topics • Consumers able to influence topics for engagement • Consumers encouraged to test the assumptions and strategies underpinning the proposal • Consumers were able to access and resource independent research and engagement
Clearly evidenced impact	<ul style="list-style-type: none"> • Proposal clearly tied to expressed views of consumers • High level of business engagement, e.g. consumers given access to the service provider’s CEO and/or board • Service providers responding to consumer views rather than just recording them • Impact of engagement can be clearly identified • Submissions on proposal show consumers feel the impact is consistent with their expectations
Proof point	<ul style="list-style-type: none"> • Reasonable opex and capex allowances proposed <ul style="list-style-type: none"> ○ In line with, or lower than, historical expenditure ○ In line with, or lower than, our top down analysis of appropriate expenditure ○ If not in line with top down, can be explained through bottom up category analysis

CCP subpanels have found this Assessment Framework to be constructive and moderately straight forward to apply. Some observations that we have made in applying the framework include:

- Engagement is most effective where there is an attitude of customers partnering with an NSP, rather than being provided with extensive information and NSP-made decisions to be accepted.
- Impartial support is crucial for many consumers to be able to participate effectively. This needs to be explored early in any engagement process.

- The AER rightly recognises the importance of sincerity of engagement, however this is difficult to quantify, though sincere engagement is generally easy to identify. Given that trust is crucial for any effective engagement, it is extremely difficult to consumers who are engaging with an NSP to say that they believe that the NSP is being insincere in its approach. A more formal mechanism is likely to be needed for all parties to better understand what sincerity looks like in practice and for early identification of any concerns about lack of sincerity.
- Demonstrated CEO and Board commitment to engagement is crucial but not regularly evident at the moment. CCP has observed some businesses who undertake excellent engagement, but then consumers observe that the outcomes become diluted the further they move towards senior decision makers. This aspect of engagement remains a challenge for some NSPs, and will require further exploration about the expectations of CEO, senior staff and Board members in practice.

The merits of multiple engagement channels, breadth vs depth and evidenced impact are considered in the following sections

3.3 Breadth and depth

This aspect of engagement has been the subject of discussion since the table was first released by the AER, who have been understood to favour ‘depth’ over ‘breadth’ of engagement with some NSPs interpreting this to mean that the AER wanted to see the Customer Forum model as trialled by AusNet Services distribution through the NewReg trial.

It is not our understanding that there is any intent for a specific approach to engagement being preferred, CCP subpanels have regulatory supported the AER in maintaining an approach encouraging a diversity of methodologies.

The importance of breadth in engagement is crucial as consumers are not homogeneous. It is indeed remarkable how much commonality there has been in the views of disparate consumer groups over recent years, however this cannot be assumed. Some of the emerging and future network challenges will most likely see some consumers being better off and others worse off from various expenditure proposals. For example, there a very different reliability expectations for C&I customers and some small businesses, e.g. dairy farmers and fresh food dependant businesses compared to some residential customers who will accept lower reliability and lower costs.

Given that high energy costs impact most heavily on vulnerable people, we suggest that all network engagement strategies should include consideration of impacts on vulnerable people, broadly defined.

3.4 Clearly evidenced impact

This aspect of the Handbook as well as recent AER decisions is clear and, we suggest well understood. It is central to good engagement, but we do not think that the Handbook needs to be changed to adequately reflect this aspect of engagement, its application and its assessment.

3.5 Resourcing consumer engagement

A significant question for implementation of the Handbook process is how consumers are adequately resourced, briefed and equipped to participate?

From likely start of a regulatory process to final AER determination takes about three years, as described in the Handbook. Funding for consumer groups does not currently fund for three-year regulatory proposal engagement.

This is a perennial challenge, and we suggest the following resourcing roles as a basis for future consideration of application of the Handbook process.

Network businesses are responsible for:

- Paying realistic sitting fees for consumer participants in ongoing engagement
- Clear and practical site visits and briefings
- “Impartial support”
- Costs to seek separate advice, than from the NSP, on specific questions of interest or concern

The AER is responsible for:

- Briefing engaged consumers on regulatory processes and AER analysis
- Plain English publications
- Regular updates
- Participation in deep dives and relevant pre-lodgement engagement

Funding bodies (e.g. Jurisdictional Governments / Energy Consumers Australia) are responsible for:

- Funding to relevant organisations for ongoing consumer advocacy
- Consumer capacity building

3.6 **How groups work effectively**

Where a group of consumers are brought together by a network business to engage on a reset process, the main relationship for participating individuals is invariably with the network business that generally sets meeting agendas, chooses who provides briefings, takes minutes and often provides the chair

This means that the relationships of participants are mainly one to one relationships with the NSP engagement staff. These relationships are very important but consumer reference / engagement / consultation groups members need time on their own as well as with the NSP to be able to gel as a functioning group and to have space to think independently. Resources should be allocated to consultative groups so they can meet on their own (and probably, on occasions with the CCP).

Independent chairs can also be very helpful for effective engagement as this provides a better chance for group time and guided thinking and enables clearer role specification for the NSP and their consumer reference / consultative group.

Attention to group process is a very important aspect of effective engagement, particularly over an extended time, that is often overlooked in our observation. The Handbook should reflect the importance of setting up consumer consultative / engagement group process that optimises group functioning.

3.7 **Some additional comments**

Consumer engagement is not a goal in and of itself. Rather, consumer engagement is a means to achieve prudent, efficient and sustainable outcomes that meet the needs and interest of consumers.

In addition, we emphasise that spending by networks on consumer engagement needs to be prudent and efficient, as with all other expenditure. A consumer engagement ‘arms race’ of spending would not be in the best interests of consumers, just as underspending is also not in consumer interests, as it is not sustainable in the longer term.

“Technical Considerations”

4 Capital Expenditure proposals

4.1 Summary

This section includes a summary of the concerns expressed by the AER, and the CCP with the quality of many network capital expenditure (capex) proposals.

We have then considered whether the AER’s outline of its expectations on capital expenditure proposals, and the criteria for a targeted review are consistent with the objective set out above, and addresses the concerns of the AER and the CCP with the quality of some capital expenditure proposals.

We make the following conclusions:

- We support the AER’s overall objective in the assessment of a network’s capex proposal, namely that its assessment of the network’s capex proposal: *“seeks to ensure that consumers are provided with safe reliable and good quality services that meet their needs at an efficient price”*. The objective is appropriately consumer focused, that is, it is concerned with the delivery of services that consumers need at an efficient price.
- We support the AER’s statement of expectations for capital expenditure proposals. The expectations are consistent with the statutory obligation of the AER to ensure capital expenditure is prudent and efficient while also ensuring customers can meaningfully participate in the process.
- We are concerned that the process for targeted review of capital expenditure will not drive the improvements in capex productivity that is required to ensure efficient network prices over time, given the challenges facing the networks over the next decade.

We make the following recommendations:

The quality and relevance of consumer participation in the process will be enhanced by the AER’s early involvement in:

- The ‘education’ of consumers on the AER’s assessment tools and processes.
- The co-development and ongoing review by the network and its consumers of an overarching business narrative that provides the strategic context for the capital expenditure plans.
- The early provision by the AER (and the network) of relevant information to consumers on the network’s performance and relative productivity.

The AER cannot rely on the current CESS incentive scheme to drive improvements in capex productivity, and we support the AER’s commitment noted in the Handbook to review the scheme in 2021, prior to the roll-out of the Handbook.

In the absence of an effective incentive scheme, it is not sufficient to focus targeted reviews based on any comparisons between the current and forecast capital expenditure levels and BAU processes given the ongoing decline in capex productivity measures.

4.2 Overview

4.2.1 The AER's capital expenditure objective

The Energy Laws and Rules provide the overarching framework for the AER's assessment the networks' revenue proposals including their capital expenditure forecasts. The AER has summarised this in consumer-centric terms as follows:⁴

“Our primary role is setting the maximum revenue and prices that network businesses can recover from users of their networks. We aim to ensure consumers pay no more than necessary for safe and reliable energy.”

In turn, the National Electricity Rules (NER) require the AER to be satisfied that the capex forecast reasonably reflects prudent and efficient costs and a realistic expectation of future demand and cost inputs. The National Gas Rules (NGR) expresses this somewhat differently but with the same objective of achieving the lowest sustainable cost of providing the network services.

The AER also recognises this obligation when it restates the objective of its assessment of a capex proposal as follows:⁵

“Our assessment of forecast capital expenditure seeks to ensure that consumers are provided with safe reliable and good quality services that meet their needs at an efficient price”.

We consider that this is a fundamental obligation of the AER to develop and implement processes for reviewing capital expenditures that achieve this statutory outcome for the long-term benefit of consumers.

4.2.2 The growing challenge of ensuring efficient and prudent capital investment

The AER faces a particularly difficult challenge when assessing networks' capex proposals in the context of the AER's overall objective of a more consumer-centric regulatory reset process through enhanced by customer engagement in the networks' proposals.

This is because the AER's assessment of the prudence and efficiency of a capex proposal requires the AER to consider the economic, policy, technical and regulatory context of the capex proposal, and the potential changes in these factors over time.

For example, the AEMC has recently announced it will review how the planning, investment and economic assessment processes for large-scale transmission infrastructure can support a renewable energy future.⁶ This review is likely to lead to changes in rules and to AER guidance notes on the processes for assessing the costs of large-scale projects. There are many other such examples.

The network performance standards set by various governments and regulatory authorities such as AEMO and the AER, and the technical standards set by industry authorities, similarly impact on networks' capex proposals. These include metering performance standards, DER standards, environmental standards, and national industry standards such as the ISO 55000 and ISO 31000.

In many, perhaps most instances, these standards have been developed with minimal input from the consumers of the energy services. It is also likely that that these consumers are unaware of such complexities and constraints.

⁴ p. 3

⁵ p. 17

⁶ See: <https://www.aemc.gov.au/market-reviews-advice/transmission-planning-and-investment-review>

Therefore, a key question for the Handbook to address is how customers of a network's services can be meaningfully involved in the determination of efficient and prudent capital investment for that network.

In this context, we highlight that the issues of capex efficiency and prudence have become increasingly important and urgent. Various factors drive the complexity of capex decision-making and the necessity to ensure a robust capex review process, including:

- The rapid growth in large-scale non-synchronous renewable generation as a proportion of total generation.
- The decentralisation of electricity generation.
- The rapid changes in how customers use the network reflecting the growth in behind the meter generation and two-way flows between premises and the network.
- The decline in energy consumption, at least over the next decade, relative to trends in peak demand.
- The need for significant new capital investment to address system strength and the overall reliability and safety of the networks.
- The growth in the regulated asset bases (RAB) of many networks particularly transmission networks.
- The potential for increases in inflation and interest rates, exacerbating the impact of the expanded RAB on customer prices.

The AER also recognises the growing importance of reviewing its approach during this period of rapid transition in the networks external and operating environments. The AER states:⁷

“In this energy transition it is more important than ever to ensure customer preferences drive outcomes and we continue to evolve how we regulate to ensure the long term interests of consumers are met”

All the factors listed above will tend to further decrease capex productivity particularly if few changes are made to BAU processes or arrest the long-term decline in capex productivity since 2006. This decline in capital productivity is demonstrated in Figure 4.1 below from the AER's 2020 Annual Benchmarking Report.⁸

Further, there is little evidence that the AER's current capital expenditure sharing scheme (CESS) provides an incentive for continuous improvement in networks' capex productivity.⁹

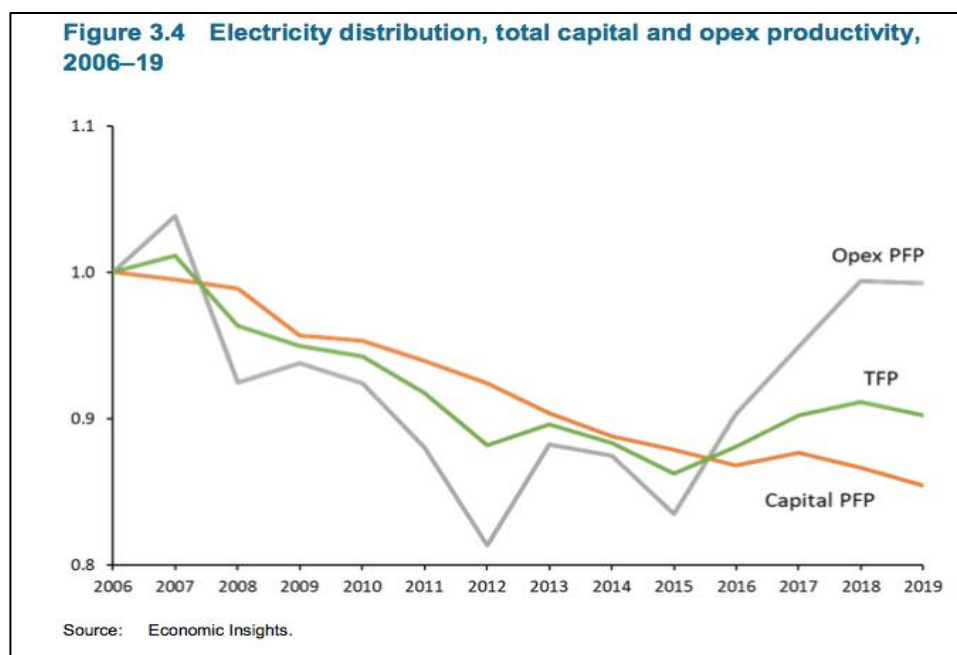
We review the AER's proposed expectations on capital expenditure proposals against the backdrop of both the long-term trend of declining capex productivity and the future capex challenges identified above.

⁷ AER, *Draft Better Resets Handbook*, p 4

⁸ See AER, *Annual Benchmarking Report – Electricity distribution network service providers*, November 2020, p. 18 <https://www.aer.gov.au/system/files/AER%20-%202020%20distribution%20network%20service%20provider%20benchmarking%20report%20-%20November%202020.pdf>

⁹ See for instance, AER, *Electricity network performance report*, September 21. In this report, the AER discusses the impact of incentive schemes, including the CESS, on the rate of rate of return on assets and return on equity (see pp 72-73) compared to the AER's allowance. The discussion suggests that the CESS is on average contributing to higher returns on equity and that the design of the scheme will need to be monitored and refined over time. <https://www.aer.gov.au/system/files/AER%20-%20Electricity%20network%20performance%20report%202021%20-%20September%202021%20-%20v1.1.pdf>

Figure 4.1: Trends in total capex productivity, and capital and opex partial productivity¹⁰



4.2.3 Addressing the current limitations in network planning processes

The AER has identified a range of issues in the networks' approaches to developing capex proposals both in the revenue resets and in the Regulatory Investment Test (RIT) processes. For example, in its guidance to networks on replacement capex planning¹¹ the AER identified the following issues with networks' replacement capex plans:¹²

- Inadequate analysis of possible and imminent changes to the operating environment
- Failure to define the identified need in regard to the objective that the NSP seeks to achieve
- Inadequate identification of potential credible options, including life extensions and non-network solutions
- Failure to define and reasonably assess a credible counterfactual based on the relevant identified need
- Failure to select the option of combination of options that represent the lowest service cost in the long run. This includes the option of deferral or staging of the capex.

The AER concluded:¹³

*“The decision-making process followed by many NSPs has traditionally been asset centric, with an orientation towards asset replacement. This contrasts to the processes centred on service level outcomes with an **orientation to the lowest long run cost to meet the required service levels (i.e. the NEO).**” [emphasis added]*

¹⁰ AER, *Annual Benchmarking Report 2020*, Figure 3.4, p. 18

¹¹ AER, *Industry practice application note, Asset replacement planning*, January 2019.

<https://www.aer.gov.au/system/files/D19-2978%20-%20AER%20-Industry%20practice%20application%20note%20Asset%20replacement%20planning%20-%202025%20January%202019.pdf>

¹² AER, *Application Note, Asset replacement planning*, January 2019, p. 14.

¹³ AER, *Application Note, Asset replacement planning*, January 2019, p. 14

CCP23's recent presentation at the AER's Public Forum (6 October 2021)¹⁴ also identified issues that CCP23 had observed in the way capital expenditure was explained to customer representative bodies. They included:

- Failure to identify the full cost implications of a capex proposal ('just a cup of coffee a week')
- 'Scary pictures' that distort the consumers perception of actual risk that is being addressed
- 'Guiding' the engagement and failing Failure to present the full range of options for resolving the identified problem
- Simplistic trade-offs and Implied threats to future service standards (without consideration of productivity improvement options).

In addition, CCP subpanels have observed instances in the past where there has been limited engagement in defining the context of the problem that the proposed capex is designed to address, and the impact of the proposed solution on prices and services to different segments of their customers.

In particular, there have been significant gaps in the effective communication of option analysis, risk assessments and the complex trade-offs inherent in the decision making process such as:

- Capex and opex
- Capex and network reliability and resilience
- Network and non-network options
- Current and future investment
- Current and future consumers
- Consumer segments.

The next section will summarise the AER's stated expectations for capital expenditure proposals. This is followed by a section that discusses whether the proposed methodology addresses the issues raised in the in this section. This will include whether the AER's proposal for better capex resets is sufficient to achieve its stated outcome objectives, namely:

- *"We aim to ensure consumers pay **no more than necessary** for safe and reliable energy."*
- *"Our assessment of forecast capital expenditure seeks to ensure that consumers are provided with safe reliable and good quality services **that meet their needs at an efficient price**".*

4.3 AER's Proposed Approach

4.3.1 The AER's capital expenditure objective

As noted above, the AER stated its overall assessment objective as follows:

"Our assessment of forecast capital expenditure seeks to ensure that consumers are provided with safe reliable and good quality services that meet their needs at an efficient price"

¹⁴ CCP23, *"Better Resets Handbook – Towards consumer-centric proposals, Presentation 2: Technical Considerations"*, Public Forum, 6 October 2021, p. 7

In the draft Handbook, the AER has taken account of the existing suite of capex guidance notes and modelling tools in developing the AER's five draft expectations for capital expenditure proposals. The AER states:¹⁵

“Having regard to the Rules and drawing from the comprehensive suite of guidance and tools, the AER has developed five expectations of a network business’ capital expenditure proposal. A business that meets these five expectations will have the benefit of a targeted review of its capital expenditure proposal.”

The five categories of the AER's 'expectations' for a capex proposal are summarised below.

4.3.2 The AER's expectations for networks' capex proposals

1. Top-down testing of the total capex forecast and at the category level

The AER's starting assumption which it applies to a network that has been subject to a CESS incentive scheme, is that the network's total forecast capex will not be materially different from its current level of capex, particularly if the network's performance metrics (such as SAIDI and SAIFI) are within the AER's benchmark level.

The AER states that it expects a similar outcome at the category level of capex. The AER's models, such as the repex model, will further assist the AER in evaluating a network's capex proposal.

Importantly, the AER recognises there are some exceptions to these basic assumptions, such as when a CESS has not applied, or for large 'one-off' or non-recurrent projects. The AER expects that when such exceptions apply, the proposals should be supported by a cost benefit analysis.

2. Evidence of prudent and efficient decision-making on key projects and programs

When a proposed capex category is a material proportion of the total forecast, the AER expects a more substantive demonstration of the prudence and efficiency of the proposal for both recurrent and non-recurrent projects and programs.

This evidence includes:¹⁶

- Demonstration of the need for the project (expressed in terms of the capital expenditure objectives in the Rules)
- Quantitative cost benefit analysis of all feasible options including non-network options
- Relevant trade-offs between capital and operating expenditure, demonstrating that the preferred option is prudent and efficient
- Compliant RITs for eligible capital expenditure projects submitted in its regulatory proposal.

3. Evidence of alignment with asset management and risk management standards

The AER states it expects businesses to provide evidence that their asset and risk management are consistent with well-established relevant Australian industry standards such as ISO 5500 (asset management) and ISO 31000 (risk management).

¹⁵ AER, *Draft Better Resets Handbook*, p. 18

¹⁶ AER, *Draft Better Resets Handbook*, p. 19

4. A steady and stable regulatory asset base (RAB)

The AER expects businesses to provide reasons for increases in the business' RAB in the forecast period and over time. Where a business proposes an increase in RAB, there should be evidence that it has demonstrated its reasons for the proposed increase in RAB and the implications of this for consumers.

5. Genuine consumer engagement on capital expenditure proposals

The capex assessment process will require networks to demonstrate 'genuine' customer engagement (as per the Handbook) that includes:

- Why the expenditure is required over the forecast period to meet service level outcomes?
- What other options are available to address the service level outcomes, and how do the costs of these other options compare to the proposed option?
- Providing consumers with the reasons why a proposed capex program may not align with consumers' priorities and preferences, and the implications of the proposed capex including trade-offs in the short and long term.

4.3.3 The AER's targeted review of a network's capex proposal

If a network's proposal satisfies the AER's five 'expectations' of good practice, the AER proposes to conduct a targeted review. The targeted review would focus on more detailed assessment of specific capex categories of projects and programs that are the most relevant to the capex forecast. The AER includes the following target project areas for further investigation.¹⁷

- Projects that are driving the capex forecast
- Have strategic significance in the proposal
- Relate to a change from business-as-usual practices, and
- Are a new category or program of works.

4.4 CCP conclusions on the AER's Approach

As noted above, the AER has set out its objective for the assessment of a network's capital expenditure proposal. That is, the AER states: *"Our assessment of forecast capital expenditure seeks to ensure that consumers are provided with safe reliable and good quality services that meet their needs at an efficient price"*.

This objective appropriately puts consumers and their needs at the centre of the decision-making. This does not necessarily mean that the consumers' role is to critically assess the details of the capex proposal. Consumers are not always in a position to understand the detail nor should they be expected to do so.

We acknowledge that the AER's targeted review process recognises this limitations. It does so by signalling to the networks its expectations regarding the 'technical' evidence that the network should provide to demonstrate its capex proposal is prudent and efficient and that the proposal aligns, with asset management and risk management industry standards and controls the growth in the RAB.

We therefore support the AER's objective for the assessment of a network's capital expenditure proposal.

¹⁷ AER, *Draft Better Resets Handbook*, p. 21

The AER’s approach also builds on its existing capital expenditure assessment processes, guidelines and models. These processes and models, such as the repex model and the RIT guidelines have been progressively enhanced over many years to address the gaps in the networks’ capex proposals such as the ones identified by the AER and described in section 4.2.3 above.

The application by the AER of these regulatory tools will provide consumers with greater confidence in both the networks’ proposals (where these meet the AER’s expectations) and the AER’s essential role in ensuring that consumers are provided with safe, reliable and quality services to meet their needs, and do so in a prudent and cost efficient way.

The AER’s approach, however, still leaves room for genuine consumer engagement on matters that consumers can reasonably be expected to engage on. For example, it requires the networks to explain why a capex project is required, what options were considered and why the proposed option was selected, how the proposal aligns with consumers’ priorities and preferences (and if not, why not) and why aggregate capex and/or RAB would increase above recent trends.

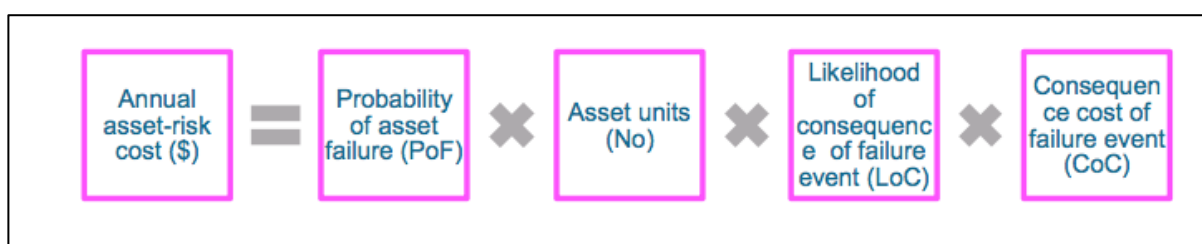
The AER’s process also requires the network to demonstrate in its final proposal how it has taken consumers’ expressed priorities and preferences into account, and if not, why not.

In other words, the reset approach outlined in the Handbook has the potential to bridge the gap between consumers’ conclusions that a capex proposal is “capable of support” and the AER’s conclusion that the proposal is “capable of acceptance”.

We are also pleased to see the AER’s specific reference to networks’ capex proposals complying with industry standards for asset management and risk management and the AER’s requirement for a transparent and comprehensive options analysis. Complying with these standards indicates that the network has adopted ‘good industry practice’. We have also identified some of the problems that CCP has observed such as when the risk and options analyses have been presented to consumers in a way that limits consumers’ ability to critically evaluate capex proposals.

Industry standards such as the ones highlighted above can reasonably be explained to consumers and will provide consumers with a ‘tool’ for them to make a more objective assessment of the probability and cost of the risk being addressed by the proposed capex. For example, Figure 4.2 below sets out a standard ‘risk cost equation’ for consumers to consider.

Figure 4.2: Risk-cost equation¹⁸



Similarly, while option analysis can become very complex, there are ways that the consumers can be engaged in discussion on the outputs of the analysis. For example, Figure 4.3 below is sourced from AusNet Services – Transmission Regulatory Proposal 2023-27. It sets out the main options that were subject to a cost benefit analysis in order to select the preferred option for a significant capex replacement project that the AER had rejected in its Draft Decision.

¹⁸ For example, see: AER, *Application Note, Asset replacement planning*, January 2019, Figure 2, p. 39

This option analysis was an important element in CCP23 revising its initial opposition to the proposed capex project. In response to this additional information that was provided by AusNet Services' in its revised proposal, CCP23 recommended that the project be accepted by the AER.

Figure 4.3 Options Analysis – South-West Victoria Communications Loop¹⁹

Option Number	Option Description	Capex	Opex	Risk Cost	Present Value	PV Cost Ratio (compared to BAU)
Option 1	BAU - Do nothing different	\$0	\$318,654	\$56,146,101	\$37,836,944	1.000
Option 2	Replace 10 assets per year add new optical fibre link	\$21,000,000	\$96,000	\$10,054,915	\$31,237,126	1.211
Option 3	Replace 20 assets per year add additional radio links	\$26,000,000	\$67,500	\$7,069,862	\$34,936,968	1.083
Option 4	Replace 20 assets per year add new optical fibre link	\$21,000,000	\$67,500	\$7,069,862	\$29,936,968	1.264
Option 5	Replace 20 assets per year add additional radio links start year 5	\$26,000,000	\$157,500	\$16,496,345	\$35,208,613	1.075
Option 6	Replace 20 assets per year add new optical fibre link start year 5	\$21,000,000	\$157,500	\$23,330,546	\$36,327,974	1.042

We therefore support the AER's statement of expectations for capital expenditure proposals.

Overall therefore, we support the AER's approach to the assessment of capital expenditure proposals and, in particular, the clarification of the roles of the AER in ensuring that proposals are efficient and prudent and the role of consumers to ensure the projects are consistent with their preferences and priorities.

We remain strongly of the view that we expressed in the recent Public Forum, namely that the AER has the ultimate accountability to consumers to ensure that its decision satisfies the objective of providing the network services consumers want at an efficient cost.

Enhanced consumer engagement with the networks during the pre-lodgement process will certainly contribute to the quality and robustness of the outcome, but it does not obviate the need for the AER to conduct a thorough review process. The AER's process as set out in the draft Handbook provides additional comfort to the CCP. In particular, even if a proposal meets the AER's 'expectations' (including good consumer engagement), the AER will still conduct a targeted review that focuses on the key capex drivers.

As discussed in Section 3 of this advice to the AER, for consumers to contribute meaningfully to this capex assessment process, there will need to be 'education' of consumers early in the pre-lodgement process. The education (or 'inform on the IAP2 scale) should at a minimum address:

- the relevant regulatory requirements and industry standards, and
- the relevant assessment and decision making 'tools' used by the AER and the networks.

Based on our recent experience, we also strongly recommend that the networks develop a 'business narrative' in conjunction with their consumer panels at the start of the pre-lodgement process. This narrative provides the broader context in which the capital expenditure proposal is being developed, and

¹⁹ AusNet Services, *2023-27 Revised Revenue Proposal*, Figure 3.17, p. 64
<https://www.aer.gov.au/system/files/AusNet%20Services%20-%20TRR%202023-27%20-%20Revised%20Revenue%20Proposal%20-%201%20September%202021.pdf>

should be regarded as an evolving document that is responsive to the changing environment as it emerges over the course of the engagement.

Early consumer education and the co-development of a business narrative will enhance the quality and relevance of consumer participation.

While we support these developments in the Handbook, CCP is concerned with the absence of drivers for improvements in performance and capital expenditure productivity. The AER provides two annual publications that can potentially provide consumers with a robust and independent set of data on the network's performance and its capital productivity relative to other networks.

The AER has an important role in ensuring that consumers have the opportunity to access and to understand these reports and how this data may be used as part of their discussions with the network. For example, this might empower consumers to challenge the networks to explain any variation in the performance of their network compared to:

- The network's historical performance compared to its current and forecast performance
- The network's performance compared to the performance of similar networks (as applicable)
- The network's performance compared to the regulatory performance targets such as SAIDI and SAIFI.

We note that this independent performance information may provide a balance to the network's own reporting on its performance. We have observed instances where the consumer panels are provided reports prepared by the networks or their consultants, which provide an assessment of performance that differs (sometimes significantly) from the AER's reports. This is potentially confusing for consumers, and we encourage open conversation between the AER, networks and consumers on these matters.

In this context, we also have some reservations regarding the AER's focus for 'targeted reviews'. While we agree with targeting significant projects that drive the overall capex, there is also some focus on identifying areas for review on the basis of variation from the existing processes and expenditures. This implies a prima facie view that existing process and expenditures are efficient. This assumption is not necessarily the case, particularly in the context of concerns about the effectiveness of the CESS as an incentive mechanism to drive continuous improvement in efficiency as discussed above.

The early provision by the AER (and the network) of relevant information to consumers on the network's performance and relative productivity will enable consumers to have confidence in challenging the networks to demonstrate that the network's proposal is the most efficient and prudent option to meet their needs.

The AER cannot rely on the current CESS incentive scheme to drive improvements in capex productivity, and we support the AER's note in the Handbook that it plans to review the scheme in 2021, prior to the roll-out of the Handbook.

In the absence of an effective incentive scheme, it is not sufficient to focus targeted reviews based on changes from BAU or new category of works. This encourages the network to limit its proposals to BAU processes and outcomes.

CCP considers it is equally as important for the AER to address the question of whether BAU is 'good enough' and whether 'good enough' is sufficient to meet the AER's assessment objectives and the challenges to the networks of the future.

5 Operating Expenditure Proposals

5.1 Main considerations

The AER says on page 26 of the discussion paper: “Broadly, we must decide whether or not we are satisfied that the opex forecast proposed reasonably reflects prudent and efficient costs required by a network business to deliver the current levels of service to customers”.

The AER’s expectations for a targeted review are also given as follows:

- “Use of the base-step-trend approach
 - **Base cost** is consistent with the economic benchmark efficiency score >0.75 (or consultant report for gas). Adjustments to the base cost to be discussed with the AER
 - **Trend** in output, price and productivity growth – factor in a ‘challenge’ productivity growth?
 - **Step changes** limited to “a few well justified ones, or none at all” for regulatory obligations, capex/opex substitution & step change driven by major external factors outside the control of the business.
- Category specific forecasts – limited to categories previously identified
- Consumer engagement evidence
 - Provide details on how the proposed forecast opex is consistent with or takes account of consumer preferences
 - Where forecast deviates from the consumers’ preferences or the base-step-trend approach, then this should be discussed with consumers & outcomes identified.”

We are supportive of this approach that has been developed over several years and in compliance with the National Electricity Rules.

Many of the observations presented in the previous section, capex, also apply to opex, though generally at a lesser financial scale. This section does not repeat the observations from the previous section, rather making the following comments that are more specific to opex.

Operating costs in a regulatory proposal can be quite straightforward, or complex and anything in between. Since the AER has expertise and ‘tools’ to assess the efficiency of opex proposals, it is important that the role of consumers is focused on the matters that can most useful help to problem solve or express clear preferences.

5.2 Base opex and productivity

We support the ongoing application of the “base – step – trend” approach for considering opex.

One of the nuances for engaging consumers is the treatment of category specific forecasts within the determination of base opex. These are expenditures that are not necessarily ongoing costs from period to period, so identifying these cost items is important so that consumers can determine, in their own minds, whether they should be part of base opex.

An important discussion over recent years has been about reasonable expectations for consumers and regulators about productivity improvements, including for ongoing operating costs. This matter is a focus of box 2 on page 24 of the draft Handbook. The AER’s annual benchmarking report is an important evidence base for productivity considerations, particularly MPFP (Multilateral partial factor productivity) data. This is another topic for which early AER briefing of engaging consumers will be important.

We regard productivity consideration as an important aspect of early engagement, Targeted Review Stream and top down assessment of actual and proposed expenditure.

The targeted review considerations of opex (page 26 Of the Handbook) should also include productivity improvements as related to, but separate from the “efficiency score” gleaned from the benchmarking report.

5.3 Step Changes

A majority of consumer attention on opex budget proposals is likely focus on proposed “step changes,” since this is where more significant changes in cost proposals are likely to be presented. So consumers should be adequately briefed about the criteria and key considerations for step changes.

CCP17 summarised its view of “four criteria for assessing whether a proposed expenditure meets the requirements for a step change:²⁰

1. Legitimate obligations or capex / opex trade-offs.
2. Something that is new and exogenous, meaning that is imposed from outside of the business.
3. Recurrent, or likely to be recurrent, it cannot be a one-off cost.
4. Material cost increase, being increases in costs for an existing recurrent item that an efficient business could not readily absorb into its cost structure.

These ‘simplified’ criteria are compatible with the step changes criteria given in box 3, page 25 of the Handbook which is a useful guide of engaging consumers.

A proposed expenditure that meets either the first or second criterion, as well as the third criterion, is highly likely to be justified as a step change, being an increase in operating expenditure that customers will pay for. Step changes can be negative, providing savings for customers, but in practice there are very few examples of a negative step change.

The fourth criterion, materiality, is potentially more subjective. A material cost increase is an increase in costs for an existing recurrent item that an efficient business could not readily absorb into its cost structure. It is also a function of the AER and consumer expectations that a 0.5% operating cost productivity ‘dividend’ be provided by network businesses to incentivise dynamic operating cost efficiency.”

These, or similar criteria can usefully be included in the next iteration of the Handbook as a guide for engaging consumer groups

A part of resourcing engaging consumer that the AER can support is to provide consumers with a short list of questions to ask an NSP about proposed opex expenditure increases. Indicative questions are:

- Has a range of reasonable options for the proposed expenditure been explored?
- Is there a reasonable ‘spend less’ option under consideration and if so, what are the likely consequences, if any, of the ‘spend less’ option?
- Are there ‘winners’ and ‘losers’ among different consumer groups from the proposed expenditure, if so, can the ‘losers’ reasonably be expected to bear the consequences, or could inequity be increased?

²⁰ Page 57. https://www.aer.gov.au/system/files/CCP17%20-%20Submission%20on%20the%20Victorian%20EDPR%20Revised%20Proposal%20and%20draft%20decision%202021-26%20-%20January%202021_3.pdf

Within consideration of opex, we suggest that this is merit in the AER developing an acceptable range of total opex expenditure in a proposal, to give consumers cause for concern or confidence in accepting or challenging NSP opex proposals. We understand that some overseas regulators, including Water Industry Commission of Scotland in determining 'tram tracks' – a range of likely acceptable opex costs – early in engagement processes

The AER can also usefully suggest indicative materiality thresholds for any step changes and provide opinion on whether 'current levels of service' are optimal and can ask consumers what they think about current levels of service / expenditure.

Consumers should be able to reasonably expect iterations of both opex and capex proposals in developing a regulatory proposal. All / any step changes will need to be directly explored with consumers.

6 Depreciation

6.1 Summary

Depreciation costs are a significant component of the revenue building blocks and changes to depreciation approach and/or profile can have important implications for networks' current and future prices. In particular, changes raise issues of intergenerational equity.

We therefore agree with the AER's identification of and concern with some of the current developments in network depreciation proposals which in some instances appear to be motivated by a desire to bring forward higher revenue allowances. CCP observations in general support this conclusion.

CCP23 has previously commented on the various levels of engagement by networks with consumers when they have proposed changes to the depreciation approach. We recognise that consumers may not understand the potential impact of such changes on current and future prices and/or find the subject to obtuse. However, a network proposing such changes still has an obligation to identify such changes, explain its reasoning and the impacts of such changes in the short and long term. The network should also be required to demonstrate in its proposal how it has responded to such changes.

Overall, we support the AER's assessment of the issues and proposal for targeted reviews.

6.2 Overview

The AER has stated the objective for its assessment of the depreciation allowance is to ensure NPV neutrality, and in particular, the AER states:

No more or less than the real value of the asset should be recovered through regulatory depreciation over the economic life of the asset in net present value terms.

The AER goes further to explain its preferred position, saying:

We generally employ an approach where regulatory depreciation is recovered evenly over an asset's useful life. As a general proposition, economic theory suggests sunk costs be recovered in the least distortionary way. An even profile of recovery over the life of the asset supports this idea

...

Given this, the AER also highlights that in a mature business with relatively stable operating conditions, demand, costs and technology, there is little justification for network proposals that either front or back load depreciation profiles. An important exception to this may be in the area of gas networks.

As a result, the AER reports that it has not accepted broad changes to the depreciation approach that would bring forward costs to consumers. However, the AER has accepted more targeted approaches to some proposals that involve changes in the economic lives of assets, for example, following the ACT government's restrictions on future gas network reticulation.

Importantly, the AER states that any exceptions such as accelerated depreciation proposals, the separation of existing assets from broader asset classes and decommissioning assets before the end of their technical life require detailed justification by the proponents of such changes, and evidence that options for example of reusing components are demonstrated in the proposal.

The AER also advises that where changes in depreciation approach impact on network prices to consumers, these should be disused with consumers during the pre-lodgement engagement.

6.3 AER's proposed approach to targeted review of regulatory depreciation

The AER proposes that in determining if it will undertake a targeted review of a regulatory depreciation proposal, the AER would expect:

- The network would use the AER's revenue and RAB models and the depreciation tracking module (where relevant) without amendments
- The asset classes would be unchanged from the last reset and the asset lives would reflect those approved in previous decisions.

In the event that the network proposes any changes to the AER's models, asset classes, asset lives and/or proposals for accelerated depreciation of assets, the AER would conduct a more targeted and detailed assessment.

The AER would also expect the network business to discuss any such changes with consumers.

6.4 Our conclusions on the AER's Approach

CCP23 has previously expressed its concerns about proposals by some networks to change to asset lives and reclassification of some assets to new asset classes. There are also issues when assets are decommissioned for non-technical related issues.

In addition, the NER and NGR allow some discretion to networks to propose new forms of depreciation as long as they are consistent with the general principle of recovering the real value of the assets over the life of the assets. This has allowed networks to change their approach such that depreciation costs are brought forward.

The CCP in general has had extensive discussions around the use of accelerated depreciation for gas network assets in regions where governments are introducing constraints on existing and new gas pipelines.

While we recognise that depreciation may not be a topic that consumers readily engage with, it is essential that networks have an obligation to be transparent with consumers about the proposed changes to depreciation, the reasons for the changes and the short and long term impacts of these changes on current and future prices, including the impact on the RAB and other cost components.

Overall, we support the AER's assessment and approach to targeted review of regulatory depreciation.

7 Tariff Structure Statements

7.1 Introduction

Tariff Structure Statements (TSS) are discussed in section 8 of the Draft Better Resets Handbook. Based on the National Electricity Rules, TSS currently only apply to electricity distribution businesses, given that electricity distribution tariffs are and for the last few years have been subject to more structural reform than other network tariffs. However, we see no reason why they should not in future be applied to all electricity and gas distribution and transmission businesses.

7.2 Stakeholder and consumer engagement

As with other elements of network businesses' regulatory proposals, demonstration of significant stakeholder and consumer engagement and broad stakeholder and consumer support for tariff proposals is essential. Besides the broad steps that the business takes in stakeholder and consumer engagement, the considerations in the following sub-sections are also likely to be factors in determining whether that stakeholder support is achieved.

7.3 Incentivising efficient investment

We concur with the AER that "tariffs should signal future network investment costs in the event that network use doesn't change. For example, tariffs should make energy use more expensive during times of the week when networks are congested, to signal that further use during those times will drive future network investment. Conversely, tariffs should be low when networks are not congested to incentivise network use during those periods."

In other words, tariff structures should be designed to be future looking and incentivising efficient future investments, rather than focusing on sunk costs. However, the focus on future network investment is insufficient. The AER and the businesses must recognise that:

- Customers are also making investment decisions, such as installing solar PV, installing on-site storage, investing in more efficient appliances, and control systems to automate and augment behaviour changes in response to energy costs, tariff reform, concerns regarding climate change and other environmental factors. Ultimately, they may choose to go off-grid.
- Community groups, energy service providers and other third parties are also making investment decisions.
- It is important that network tariffs and network tariff structures act in a way to incentivise all parties to make efficient investment decisions.

7.4 The role of tariffs as part of a business narrative

It is important that the tariffs and tariff structures are compatible with and form a part of the overall business narrative of the network. Stakeholders should understand how the tariffs fit with the business narrative, support the business narrative, and help the business to achieve its overall objectives in the long term interests of consumers.

7.5 Two way feedback – tariffs should also improve business efficiency

To the extent that tariff reform is intended to optimise network business operational and investment efficiency, stakeholders should be able to see tangible differences between the business' spending plans when tariff reform is implemented as against if tariff reform were not implemented. Tariff reform that is

implemented without affecting the business' spending plans means that one or more of the following may be occurring:

- Tariff reform is not effective in making the business more efficient; and/or
- Somehow the regulatory process is not picking up the benefits of tariff reform to ensure that they are captured by customers.

Customers are expected to buy-in to the benefits of tariff reform, yet we rarely see any quantification of the benefits of tariff reform. How are stakeholders expected to accept that there significant benefits to tariff reform in the absence of tangible significant benefits? We propose that evidence of achievement of quantified benefits should be a pre-condition for acceptance of tariff reform. Otherwise, stakeholders are being expected to have a "leap of faith" that tariff reform is in the long-term interests of consumers, with no evidence provided that this is the case. Tariff reform should not have an exemption from the evidence-based analysis of benefits that applies to other elements of regulatory proposals.

We understand that benefits realisation may lag tariff reform implementation. Where this is the case, the regulatory proposal might set out a methodology for assessing the expected benefits of tariff reform, with post-implementation review of the extent to which those benefits were actually achieved. Prior experience may also be a basis for evidence.

7.6 Careful consideration of any adverse customer impacts will be necessary along with discussion about 'losers' and how they will be informed / supported / transitioned

Often we scatter graphs and other such diagrams that illustrate the effects on different customers of tariff reform.

Sometimes these diagrams compare the current network tariff component of bills in one regulatory period against the proposed network tariff component of bills in the next regulatory period. Where the network's allowed revenue (per customer) is declining, this masks the reduction in bills due to factors such as lower rate of return, or lower capex or opex expenditure vs. tariff reform.

These diagrams can also mask bill differences through lower consumption (such as for example because of installation of solar PV or more efficient appliances or home insulation / improvement in building energy ratings). In those cases, effectively the customer is not overall saving money through tariff reform. Rather, they have simply transferred some of the money they would have spent on their energy bill to spending on in-premise investments. To portray those spending transfers as bill savings only is not to see the full picture.

Bill comparisons to support tariff reform must be like-for like. *All other things being equal*, what would be the network component of the energy bill with vs. without tariff reform? That is the comparison that needs to be made in order to compare bills with and without tariff reform.

Scatter diagrams also give no indication as to the nature of the customers who might face higher bills due to tariff reform. Stakeholders need to know the extent to which those customers are vulnerable or might experience hardship. Customers are not a single homogeneous group; rather their characteristics, interests and expectations diverge considerably. But it is impossible to design support mechanisms for customers who may be 'losers' from tariff reform if their characteristics are unknown.

Further, there is sometimes an assumption that a lower annual network cost means the customer will be "better off". This ignores the fact that many customers find budgeting difficult, and may be considerably "worse off" if their annual network costs are say \$20 lower, but that comes about through their summer quarter bill being (say) \$200 higher while the bills in each of the other three quarters are (say) each \$60 lower. While overall the annual cost is \$20 lower, the need to find the extra \$200 for the summer period bill, at a time of other holiday costs, may actually cause more hardship to the customer than the old tariff

even though that cost more overall. There are ways of alleviating this through bill smoothing, but again if the customers affected are not identified they cannot be targeted for remedial measures.

There is also a growing body of research showing that more complex tariffs increase household stress, but that is to date never considered in tariff reform.

A further issue from a consumer perspective are customer facing materials that talk about bill reductions when actually what is meant is “bills that will increase by lower than the expected inflation rate”. Customers think in “dollars of the day”; a bill that increases by lower than the rate of inflation may be considered by industry and regular as a bill that decreases in real terms, but that is not how customers view bills. Customer facing materials must address this; otherwise they mislead.

7.7 Avoid confusing cost-reflective tariffs with tariff complexity: increase efficiency benefits but minimise unnecessary complexity

Often we see flat rate tariffs on the one hand equated with not being cost reflective, while more complex tariffs are “obviously” more cost-reflective. While more complex tariffs have more flexibility and provide more opportunity to be more cost-reflective, they are not necessarily actually more cost-reflective. Further, slugging flat tariffs with increased costs and correspondingly lowering the prices in more complex tariffs to “encourage” people to move to more complex tariffs actually decreases rather than increases cost reflectivity.

The term “cost-reflective” is itself somewhat undefined, and can be misunderstood and misleading. The aim of tariff reform is to incentivise future efficiency as discussed above. To the extent that more complex tariffs reflect sunk costs that are already spent to support electricity use at certain times of the day, they may be more “cost-reflective”, but they work against the objectives of tariff reform, which must be forward looking rather than backward looking.

7.8 Remember that customers may have other off-grid and alternative technology options

Sunk costs through historic capital expenditure (calculated by multiplying the RAB by the rate of return) do have to be recovered under the Rules. However, when customers can choose to make their own investments / choose to go off-grid the actual tariffs charged need to reflect this. The grid provides benefits to customers through economies of scale and load diversity. Customers may go off-grid, particular if their grid supply is unreliable, and their supply costs off-grid are lower than or not significantly higher than the costs they would face remaining grid connected. However, if the grid-connected costs are largely sunk costs, while disconnecting from the grid may give the customer leaving the grid a better outcome, it may be a poorer outcome for customers at large, since there is little cost saving to the network when the customer leaves, and its fixed costs simply have to be recovered from fewer customers.

The opportunities for customers to make alternative investment decisions, including off-grid and alternative technology options, need to be taken into account in considering the efficiency of tariffs.

7.9 Tariff implementation after final decision for five-year implementation

The focus of stakeholder engagement is often on the five-year resets. While we encourage to include stakeholder engagement as “business as usual”, customer resources may not be there to support ongoing engagement, and the network may not be geared up to that engagement.

These days we are seeing final decisions on tariffs including phasing in of tariff reform over the upcoming five-year regulatory period, with much discretion on how that phasing occurs, sometimes tied to roll-out of interval metering. Customer acceptance and opportunity to respond to tariff reform depends on adequate provision being made in the regulatory proposal in regard to tariff reform for significant

stakeholder and consumer engagement not just in the processes leading up to the AER's final decision but also in the activities that follow in the next regulatory control period.

7.10 To what extent can retailers be expected / encouraged to participate and to pass on "network price signals"?

Tariffs are levied by the network business on retailers, not directly on customers. Large customers see network tariffs as a cost pass-through. In contrast, small and medium sized customers see bundled retail tariffs, which may or may not have the same structure as the underlying network tariffs. In the past, retail tariffs generally had the same structure as the underlying network tariffs, but as tariff reform has progressed, the structure of retail tariffs and underlying network tariffs have diverged in some cases. Retailers now are likely to have different cost structures for wholesale energy purchase as against network costs, and both need to be taken into account in structuring retail tariffs, along with other market and regulatory considerations in the retail market.

From an end-use customer perspective, the retail tariff is what matters – because that is how their bills will be calculated. Even if the retail and network tariff structures are different, the network tariffs and tariff structures will have influenced the retail tariffs. On this basis the Rules require the network businesses to take into account the impact of network tariffs and network tariff reform on end-use customers, even if the customers do not see the actual network tariff structures.

“Other Considerations”

8 What’s Missing and Other Comments

8.1 Questions for further consideration

- Where does “handbook” fit into the F&A? Would the Handbook directions, in particular be effectively included in the Frameworks and approach process?
- Where do pass throughs, contingent projects, RIT-T, RIT-D all fit into engagement expectations? Consumers don’t want NSPs incentivised to limit regulatory proposal expenditure bids in order to achieve “an easier” run, i.e. less consumer scrutiny through using other capex (and some opex) approval processes.
- How are exogenous shocks to be treated, particularly where they occur at short notice and outside the reset timeframe? Examples include e.g. AEMO directives, Jurisdictional Government interventions and the ISP.
- How are the interests of future customers included in considerations by present day consumers and networks? There is a risk that over emphasis on prices in the immediate future can lead to high costs for future generations. For example, several networks are currently observing that substantial parts of their network are ageing and so addition costs for replacement expenditure are needed. Determining fair balance between current and future customers in replacing ageing assets and the risk of networks over emphasising the current risk of asset ageing will be a challenge for the Handbook process.
- Where does innovation fit in to the reset and hence Handbook process? For example DMIAM, DMIS, gas network innovation deliberations, and innovation more broadly?
- How does the Handbook process link to the AER’s Consumer Engagement Guideline? This guideline was developed in 2013 as part of the Better Regulation program, and needs to be updated too.
- Transition timing. It is too late for ElectraNet, TransGrid, maybe Vic Gas too, all which are due to lodge their next reset proposals during 2022. It is likely that starting with opportunities for NSW/ACT distribution makes pragmatic sense.
- If a ‘trial’ process is initiated for those networks submitting proposals prior to 2023, how will the AER and the CCP evaluate consumer engagement processes established by agreement before the Handbook requirements have been finalised.
- The AER and consumers may have some confidence in the efficiency of existing opex as a base for examining future opex forecasts (given the EBSS and other benchmarking has been in place for some time. This is not the case, however, for capital expenditure where the current incentive scheme (CESS) is relatively new and has not been particularly effective and when capex productivity continues to decline. On what basis will the AER have confidence in using existing capex as a base for assessing targeted reviews?

8.2 Incentives and other reviews

We are aware that the AER is planning a future review of incentive schemes, and there will also be other processes, including vulnerable customer consideration and future of gas that will also impact on

engagement with NSPs by consumer interests. It is crucial that the AER briefs members of reset engaging groups with updates and implications arising from these processes.

8.3 The journey continues

In the opening paragraph of this submission, we wrote:

“We commend the Australian energy network businesses, the consumer groups and consumers and the AER for the substantial progress that has been made over the past 4-5 years that provides a base from which this paper can consolidate progress and look forward.”

We conclude by reflecting that this submission has dealt with much of the progress to date for consumer engagement, and has focused on pragmatic issues associated with the initial implementation of the handbook process. We anticipate that future developments for consumer engagement will increasingly move to a focus on the outcomes for consumers achieved by excellent engagement and regulatory practice.

Appendix 1 – CCP10 recommendations from “Signals” paper, August 2017

Recommendations

1. That the AER include a ‘signals’ statement in future Framework and Approach documents to encourage high calibre consumer engagement. Framework and Approach statements signalling such engagement should also be produced for gas network Access Arrangements. There will also need to be recognition of the business context in which the engagement process is occurring.
2. The AER Board develop a short statement for all interested parties, specifically networks, identifying outcomes and examples of a range of high calibre consumer engagement and specifying the extent to which the AER is willing to work with network businesses and their stakeholders in applying these processes. The extent to which AER was able to work with ElectraNet on their Preliminary Revenue Proposal, without compromising regulatory responsibilities is a useful example. Note that these need to be identified as examples, and are not to be regarded as prescribing any process
3. AER to document examples of consumer engagement that it considers to be noteworthy in as many published documents as possible, for example the State of the Energy market report, as well as preliminary and final determinations.
4. A paper identifying potential incentives for high calibre consumer engagement to be developed by AER as part of the ENA, ECA, AER joint project.
5. That the next iteration of the Consumer Engagement Guideline is focused on the outcomes that consumer engagement is expected to achieve, rather than seeking to specify any particular methodology.
6. AER undertake “ex post” analysis of consumer engagement, to ascertain the extent to which intended outcomes are achieved. This to particularly apply to businesses and processes that are encouraged or cited as being good practice.

Appendix 2 – Acronyms, abbreviations and terminology

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ARR	Annual Revenue Requirement
augex	Augmentation expenditure
BAU	Business as usual
capex	Capital expenditure
CCP	Consumer Challenge Panel
CESS	Capital Efficiency Sharing Scheme
CPI	Consumer Price Index
DER	Distributed Energy Resources
DB / DNSP	Distribution Business / Distribution Network Service Provider
DM / DR	Demand Management / Demand Response
DMIA	Demand Management Incentive Allowance
DMIAM	Demand Management Innovation Allowance Mechanism
DMIS	Demand Management Incentive Scheme
DNSP	Distribution Network Service Provider
DUOS	Distribution Use of System
EBSS	Efficiency Benefits Sharing Scheme
engaging consumers	A term that we have used for consumers and consumer representatives who are formally involved in a network engagement process, eg regarding a reset
EV	Electric Vehicle
ICT	Information and Communication Technologies
ISP	Integrated System Plan
MPFP	Multilateral partial factor productivity
MW	megawatt
NEL	National Electricity Law
NER	National Electricity Rules (or Rules)
NSP	Network Service Provider
Opex	Operating and Maintenance Expenditure
PV	Photovoltaic (Solar PV)
RAB	Regulatory Asset Base
RBA	Reserve Bank of Australia

Regulatory Proposal	regulatory proposal submitted under clause 6.8 of the NER
Repex	Replacement capital expenditure
REZ	Renewable Energy Zone
RIT-T / RIT-D	Regulatory Impact Test, Transmission / Distribution
SOEN	Statement of Expectations for Networks
STPIS	Service target Performance Incentive Scheme
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System