9 July 2020

Ed Chan
Director
Australian Energy Market Commission

Submitted online

Dear Mr Chan,

Submission to ENERF 2020 approach paper

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the AEMC's approach paper to the Electricity Network Economic Regulatory Framework (ENERF) review.

PIAC agrees with the 3 issues the AEMC has identified to examine in the 2020 ENERF, namely:

- large transmission investments and the increasing use of contingent projects;
- risk allocation between network businesses and consumers; and
- the need for enhanced consumer engagement.

Large transmission investments and their cost recovery

The current regulatory framework is designed to deliver efficiency of incremental investment to a centralised generation and transmission system, which has already been 'built out'. The transformation the NEM is currently going through is not incremental – it is a step change.

A planning and investment framework that delivers efficiency for strategic, whole-of-system investments is needed to ensure this transformation is delivered in a timely and cost-effective manner.

Without such a framework, we expect to see the cumulative impacts of individual generation and transmission investments diverging from the optimal system-wide outcome with inefficient generation and network investment and a lack of coordination between the two resulting in consumers paying twice to solve the same problem; missed opportunities to exploit economies of scale and scope; and a longer and more expensive transition to a low- or zero-emissions energy sector.

All of these ultimately lead to increasing pressures on consumers through the wholesale and network components of their electricity bills, as well the impacts of climate change.

PIAC has identified three objectives for the regulatory framework for delivering centralised generation and transmission, especially in the context of the NEM's transformation and affordability challenges. We use these objectives to assess the need and priority of any reforms to the current framework and the merit of

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any solutions proposed. They are described in further detail in our submission the COGATI Access and Charging consultation paper.[1]

The framework must:

- identify the most efficient system-wide solution;
- deliver the solution in a timely and efficient way; and
- recover costs for the delivered solution in the fairest and most equitable way.

To date, reform has focussed on the first two, leaving how the cost of these projects is assessed and recovered largely unaddressed. As the AEMC notes, many ISP projects are large, discrete and non-recurrent and hence are distinct from the more business-as-usual network projects in terms of their procurement and construction, as well as the AER's assessment of what is a prudent and efficient cost to include in the Regulatory Asset Base.

Risk allocation between consumers and industry

In general, PIAC considers risks should be allocated so that those exposed to them have the ability and incentive to manage them. This is particularly important in the regulated network segments of the energy supply chain. Under the current regulatory frameworks, network investment costs have been borne by consumers – i.e. socialised – through a regulated fee, regardless of actual asset utilisation or benefits accrued. PIAC does not consider this to be an appropriate allocation of risk. Instead, risk should be shared between consumers and businesses based on an assessment of which party has the ability and incentive to manage it.

PIAC supports examining frameworks and schemes that allow network businesses, or third parties, to bear more of the risk of speculative investment projects and receive an appropriate return should the investment be successful. One such example is PIAC's model for Renewable Energy Zones whereby consumers and speculative investors share the risk of transmission investments that enable future renewable generation projects to connect.[2]

Distinct from the allocation of risks, is the recovery of costs – noting that while the costs and risks are generally related, they are not necessarily the same. PIAC's key principles for cost recovery are:

- Costs are recovered according to a beneficiary-pays framework, such that those who benefit from a given investment should also pay for that investment.
- Where there are multiple beneficiaries, the costs should be recovered proportionally to their share of the benefits.
- Where it is not practical and transparent to identify or measure the beneficiaries, a causer-pays principle should be used.
- Cost recovery should also include the risk, to the extent it exists, of the underutilisation of assets and hence asset stranding.
- Cross-subsidies, such as consumers in one region bearing the costs of transmission investments that benefit those in another region, should only be permitted where they are accepted by informed consumer feedback or are immaterially small.

Enhanced consumer engagement

Having been involved in several network revenue determinations in the last three years, PIAC agrees 'the environment of network revenue determination processes has changed markedly in recent years, with increasingly positive and constructive engagement by the AER, networks and

1 PIAC, *Submission to COGATI Access and Charging consultation paper*, April 2019, 3-4.
2 ibid, 19-23.

consumers on regulatory processes.'[3] We consider effective, early engagement by network businesses is good practice as it helps them plan and operate their networks in a way that reflects the requirements and preferences of their customers.

However, engagement does not abrogate the AER's primary role in revenue determinations. The AER, as an expert regulator, must ensure that any expenditure decision remains prudent and efficient and that the revenue recovered from consumers remains in the long-term interests of consumers.

While we agree trust is vital in such engagement processes, we disagree with Jemena that necessarily 'making decisions which go against the outcomes of direct customer engagement will undermine trust and belief in the legitimacy of the process and weaken incentives for both networks and customers to engage in future engagements.'[4]

Trust in engagement processes may be undermined if it is unclear or opaque how the regulator considers these preferences in making its decision. It is not a simple matter of direct engagement outcomes trumping other considerations or perspectives, particularly in matters of economic efficiency.

The outcomes of deliberative forums and engagement must be transparently and honestly considered by the AER in making its decision, and clear reasons provided for why and how it has chosen to use or not use the outcomes.

Therefore, PIAC considers more formal consideration of how differences between the AER and consumer engagement in revenue determinations are identified and resolved would be beneficial.

Continued engagement

PIAC would welcome the opportunity to meet with the AEMC and other stakeholders to discuss these issues in more depth.

Yours sincerely,

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3 AEMC, *Electricity network economic regulatory framework 2020 review – approach paper*, June 2020, 6.

4 Jemena, *Jemena Gas Network Revised 2020 Plan*, January 2020, x.