AusNet services

Locked Bag 14051
Melbourne City Mail Centre
Victoria 8001 Australia
T: 1300 360 795
www.ausnetservices.com.au

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John Pierce
Chairman
Australian Energy Markets Commission
PO Box A2449
Sydney South NSW 1235

Via website: www.aemc.gov.au

Dear John,

Approach Paper: 2019 Economic Regulatory Framework Review

AusNet Services is pleased to make this submission on the scope of the 2019 review, in response to the Commission's Approach Paper. We have provided views as to priority economic regulatory framework issues through discussions with Commission staff late in 2018, however the release of the Approach Paper provides the opportunity for more formal sharing of views with the Commission.

The Approach Paper identifies the priorities for the 2019 review being around:

- arrangements that promote efficient investment and supports the evolving role of NSPs and the electricity sector transition more broadly at lowest cost; and
- improving the approach to expenditure assessment and remuneration

We agree that the first of these matters is a priority area for consideration in the review, and will likely continue to be for some years, aligned to the transformation occurring in the industry and which is not expected to abate. While the future state following this transformation is unknown, regulation should support the efficient integration of distributed energy resources today, and enable the creation of flexible foundations (or 'least regrets' investments) to support the long-term interests of customers.

Some of the relevant regulatory issues were discussed in the 2018 review, however, AusNet Services considers there is a need to keep these under close examination, to build broad stakeholder understanding of the issues and to report on them in the 2019 review. These include:

- recovery of costs of providing shared network services – in the 2018 review the Commission determined that DUOS costs should remain fully assigned to consumption. A complexity is the treatment of storage. With storage connections on distribution networks becoming prevalent, certainty is needed regarding the application of DUOS charges, and consideration of consistency and neutrality with arrangements for transmission connected storage systems;
- access arrangements for embedded generation – similarly to the previous point, the review should consider the implications for the distribution system, of a potential introduction, of a firm access regime for transmission connected generation, through which generation would contribute to shared network costs
- revisit the approach to recovery of network costs resulting from solar installations, particularly at the household level – this matter is very much related to the previous point. Although the 2018 review concluded that the framework and tools available to NSPs enable management of this issue, the framework is not readily understood or appreciated by customers. The current arrangements could be seen as inequitable as the customer

who will trigger an augmentation must choose to either pay this cost or be export constrained, even if his neighbours have previously connected and are exporting without restriction and free of cost. There also would be merit in examining the methodologies for valuing DER, and thence consider an economic framework for assessing whether network upgrades are warranted to accommodate export. The workstream would link closely with the direction of system operation support for DER markets being explored by the OpEN program.

The Approach Paper observes that the Commission intends to use the outcomes of the joint bodies Distributed Energy Integration Program as a key input in considering DER matters. We understand that this collaborative program is conducting valuable work, however there appears to be limited opportunity for individual businesses and stakeholders to participate. Potentially there is the opportunity for greater information sharing and consultation on that program via this review.

In relation to expenditure assessment and remuneration, from examination of the matter, including from the findings in the 2018 review, there does not appear to be a material capex bias issue to be addressed. The review found that the conditions for a bias are related to the condition of a material difference between the regulated rate of return and the regulated business' actual cost of capital. As the regulated rate of return has fallen dramatically in the AER's December 2018 Rate of Return Guideline, the likelihood that this bias exists is far lower than at the time of the Commission's 2018 review.

We also note that the Finkel recommendation was for assessment of alternative models, if there is demonstrated bias towards capital expenditure. The recommended criterion was not if there is risk of this outcome, and clearly, as the Commission's 2018 review demonstrated, there is risk of deviation in either direction from a neutral outcome. Importantly, it is not long since measures were put in place to balance incentives through the AER's Better Regulation program, which included the introduction of a capex efficiency sharing scheme (alongside the opex efficiency sharing scheme) and introduction of the demand management incentive scheme. The success of these reforms has yet to be fully tested, but recent capital underspends compared to allowances does not indicate that there is an ongoing bias towards capital solutions.

The final report for the 2018 review advised that the subsequent review would continue exploration into improving the flexibility of the revenue setting framework to incorporate more outcomes based measures (refer to section 7.2.1 of the report). We would support the inclusion of this work in the scope of the review. The framework would benefit from recognition of a range of desirable outputs across the framework. It is currently highly focussed on average reliability outcomes and cost efficiencies.

The narrow view of a network's performance under the current framework can be seen in the AER's benchmarking reports, which for example, does not account for safety outcomes or customer experience. The importance of customer experience has been revealed through the New Reg process which AusNet Services is trialling in its current revenue determination for its electricity distribution network. The more extensive customer engagement that is arising should lead to the framework supporting arrangements more tailored to the needs of each network's customers.

A desirable outcome of the 2019 review would be a broadening of concept of performance so that benchmarking considers a wider set of measures. This would be an important step towards an output-based framework.

The more extensive and lengthy stakeholder engagement processes that are undertaken by many networks prior to submitting their Revenue Proposals mean that shortening the regulatory process post-submission should be considered. Consultation on the Revenue Proposal often starts more than three years prior to the new regulatory period, and considers network services three to eight years into the future. This is particularly challenging in this transitional period. Shortening the formal process by at least 6 months would facilitate more effective and up-to-date consultation prior to lodgement.

We look forward to participating in the 2019 review. If you have any queries regarding our submission please contact Kelvin Gebert.

Yours sincerely

C. Eddy

Charlotte Eddy
Manager Economic Regulation
AusNet Services