



NEW REG: TOWARDS CONSUMER-CENTRIC ENERGY NETWORK REGULATION

A joint initiative of the Australian Energy Regulator,
Energy Consumers Australia, and Energy Networks
Australia

Directions Paper

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1. INTRODUCTION

The Australian Energy Regulator (AER), Energy Networks Australia and Energy Consumers Australia (ECA) are exploring ways to improve sector engagement and to identify opportunities for regulatory innovation. 'We' have collectively decided to attempt to develop an 'alternative path' for network businesses to take in building their regulatory proposals, and for the AER in assessing those proposals.

The overall vision for the project is that energy consumers' priorities should drive energy network business proposals and regulatory outcomes. We believe there are opportunities to better incorporate consumer preferences in revenue determination processes, and to improve consumer trust and confidence in network regulation. Further, there is scope to improve the efficiency and effectiveness of the regulatory process.

The three organisations share a commitment to engage consumers in a process that is robust, challenging, flexible and innovative, and which carries public confidence. The proposed New Reg Process is detailed in section 2 and some key design features are explained in section 3.

We have agreed to develop and trial an alternative approach to network regulation within the established regulatory Rules. This may present constraints which we are keen to identify and understand to help inform possible future refinement of the regulatory framework (section 4).

This directions paper sets out the alternative regulatory approach, which we are calling the 'New Reg Process', and identifies key issues within this framework. Wherever possible we have explained how we expect the process to be trialled. The word 'consumer' is used here in the same way as it is in the National Electricity Objective (NEO) to refer to all end-users of energy, including residential, small business, and commercial & industrial users.

This directions paper is accompanied by an approach paper. Our directions paper assumes a good understanding of the current regulatory practice and what we are trying to achieve in this project. Further background information on the project can be found in our approach paper.

Applicability of the approach to gas networks

The New Reg process set out in this directions paper has been drafted in a way that references the terminology and process set out in the National Electricity Law and Rules rather than the Gas Law and Rules (for example, the process described below refers to regulatory proposals and determinations rather than access arrangements). However, that said we consider that the approach outlined in the New Reg process is transferable to the process for assessing gas access arrangements and as such would welcome trials of this process for gas networks.

2. NEW REG PROCESS

The main idea of the New Reg Process is that consumers—through what we are calling a 'Consumer Forum'—and the network business can come to an agreement that the revenue proposal reflects consumer perspectives and preferences. The Consumer Forum is created to become 'counterparty' to the business in reaching these agreements. The Consumer Forum should be equipped to understand consumer views, and to reflect these in a process of 'mutually advantageous discovery' to find better outcomes for consumers.

The AER is integral to these discussions and will support the Consumer Forum. This ensures the process is sufficiently robust that the AER can have regard to the agreed outcomes in making its formal revenue determination. So, at least for the purposes of a trial, such agreements should be developed to meet the requirements of the current regulatory framework.

The New Reg Process has two main components:

- The development of the regulatory proposal through an Early Engagement Process – this Process extends consumer involvement beyond current engagement processes to a point where the network business reaches agreement (or otherwise) on some or all aspects of the regulatory proposal
- The assessment of the regulatory proposal by the AER – including having regard to areas of agreement (or otherwise) between consumers and the network through the Early Engagement Process, with the reasoning and evidence for this agreement set out in the Engagement Report.

The steps of the proposed New Reg Process to be trialled are outlined below.

1. A network business may propose to the AER to undertake an Early Engagement Process to develop its regulatory proposal.
2. If a network business decides to pursue the Early Engagement Process, it would submit an Early Engagement Plan to the AER. This would draw on informal discussions and consultation with the AER, the network business' existing consumer relationships and ECA. The Plan outlines the process the business intends to undertake to develop its regulatory proposal (section 2.1), including:
 - a. establishment of a consumer representative group (Consumer Forum) which the network would resource and fund;
 - b. high-level scope of matters proposed to be considered within the Early Engagement Process;
 - c. process of dialogue and engagement that will be followed by the network business and Consumer Forum; and
 - d. role and expectations of the AER to support the Early Engagement Process.
3. The Consumer Forum should:
 - a. represent, 'bring' the perspectives of, and act on behalf of all consumer voices (large and small), having regard to the long-term interests of current and future consumers;
 - b. be fully independent of the network business;
 - c. have the skills and expertise to serve the role of being a credible counterparty to the network business; and
 - d. operate in an open and engaging way to establish and maintain its legitimacy with consumers and the wider community.

4. The AER will decide whether or not it accepts the proposed Early Engagement Plan (section 2.1.1). The AER may propose amendments to the Plan. If the AER accepts the Plan, it commits itself to be deeply involved in the Early Engagement Process.
 - a. This commitment is formalised through an 'Engagement Agreement' entered into by the business, the AER and the Consumer Forum.
 - b. The Engagement Agreement sets out the roles and expectations of each of the parties, including the scope, funding arrangements, anticipated timelines, 'off-ramps' or termination conditions, and arrangements for a jointly conducted ex post review.
5. It is anticipated that the early phases of engagement between the network business and Consumer Forum will involve induction, training, and information sharing. The AER will be closely involved in providing background information including on network performance comparisons and previous related decisions, and guidance on AER assessment approaches and its statutory roles and responsibilities in revenue determination processes. Both the business and the Forum will do this in a way that does not require energy industry or regulatory expertise.
6. The next step involves the business and Consumer Forum scoping in detail the matters to be considered in the Early Engagement Process. This should also set out how the parties intend to collect information on the perspectives of customers (for example, through customer research or direct engagement) to inform their consideration of these matters. The scope of matters to be considered must be agreed between the business and Consumer Forum, and accepted by the AER—although the AER may be more closely involved in the scoping phase for the purpose of a trial.
 - a. Ideally the business and Consumer Forum can agree to the proposal as a whole—and that it fully reflects consumer perspectives and preferences wherever relevant. It is envisaged that the Early Engagement Process will, in principle, deal with any matter that may arise in a network business' regulatory proposal. However, for reasons of practicality or due to regulatory constraints, certain matters may be taken 'off the table'. For example, at least for a trial, some aspects of the proposal may be out of the business' control due to government regulations or reliability standards, or are subject to a binding AER guideline.
7. The Early Engagement Plan will specify how the Early Engagement Process will be carried out. Central to the Early Engagement Process is the idea of creating a 'dynamic conversation' between the network business and Consumer Forum, supported by the AER, to achieve outcomes in the long term interests of consumers. These discussions should be structured with the aim of reaching agreements in a timely way. The AER needs to be assured that it has sufficient visibility during the Early Engagement Process that it can indicate that something will not be acceptable before it is submitted.
 - a. Throughout the engagement process, the AER will contribute to the process of reaching agreement by providing information and explaining issues through 'advice notes' and/or presentations that communicate the 'boundaries' of the rules, and what it may consider as an acceptable regulatory outcome—consistent with AER guideline approaches. The AER may also identify aspects of a proposal

that in its view would most benefit from consumer perspectives, including through customer research and wider stakeholder consultation.

- b. The Consumer Forum should be resourced to communicate directly with end-customers, customer representatives, and other engagement channels and forums the network uses for its business-as-usual engagement, to elicit and understand their preferences, to carry out customer research (or help shape the business' research program), and to communicate issues and trade-offs back to customers.
8. At the conclusion of the Early Engagement Process the parties submit an Engagement Report setting out the process followed and outcomes from the engagement. The Engagement Report is a critical input to the AER's subsequent assessment of the regulatory proposal submitted by the network business, contributes to learning and improvement for future applications of the New Reg process, and supports accountability of the Consumer Forum to the end-use consumers.
 - a. The Engagement Report includes the scope of matters considered and, for each matter, the agreement that has been reached or, in the event of disagreement, the positions of the relevant parties.
 - b. For the matters which have been agreed between the parties, the Engagement Report should explain why these agreements reached are consistent with, or best reflect, consumer perspectives and preferences—referencing any customer research or consultation undertaken during the process.
 - c. For aspects of a proposal for which the business and Consumer Forum could not reach agreement, the Engagement Report should identify and explain the reasons these issues were left unresolved. This provides transparency and a useful starting point for the AER's subsequent assessment of the regulatory proposal.
9. If the network business and its Consumer Forum can reach agreement on some or all aspects of the regulatory proposal, there is an expectation that the Engagement Report would evidence how the agreement reflected consumers' preferences, citing relevant customer research and results of consumer engagement. Provided the Engagement Report accompanies or is included in the network business' revenue proposal, the AER must have regard to it.¹
10. While the AER would continue to undertake its current assessment process, it would now be able to have regard to the Engagement Report in forming a view about the regulatory proposal. There may be exceptions. For example, the AER may consider the proposed agreement materially disadvantages parties that were not actively represented in the Early Engagement Process (such as future consumers, which should be part of the Consumer Forum's consideration).
 - a. The AER is expected to start its assessment of the regulatory proposal by identifying agreed outcomes and unresolved issues. For the latter, it will be

¹ clauses 6.10.1(b)(1), 6.11.1(b)(1), 6A.12.1(a1)(1) & 6A.13.1(a1)(1) of the National Electricity Rules.

important for the AER to take into account the business and Consumer Forum's consideration of those aspects of the proposal.

- b. Although a matter may be unresolved, areas of disagreement should have been identified and explored (see step 8), forming a strong evidentiary basis for the AER's consideration of the matter. It may be, for example, the disagreement between the business and Consumer Forum is a question of different, equally credible methodologies. The AER, in those cases, would have the option of choosing between these alternatives, or selecting an alternative approach consistent with the regulatory framework.
11. If a business successfully undertakes an Early Engagement Process, and reflects the outcomes of this process in its regulatory proposal, the AER may if it considers appropriate expedite and/or streamline the revenue determination process. For the purposes of a trial, the AER may expedite its regulatory process only after the draft decision stage to allow for consultation on the outcomes of the Early Engagement Process (among other practical considerations).
 12. To facilitate on-going learning and improvement, especially at the trial stage, it is envisaged that the parties will engage in an ex post review of the process, undertaken by a third party. This includes an assessment of any barriers to the use of the Early Engagement Process, any obstacles to agreement, and any changes in the National Electricity Law or Rules which would facilitate better overall outcomes for the parties from the New Reg Process.

2.1 What's included in the Early Engagement Plan?

The starting point for the Early Engagement Process is the preparation by the business of an Early Engagement Plan. The Plan should set out the process the business will follow to incorporate and reflect consumer priorities and preferences in its regulatory proposal. It should also demonstrate the business' commitment to both explaining complex issues to non-experts, and supporting wider consumer engagement alongside (and as an input to) discussions with the Consumer Forum.

To initiate the Early Engagement Process, the network business is required to submit its Engagement Process Plan to the AER for consideration (see step 2 above). The Plan must outline:

- A statement of support from the CEO – the New Reg Process will be most successful if it has leadership support and can influence thinking and practice across all parts of the business
- Broader engagement strategy – how the Early Engagement Process fits in with the business' overall consultation process in the development of its regulatory proposal, including the interrelationship with the business' existing customer consultative committee
- A high-level indication of the matters proposed to be considered in scope – does the network business intend to engage with the Consumer Forum on the whole proposal? Does the network business consider that some matters should be taken out of scope at the outset?

- Formation of Consumer Forum – including the selection and appointment process, number and targeted skills or experience of members, and governance
- Roles of the Consumer Forum – in addition to engaging with the business on the development of its proposal, will the Consumer Forum have the resources and ability to commission customer research studies (either independently or in collaboration with the network business), and to communicate directly with consumers and other stakeholders?
- Consumer Forum role and resourcing post completion of the Engagement Report – is there provision for the Consumer Forum to have an ongoing role so it can contribute to the AER’s review of the regulatory proposal, and development of the network business’ revised regulatory proposal?
- Proposed funding and administrative arrangements – although the business may fund the Consumer Forum, what mechanisms are proposed to maintain its independence?
- Process to consider aspects of the proposal – including initial induction of Consumer Forum members, structure of the process to identify (scope) and debate issues, timeframes, and how information is exchanged
- Proposed roles of the AER (including steps 5–7 above) and potentially ECA – ECA or another credible third party may play a key role in supporting the business’ Early Engagement Plan, and providing independent advice. The AER (and consumer representatives such as the ECA) may be part of the selection process of Consumer Forum members, at least for a trial. The AER and ECA may provide technical support to the Consumer Forum, on request.
- Potential off-ramps or termination conditions – under what conditions should the engagement phase be brought to an end?
- A process and resourcing for the preparation of the Engagement Report – which documents the extent of agreements and disagreements between the parties and reasoning/justification for these decisions
- Arrangements for ex post review of the process setting out the primary lessons – can the process be improved in the future? Do the current rules and laws create significant constraints on engagement outcomes?
- A draft of the Engagement Agreement – setting out the expectations on the network business, the Consumer Forum, and the AER

2.1.1 AER consideration of Early Engagement Plan

The AER would consider overall whether the Early Engagement Plan (including possible amendments to the Plan) provides a strong framework for the Consumer Forum and business to reach agreement on some or all aspects of the regulatory proposal.

The AER’s assessment of the Plan is intended to be outcomes-focussed with minimal prescription. The AER wants the business to innovate and customise its approach, with input from consumers generally, its existing business-as-usual consumer engagement channels and forums, ECA and the AER. That said, there are certain features that the AER will expect in considering the proposal, including:

- The network business has demonstrated it has consulted with consumers on the development of its Early Engagement Plan
- The Consumer Forum is established with the capability and resources to ensure it is a credible counterparty—for example, so that its members would be able to commission (directly or indirectly through the business) customer research, and represent consumer perspectives in their considerations and decision-making²
- The governance and operating arrangements of the Consumer Forum promote independence, transparency, accountability, and integration into the Early Engagement Process
- The AER's role in the Early Engagement Process provides adequate support to the Consumer Forum in a timely way so it can be an effective counterparty to the business.

In developing its Early Engagement Plan, the network business will need to consult with the AER, consumers (through its existing consumer engagement processes) and ECA. It will be important for the AER to understand the resource implications of a proposed Plan and provide early feedback to the business to flag potential resource constraints. This will be a factor especially if there are 'competing' proposals from different network businesses which have overlapping timeframes.

3. KEY DESIGN CONSIDERATIONS OF THE NEW REG PROCESS

The nature of engagement involved in this process will be a substantial step forward from the network businesses' current consumer engagement approaches. The objective is not simply to say that consumers have been consulted but that they agree with the revenue proposal. It will also bring forward the timing of AER resource commitment to the regulatory process.

The purpose of this Directions paper is to develop how we think the New Reg Process could work—getting into the 'nuts and bolts' and design features. We are intentionally taking an experimental approach to regulatory innovation and so these views are expected to evolve over time as the process is trialled. The key issues explored in this section are:

- Roles of the Consumer Forum, including to undertake or provide input into customer research (section 3.1)
- Scope of issues to be considered during the Early Engagement Process (section 3.2)
- How discussions between the Consumer Forum and business on aspects of the proposal are to be structured (section 3.3)
- How the AER where appropriate could expedite and/or streamline its revenue determination process under the Rules (section 3.4)

The network business is expected to provide the up-front funding for the trial. Trial lessons and evaluation can inform future funding considerations for the New Reg process.

² This is not to imply that existing consumer councils currently in operation are non-credible. Rather we observe that the minimum expectations of the capabilities and resourcing of these have not been commented on by the AER as a precondition for reliance in regulatory processes. The presumed reliance on the customer forum under the process now necessitates consideration of these preconditions.

3.1 Roles and expectations of Consumer Forum

The purpose of the Consumer Forum is to represent the long-term perspective of consumers and not to represent consumers directly. This perspective should cover the breadth of all direct customers and end-users (residential, small business, and corporate & industrial) of the network business. The Consumer Forum must be credibly capable of ensuring the full range of customer interests are addressed by the network proposals.

The Forum is not the primary channel through which the network seeks to identify the preferences of consumers. It is the partner of the network business in ensuring that an effective process of discovery is conducted, and it is the party that seeks to agree that the network has reflected those views in the revenue proposal.

The function of the Consumer Forum is:

to be the formal counterparty in negotiation with the network business and to, as far as possible, reach agreement with the network business on the regulatory proposal prior to the submission of the regulatory proposal.

The Consumer Forum does not need to be limited to this function; the network business and Forum may agree to continue to operate until the revenue determination is made or post determination to monitor and respond to outcomes. For example, this may include the draft determination and revised regulatory proposal, and potentially implementation of the final determination.

To fulfil its functions, the Consumer Forum would be required to:

1. Agree with the business on research, inquiries, or studies, as needed to understand the priorities and preferences of customers (as a whole)
2. Understand the priorities and preferences of customers (as a whole), which will involve collecting information from consumers on what their long-term preferences are (either through consultation or research, independently or by influencing the network's research)
3. Understand the needs and interests of the network business
4. Seek agreement with the network business that the revenue proposal reflects consumer perspectives

The Early Engagement Plan is expected to specify how the Consumer Forum will be involved in the development of broader consumer research. At a minimum, we expect the Consumer Forum has the ability to provide input into the business' customer research program. Alternatively, the Consumer Forum may be resourced by the network to allow it to undertake its own customer research.

3.2 Scope of issues to be considered in Early Engagement Process

The scope of issues to be considered in the Early Engagement Process is an important initial consideration by the Consumer Forum and the network business. The scoping phase starts with the whole proposal to maximise the potential for the process to allow for identification of possible opportunities for agreed outcomes. The range of issues to be considered is then narrowed from there. Scope must be agreed between the business and Consumer Forum, and accepted by the AER—although the AER may be more closely involved in the scoping phase for the purpose of a trial.

This approach is adopted due to the benefits of allowing both parties to:

- Better understand the perspectives of each on key aspects of customer value, concerns, outcomes sought
- Explore potential trade-offs between aspects of a regulatory proposal – for example, in balancing the needs of particular customer types, different network development strategies, or across different dimensions of current and future value of network service

Maximising flexibility for the Consumer Forum and the business to think across different elements of a building block proposal could allow more space for creative trade-offs and ‘win-win’ outcomes. It is acknowledged that there may be, as a result of external policy decisions, matters that automatically fall outside the scope, such as Rate of Return under a future binding guideline, or reliability standards where these are state-based. There may also be matters that the network otherwise feels it will not be able to ‘negotiate’ or ‘trade-off’ (such as mandated safety and universal service obligations).

Topics and decisions not included in the Early Engagement Plan would be dealt with in the development of the regulatory proposal, and would subsequently be assessed by the AER, in a similar way as they are currently. However, these topics would, where relevant, still be subject to the current requirements for consumer engagement.

3.3 How would discussions between the Consumer Forum and business on aspects of the proposal be structured?

The Early Engagement Plan should specify who from the network business will engage with the Consumer Forum, how often this group will meet, and how they will conduct their meetings.

The core of the Early Engagement Process is the development by the business of a revenue proposal that the Consumer Forum will agree represents the preferences of consumers and meets the requirements of the law and rules. This requires two elements: a means to discuss the proposal as it is developed and a formal process to demonstrate agreement.

At the conclusion of a successful Early Engagement Process, the Consumer Forum will:

- reach agreement with the network business on some or all aspects of the regulatory proposal within the boundaries set by the AER, and provide a report setting out why the agreed outcome reflects consumer preferences
- document the matters on which it cannot reach agreement with the network business
- provide its advice to the AER on the extent that the network business has considered the preferences of consumers in the development of the proposal, including in relation to matters that may not have been part of the agreed negotiation scope

3.4 Implications for AER’s revenue determination process

If a business successfully undertakes an Early Engagement Process, and reflects the outcomes of this process in its regulatory proposal, the AER may if it considers appropriate expedite and/or streamline the revenue determination process.

As set out in step 10 in section 2 above, for the purposes of a trial, the AER may expedite its regulatory process only after the draft decision stage to allow for consultation on the outcomes of the Early Engagement Process. This is for two principal reasons:

- it is important for all stakeholders to have an opportunity to fully understand the trial of the New Reg process and to be heard if there are further concerns
- changing the timeline of a revenue determination for one business could create practical problems in managing the process. The AER is required to assess a high number of regulatory proposals every year. The process of publishing proposal and decision documents—whilst managing confidentiality claims—creates significant logistical challenges.

Going forward, as confidence grows in the robustness of the Early Engagement Process, the AER may, where it considers appropriate, shorten its determination process—although some limitations exist under the Rules. It is acknowledged that the prospect of a shortened and less costly revenue determination process is one important incentive for a business to undertake a trial of the Early Engagement Process.

The AER may have regard to any agreements reached between a business and the Consumer Forum on an aspect of the proposal, and if it considers it appropriate, it may undertake a less detailed assessment of certain issues. Indeed, there are recent examples of revenue determination processes in Victorian gas distribution and South Australian electricity transmission where the AER recognised early, intensive engagement undertaken by the business, and undertook a less intrusive and streamlined review of the proposal or relevant aspects of the proposal.

3.5 Supporting credibility and legitimacy of the Consumer Forum with stakeholders

The approach is critically dependent on the Consumer Forum being perceived to be, a 'credible counterparty' to an engagement agreement, and that agreement having legitimacy in the eyes of stakeholders. Various measures are therefore included that will support the legitimacy of the Consumer Forum in performing this role. While these measures are captured in the relevant elements discussed in section 2, these important design features are collated below for ease of identification.

Features of the approach that are designed to support legitimacy of the Consumer Forum include:

- The Consumer Forum is one aspect of a network's engagement. It is not the primary channel through which the network seeks to identify the preferences of consumers. It is the partner of the network business in ensuring that an effective process of discovery is conducted and testing how the outcomes of that discovery have informed the regulatory proposal.
- The Consumer Forum must comprise suitably capable members and be adequately resourced for its role.
- The AER must approve the Early Engagement Plan – As section 2.1 outlines, among other things, this plan must adequately demonstrate:
 - the selection and appointment process, number and targeted skills or experience of members, and governance of the Consumer Forum

- the scope of matters to be covered, or the process by which the scope will be decided among the NSP, the AER and the Customer Forum
 - the roles of the forum, and adequacy of resourcing for them to discharge these roles, including potentially initiating research and engagement themselves
 - the funding and administrative arrangements that will preserve the forum's independence.
- The outcomes of the Consumer Forum and Early Engagement Process will be documented in the Engagement Report, which will be submitted to the AER and available for review and comment by all stakeholders during the AER's regulatory review process.

The adequacy of these measures will be monitored and evaluated during the trials to identify any required refinements.

4. TRIAL AND REFINEMENT

The New Reg project has three critical components:

1. **Trials** – to gather information and experience on the proposed approach itself, and identifying barriers under existing regulatory frameworks (in particular the National Electricity Rules) to the fullest implementation of the process
2. **Learnings for current framework** – consideration of the costs and benefits of pursuing changes to regulatory practice and the relevant Law and Rules to better support a refined New Reg process that gives greater weight to identified and tested customer preferences
3. **'Blank-sheet' design** of the regulatory framework – exploratory investigation of what type of different framework would best support and promote the New Reg process, e.g. abstracting from the current framework, examining the design and shape of a framework which would promote this approach

It is intended that these three elements proceed broadly sequentially, so that trials can adequately inform (2) and (3). Importantly, however, early work on (3) can in principle still be undertaken in parallel with the conduct of early trials.

So far, one trial business, AusNet Services, has decided to trial the process on its Victorian electricity distribution business.

GLOSSARY

Term	Definition
Consumer	The word 'consumer' is used here in the same way as it is in the National Electricity Objective (NEO) to refer to all end-users of energy, including residential, small business, and commercial & industrial users.
Consumer Forum	<p>The Consumer Forum is to be established as a credible counterparty to the network business when developing its regulatory proposal.</p> <p>The Consumer Forum should:</p> <ul style="list-style-type: none"> • represent, 'bring' the perspectives of, and act on behalf of all consumer voices (large and small), having regard to the long term interests of current and future consumers • be fully independent of the network business • have the skills and expertise to serve the role of being a credible counterparty to the network business • operate in a transparent way to establish and maintain its legitimacy with consumers and the wider community.
Early Engagement Plan	<p>The Early Engagement Plan is submitted by the network business to the AER to allow for formal approval to participate in the New Reg process trial.</p> <p>The Early Engagement Plan outlines the process the business intends to undertake to develop its regulatory proposal, including:</p> <ul style="list-style-type: none"> • establishment of a consumer representative group (Consumer Forum) which the network would resource and fund • high-level scope of matters proposed to be considered within the Early Engagement Process • process of dialogue and engagement that will be followed by the network business and Consumer Forum • role and expectations of the AER to support the Early Engagement Process. <p>The scope of the Early Engagement Plan will be refined through experience.</p>
Early Engagement Process	This process extends consumer involvement beyond current engagement processes to a point where the network business reaches agreement (or otherwise) on some or all aspects of the regulatory proposal prior to submission.