Energy Networks Australia

MEDIA RELEASE

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INCENTIVES DELIVER MORE THAN $6 BILLION IN BENEFITS TO CUSTOMERS

Energy Networks Australia has today released a report showing Australia's incentive-based energy regulation schemes are delivering more than $6 billion of benefits to customers.

The *Rewarding Performance: How Customers Benefit from Incentive-based Regulation report*, released in Brisbane as part of Energy Networks Australia's *Regulation Seminar 2019*, is the first comprehensive analysis of the schemes' performance.

Energy Networks Australia CEO Andrew Dillon said the report clearly demonstrated that incentive regulation was working for customers.

"A stable framework of incentive-based regulation encourages energy networks to continue to reduce costs and improve services – benefits that this report quantifies in savings to customers," Mr Dillon said.

"Under this system a customer with gas and electricity is better off by more than $650, while an electricity only customer will benefit by more than $500.

"Incentive-based regulation makes improving efficiency and service good for customers and good for industry.

"Aligning customer and network interests is a strength of the current regulatory framework and should be a foundation stone for regulation going forward."

Mr Dillon said the incentive-based framework underpinned the strong productivity improvements demonstrated by Australian network businesses, most recently reported in the Australian Energy Regulator's latest *Annual Benchmarking Report*.

This found electricity distribution networks' increasing overall productivity by 2.7 per cent in 2016-17 and transmission networks by a record-breaking 5.8 per cent.

Mr Dillon said the benefits outlined in the report were conservative as they did not include recent operating efficiencies made by networks and were calculated on high interest rates.

"Using current financing costs and interest rates, we estimate 81 cents of every dollar of efficiency gains made by networks ends up in the pocket of consumers," he said.

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Background

Energy networks provide an essential service to almost every household and business across Australia. However, as regulated businesses, networks are not exposed to the same degree of competitive market forces as most other businesses that would otherwise drive the need to constrain costs and/or improve efficiency.

This is where incentive regulation, operated by the Australian Energy Regulator (AER), steps in. As the regulator of energy networks, for every regulatory period (generally a five-year period) for every network, the AER sets:

- the operating and capital expenditure allowances for each year within the regulatory period; and
- the revenue that can be collected from customers in each year of the regulatory period; and
- for electricity networks, the service standards to apply for the regulatory period.

The *Rewarding Performance* report focuses on the Efficiency Benefit Sharing Scheme (EBSS) and Service Target Performance Incentive Scheme (STPIS) to provide an initial estimate of the scale of benefits offered by such schemes to date.

These two schemes are the longest-running incentive schemes in the Australian energy market and together comprise virtually all the total reported incentive scheme payments over the 2006 to 2018 period.

How the EBSS works

The AER selects an appropriate efficient year's operating expenditure result as the starting point from which to forecast network allowances for the next regulatory period. Industry benchmarking outcomes and any forecast step-changes are applied to determine the final forecast.

As the regulatory period progresses, the EBSS allows network businesses to retain the reward for any underspend (or penalty for any overspend) for six years, regardless of which year within the regulatory period the under or over-spend occurs.

This avoids any potential bias as to when businesses achieve gains. It also benefits consumers by encouraging businesses to reveal their efficient operating expenditure level to the regulator.

The lower operating expenditure revealed by the business is used to reset the allowance in the next regulatory period. It also feeds into the regulator's operating expenditure benchmarking and allows for the setting of more challenging performance benchmarks for businesses in the future.

How the STPIS works

The STPIS incentivises electricity networks to maintain and improve service performance.

Where performance improves, the network receives a reward linked to a percentage of allowed revenue. Where service performance declines, the network is similarly penalised.

STPIS targets are based on the network's average historical performance, typically over five years, but it may vary depending on the STPIS component.

The STPIS is applied to *unplanned outages*, so it excludes planned outages and extreme weather events like cyclones. It does, however, include most short-lived weather events like storms and winds.

Transmission networks are also subject to additional STPIS incentives to reduce the impact of planned and unplanned outages on the market.

In recognition of their inherent differences, transmission and distribution networks are measured against relevant service performance components under their respective STPIS guidelines.

Both the EBSS and STPIS encourage networks to continuously seek out better ways of delivering network services at a lower cost.

After allowing network businesses to earn more from these additional efficiencies/improvements for a short period, the benefits are passed on to customers - forever.

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Energy Networks Australia 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.