

# Collaborating for better customer outcomes

Response to AER Draft Better Resets Handbook

21 October 2021

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## 2 Key messages

- » ENA welcomes the release of the draft Better Resets Handbook (the Handbook) and is **strongly supportive of this AER initiative** putting consumers at the centre of network resets.
- » We **support the establishment of explicit and broader objectives to guide the development of the final Handbook design** → stronger focus on customer outcomes and improving efficiencies, and establishing expectations for all parties in the process.
- » To **maximise efficiencies and ensure that the overall regulatory burden is reduced, we strongly encourage consideration of current reset requirements and how they could be streamlined** → opportunity to achieve efficiencies and avoid unnecessary customer costs.
- » The **final Handbook should establish clear expectations between all key parties**, and ENA recommends further specific consideration be given to the role and commitments of the AER in the final design.
- » A preference to first apply the targeted review stream process to a limited number of network businesses underscores the **importance of ensuring that businesses are not penalised for not being part of the targeted review stream process as it is rolled out**.
- » It is important that AER assessment processes – including ‘default’ approaches – retain and advance the capacity for **well-founded proposals based on genuine customer engagement to be assessed in a proportionate, well-targeted and efficient manner, irrespective of involvement in the targeted review stream**.

## 3 Overview

Energy Networks Australia appreciates the opportunity to provide a response to the Australian Energy Regulator’s (AER) draft *Better Resets Handbook – Towards consumer-centric network proposals*<sup>1</sup> (**the Handbook**).

Energy Networks Australia (ENA) is the national industry body representing Australia’s electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

Collaboration and engagement across networks, customers, consumer advocates and regulators has delivered clearly better outcomes, and we welcome the AER’s acknowledgment in the draft Handbook of networks’ increasing focus on customer engagement in recent regulatory processes. ENA is strongly supportive of the development of the Handbook and considers it a valuable opportunity to address the complexity and costs of the reset process.

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<sup>1</sup> AER, Draft Better Resets Handbook – Towards consumer-centric network proposals, September 2021.

We support the establishment of explicit and broader Handbook objectives to guide the development of the final Handbook design. Alongside the AER's expectations for network businesses, we support the establishment of clear expectations between all key parties involved in the targeted review stream, and also recommend further consideration being given to opportunities to maximise efficiencies and ensure that the overall regulatory burden is reduced.

ENA looks forward to working with the AER and stakeholders through the consultation period to design a final Handbook that puts consumers at the centre of network resets, improves the efficiency of the reset process and therefore ensures better outcomes for customers.

## 4 Handbook design

### 4.1 Handbook objectives

The draft of the Handbook notes that the aim is to incentivise networks to develop high quality proposals that are driven by genuine engagement with consumers.

While we support this general objective, we consider it beneficial to consider establishing a set of broader Handbook objectives to guide the development of the final Handbook design, as follows:

- 1. Encourage network proposals that are driven by genuine engagement and deliver valued outcomes.**
  - This objective highlights the integral role of consumer engagement in reset processes and recognises that networks are employing a broad range of engagement techniques to obtain and integrate customer views. A stronger focus on customer outcomes, rather than regulatory inputs, through engagement is also supported, and is considered in ENA's feedback to the AER's reset expectations in Section 5.
- 2. Improve the efficiency of the reset process for all parties.**
  - The Handbook should seek to improve the efficiency of the reset process for all parties including the AER, consumer advocates and networks. The development of Handbook is a valuable opportunity to take a 'whole-of-system' approach and address the complexity and costs of the reset process. To maximise efficiencies and ensure that the overall regulatory burden is reduced, we have suggested improvements for the AER's consideration in Section 4.5.
- 3. Define clear expectations between all parties.**
  - To ensure a clear understanding of the role that each key party will play, we support further defining expectations for all key parties in the final Handbook and support further consideration be given to the role and commitments of the AER. Section 4.4 provides recommendations for the AER's consideration.

## 4.2 Targeted review stream selection

A stated AER preference to first apply the targeted review stream process to a limited number of network businesses<sup>2</sup> underscores the importance of ensuring that networks are not penalised for not being part of the targeted review stream process as it is rolled out.

ENA welcomes the AER's acknowledgment in the draft Handbook of networks' increasing focus on customer engagement in recent regulatory processes. Customer engagement efforts of all networks should continue to be acknowledged and consistently assessed following the introduction of the Handbook.

We recognise that resource constraints mean that the AER likely cannot run a large number of targeted review streams in parallel. It is important that AER assessment processes – including 'default' approaches – retain and advance the capacity for well-founded proposals based on genuine customer engagement to be assessed in a proportionate, well-targeted and efficient manner. Networks that are not successful in their application to be part of the targeted review stream or do not seek access to the targeted review stream should not be unduly disadvantaged or their own stakeholder engagement processes and outcomes unintentionally undervalued.

### 4.2.1 Potential criteria

Network businesses will apply to access the targeted review stream in the early stages of engagement and initial expenditure forecasts and positions are likely to be subject to significant uncertainty, change and/or not yet subjected to engagement with customers.

Strict application of the AER's current expectations as set out in the draft Handbook, therefore, could unintentionally narrow the scope of eligible network review processes, and may not be the sole appropriate criteria to use to decide whether a network should be selected for the targeted review stream.

We support an open and inclusive selection process. Possible additional criteria to decide whether a network should be selected for targeted review stream process could include:

- » A network signalling its intent to access the targeted review stream by demonstrating strong executive or Board-level support for the process.
- » A network establishing a panel/working group/committee of customers and/or customer representatives that are suitably resourced and qualified (or will be supported on the latter) to participate in extensive pre-lodgement engagement and deliver an independent customer report.

Noting that the AER highlights that the targeted review stream is a new process which it expects to refine and improve as it learns from each iterative application, there is likely value in the AER ensuring diversity in characteristics of participating networks. Examples of this could include, for example, diversity as regards electricity and gas networks, as well as distribution and transmission networks and different network characteristics (such as size, customer numbers, and rural/urban proportion).

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<sup>2</sup> AER, Draft Better Resets Handbook – Towards consumer-centric network proposals, September 2021, page 1.

### 4.3 Consistency of expectations

In undertaking its assessment of proposals or projects, the AER should place the same weight on stakeholder engagement activities and customer outcomes irrespective of whether they are subject to the targeted review stream under the Handbook. That is, customers voices on proposals or project should not be accorded greater or lesser weight depending on the form of review undertaken, as a matter of equity.

Clearly, there is no value in the AER undertaking an un-targeted or disproportionate review of a network proposal not within the targeted review stream if the business submits a well-founded proposal which is developed through genuine engagement with consumers.

Irrespective of involvement in the targeted review stream under the Handbook, we also strongly support and encourage AER involvement in networks' pre-lodgement engagement as earlier commitment of AER resources will drive efficiencies for all parties in the regulatory process.

### 4.4 AER role and commitments

The final Handbook should establish clear expectations between all key parties, and ENA recommends further specific consideration be given to the role and commitments of the AER in the final Handbook design.

Alongside the AER's expectations for network businesses, we support the development of clear and shared expectations around the AER's participation in terms of the types of resourcing it is able to commit to as part of the targeted review stream, particularly in the pre-lodgement stage.

We recommend that the AER consider adopting the following expectations in the design of the final Handbook:

- » **Joint agreement on process and roles** – To provide clarity, during the pre-lodgement stage the AER commit to participating in a joint agreement on process and roles to be played by key parties (AER, Consumer Challenge Panel (CCP), network customer panels, network) during the reset.
- » **Pre-lodgement staff involvement** – The AER commit staff to early collaboration and attendance at key engagement milestones during the pre-lodgement stage.
- » **An active staff role and identification of any 'red flags'** – During the pre-lodgement stage, AER staff taking an active role, and indicating if the engagement and analytical *approaches and methods* being employed by the network are likely to align to AER expectations. This will provide opportunities for networks to address potential issues early on (i.e., in response to potential 'red flags').
- » **Targeting of detailed justification** – During the pre-lodgement stage, AER staff indicating likely areas of a network's proposal that may require detailed justification. This will allow a network to focus its efforts on key areas and potentially reduce the volume of reset documentation.

We appreciate that AER staff during the pre-lodgement stage are unable to provide advice or guidance on how the AER Board would likely substantively decide on an issue. However, open and timely feedback from the AER during the pre-lodgement stage provides a network the opportunity to take account of AER views and refine its approach early in the process.

Note that we are not suggesting that this extend to AER staff indicating if expenditure will be approved by the AER but rather focus on whether the approaches and methods being employed by the network are likely to align to AER expectations.

## 4.5 Maximising efficiencies

The draft Handbook notes that, by providing greater clarity, and rewarding good customer engagement and well-justified proposals, there will be increased efficiency in the regulatory process.

ENA considers that the development of Handbook is a valuable opportunity to address the ever-increasing complexity and costs of the reset process. In addition to setting clear expectations as outlined in Section 4.4, to maximise efficiencies and ensure that the overall regulatory burden is reduced, ENA encourages consideration of current reset requirements and how they could be streamlined, including:

- » ENA **strongly supports a review of the Regulatory Information Notice (RIN) requirements**, which should seek to balance the data reporting benefits with reporting burden. We support minimising costs to customers of duplicative or redundant information collection processes that do not materially inform, or have a reasonable prospect of informing, regulatory decision-making or other functions. This could be undertaken as a broader review of the AER's RINs, or initially targeted at the Reset RIN as foreshadowed by the AER in recent publications.<sup>3</sup>
  - To progress this, as a first step, ENA recommends an AER and industry workshop that initially considers potential amendments to the Reset RIN, with a focus on the qualitative requirements.
- » We would also encourage consideration be given to how current consultation processes can be embedded into the Handbook to improve efficiencies. For example, **ensuring the appointment of each networks' CCP as early as possible** in a network's engagement and proposal development processes will reduce duplicative engagement processes, and ensure sufficient understanding of the issues.

Clarity of the role of the CCP in the reset process should be confirmed in the joint agreement as proposed by ENA in Section 4.4, which should then guide its reset involvement. If, for example, the CCP will be relied upon to provide assurance on the network's engagement, then it should observe the vast majority of it.

These efficiencies should apply to all networks irrespective of their involvement in the targeted review stream and will deliver benefits to all customers in the form of reduced costs and early CCP engagement in review issues.

## 5 AER reset expectations

The draft Handbook sets out the AER's expectations:

- » of how network businesses will engage with consumers and how outcomes of that engagement should be reflected in their proposals, and

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<sup>3</sup> The Reset RIN review as foreshadowed in the AER's *Issues Paper: AER standardised model for Standard Control Services capital expenditure* released in August 2021.

- » for capital expenditure, operating expenditure, regulatory depreciation and tariff structure statements.

ENA supports a greater focus towards output-based factors / customer outcomes in the application of AER's expectations, rather than a prescriptive focus on approaches and inputs, which risks providing limited scope for genuine customer engagement.

There is a need to balance prescription with principles when designing the final Handbook, which should allow for flexibility and adaption in the future to ensure that it is fit-for-purpose for future market developments.

The draft handbook has a strong focus on historical expenditure and inputs, and it is unclear the extent to which a network's proposal may deviate from historical spend, and the prescribed inputs, before it would no longer be considered eligible for the targeted review process.

An increase on actuals should be reviewed on merit against the National Energy Laws and Rules and not undermine a proposal's 'capability of acceptance' or the possibility of a targeted review, noting that the purpose of the Handbook is to facilitate consumer preferences being taken into account. In this regard, for example, best-practice innovative consumer engagement may be arguably more critical in cases where proposed expenditure may exceed historical trends (e.g., through the provision of larger projects delivering enhanced network security) than in cases of lower or more trend-based expenditure.

## 5.1 AER expectations on consumer engagement

ENA strongly supports an increasing focus on customer engagement in regulatory processes. The AER notes that the development of the Handbook will allow consumers to have a greater influence over the development of regulatory proposals by network businesses and, more importantly, ensure networks businesses deliver the outcomes valued by consumers. Application of the AER's expectations should then allow for networks' integration of consumer feedback, which may challenge the AER's standard expectations in some areas.

### 5.1.1 Independent consumer report

Those networks part of the targeted review stream must submit an independent consumer report on the proposal to the AER.

It would be valuable for implementation of the targeted review stream if the final Handbook could provide further clarity on the focus and scope of the independent consumer report, and specifically AER considerations around potential criteria for selecting an 'independent' author/s of the report.

We welcome clarification from the AER on whether, for example, the independent consumer report could be authored by the network's customer panel, or whether the AER intends on this being done by a party such as a consultant, and the associated funding arrangements.

While understanding the goal to avoid prescription and allow for flexibility and innovation, examples of the types of considerations that would flow into an AER judgement on the nature of the independent report and its potential providers would help align expectations.



## 5.2 AER expectations on capital expenditure proposals

While the AER notes in the Handbook's introduction that over the next 5–10 years it expects to see significant network investment to manage the impact of the energy transition, the capital expenditure (**capex**) expectations as they are currently drafted appear to treat forecast capex over actuals and a rising Regulatory Asset Base (**RAB**) as a condition that potentially excludes a process of targeted review.

An increase on actuals should be reviewed on merit against the National Energy Laws and Rules and not undermine a proposal's 'capability of acceptance', noting that the purpose of the Handbook is to facilitate consumer preferences being taken into account.

A deterministic use of historical capex to inform future needs in the energy transition may have unintended consequences, and not reflect changing consumer needs. In addition, not every network business is in a steady-state, and networks may have different asset age profiles, and lumpy historical investment, that results in peaks and troughs of required capex. By their nature, AER decisions on capex and depreciation will also mathematically flow through to the level of RAB growth or decline.

### 5.2.1 Incentive schemes

The draft Handbook states that if material incentive benefits are being claimed, there must be well-justified reasons for this and these have been explained to customer groups.

Incentive-based regulation serves an important role in encouraging energy networks to reduce costs and improve service in the interests of customers, and the presence of underspends against allowances and incentive carry overs should not be perceived negatively.

The scheme outcomes from the existing period, whether they are material benefits or penalties, are a mechanistic application of an AER-approved incentive scheme and not contingent on customer engagement. We would instead expect engagement on the Capital Expenditure Sharing Scheme (**CESS**) outcomes to focus on the sources of any material underspend to provide customers (and the AER) assurance that the CESS is only rewarding efficient reductions in capex rather than ineligible deferrals.

### 5.2.2 Decision-making processes

We do not support the level of prescription included Section 5.2.2 of the draft Handbook and recommend the following adjustments:

- » *“Quantitative cost benefit analysis assessing all feasible options to show that the preferred option maximises net benefits. This includes consideration of non-network options”* should be updated to recognise 'technically feasible options' or a 'reasonable range of options'.
- » We recommend removing *“For electricity businesses, compliant Regulatory Investment Tests for eligible capital expenditure projects submitted in its regulatory proposal.”* Given the time lag between a proposal and actual expenditure, particularly for those projects commencing in the later years, it is unlikely that a Regulatory Investment Test (**RIT**) would have already been undertaken prior to submission of a regulatory proposal.

It is highly inefficient to require RITs be undertaken for all potentially eligible projects by the proposal stage. The AER approves its best ex-ante estimate of total efficient capex for the network's forthcoming regulatory control period, and the network then delivers the required

capital program within the period, including undertaking a RIT closer to the time of a network's identified need.

### 5.2.3 Regulatory asset base

We support engagement on the sustainability of a proposal with reference to RAB per customer, however, an expectation for a steady and stable RAB may not necessarily always be compatible with the outcomes of consumer engagement on the proposed capex.

We would therefore suggest removing this as a standalone capex expectation, and instead integrating it into the 'genuine consumer engagement on capital expenditure proposals' expectation.

## 5.3 AER expectations on operating expenditure proposals

### 5.3.1 Trend

While the AER's expectations with regards to opex trend inputs do not prevent a network from proposing an alternative, the risk of not being able to access a targeted review on the basis of doing so would be disproportionate and potentially create perverse incentives.

We therefore suggest the following factors are considered further:

- » **Adoption of Australian Energy Market Operator (AEMO) consumption and demand forecasts:** A network must satisfy the Rules' operating expenditure criteria, which include 'a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives.'

Rather than the Handbook prescribing that the AEMO forecast be used, we would instead suggest that the Handbook reference a realistic or independently verified forecast is used and/or reasonable explanations exist for differences between the network forecast and AEMO's forecast. For example, the AEMO forecast may be at a more aggregated network level or apply different assumptions (for instance to forecast spot loads) where networks will have more accurate information.

- » **Forecasting customer number growth consistent with the historic trend:** a specific approach to forecasting customer growth need not be embedded as the starting point, and we would suggest removal from the Handbook. A historic trend may not be appropriate where better forecasting information (such as State and/or developer-based housing forecasts are available) or expert advice is available.

### 5.3.2 Step changes

The draft Handbook includes the AER's expectations for step changes by category. The presence of step changes and proposals that may not formulaically fit the AER's typical approach to step changes but are required to enable a reasonable opportunity to recover at least efficient costs, should not automatically invalidate the application for a targeted review.

The AER also notes its expectation for step changes to have a 'material impact on the costs of providing prescribed network services'. In theory, if a NSP's opex is efficient, 'immaterial' adjustments to the forecast may still be required to provide adequate opex. ENA does not support materiality being a key consideration in step change criteria.

If 'material' is to be retained in the handbook, it would be useful to give guidance on what is a material impact, as well as have some consideration of materiality of step changes in totality – if several 'immaterial' step changes sum to be a material impact, for example.

#### 5.4 AER expectations on regulatory depreciation

The draft Handbook notes that the AER, in determining whether it will undertake a targeted review of a network business' regulatory depreciation proposal, would expect the asset classes would be unchanged from the last reset and the asset lives would also reflect those approved in previous decisions.

If a divergence from the AER's expectation that the assets classes would be unchanged from the last reset and the assets lives would also reflect those approved in previous decisions is strongly supported by consumers, then this should not preclude a network from being eligible for the targeted review stream.

#### 5.5 AER expectations of tariff structure statements

ENA would recommend this section be expanded to reflect the recent Australian Energy Market Commission's (AEMC) DER access & pricing rule change<sup>4</sup>, which broadened the scope of pricing principle 6.18.5(i) to allow for more complex pricing options that are still sufficiently clear as to be capable of flowing through to customer contracts.

Under this provision, DNSPs are required to demonstrate that any tariffs are reasonably capable of being:

- » understood by customers, or
- » directly or indirectly incorporated by retailers or by Market Small Generation Aggregators, in contract terms offered to those customers.

We note that there is possibly an inherent tension between the desire to progress the cost reflectively of network prices signals and tariff assignment policies. Therefore, we recommend that the AER give further consideration to the interaction of the following proposed issues:

- » fails to progress the cost reflectivity of network price signals, and
- » reduces customer choice in the network tariff customers are assigned to.

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<sup>4</sup> AEMC, Access, pricing and incentive arrangements for distributed energy resources, Rule determination, 12 August 2021.