

Economic regulatory framework review

AEMC Workshop

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Key messages

1. Support regular evidence-based reviews and 'stress testing' of framework
2. Need to recognise the long-term value to consumers of regulatory predictability and stability
3. Should explore evolutionary approaches to regulatory allowance setting and incentive frameworks where long-term benefits can be demonstrated
4. Need to measure and assess the right metrics for changing energy market

Need for predictability and stability

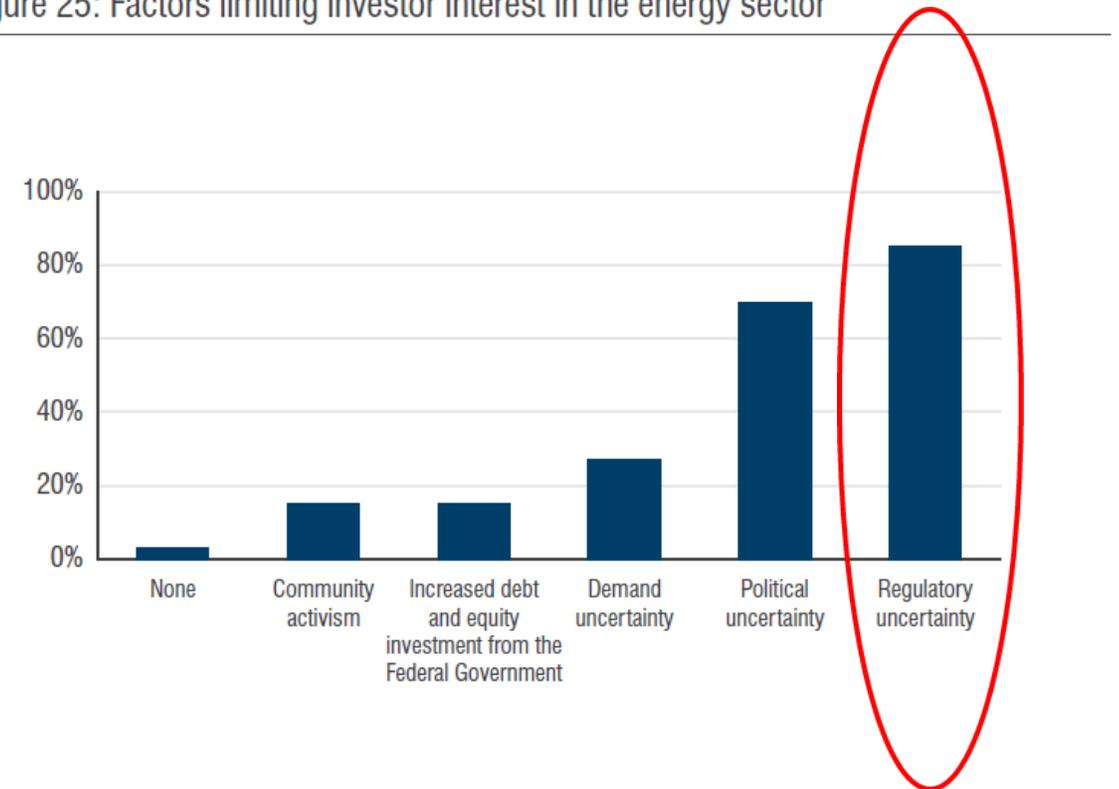
Context for review – need for improved confidence

“When it came to investment preferences, participants showed an **increased preference for unregulated assets**, which are substantially more popular than last year when most participants had no preference.

Participants suggested that the **increased preference for unregulated assets** can be partly attributed to **increased uncertainty surrounding regulated assets** and the **expected returns on investment**. A **myriad of regulatory reviews and proposals**, some influenced by a **perception of political objectives**, is making investors rebalance their interest toward unregulated assets.”

- *Australian Infrastructure Investment Report* (October 2018), p.8

Figure 25: Factors limiting investor interest in the energy sector



Context for review – the view from investors

- » Regulated energy networks ranked **12 out of 13** preferred Australian asset types to invest
- » This is down from equal third ranking in 2015

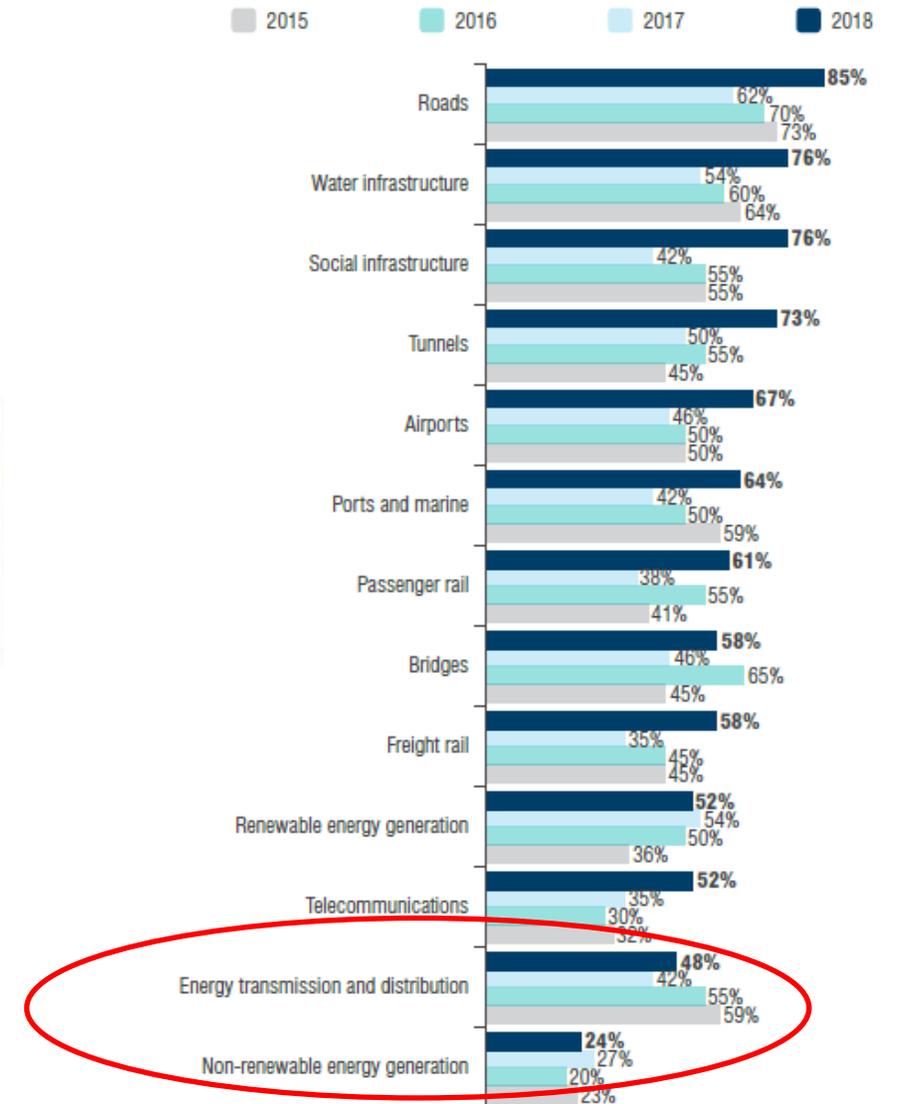


SECTOR COMMENT
14 July 2018

✓ Rate this Research

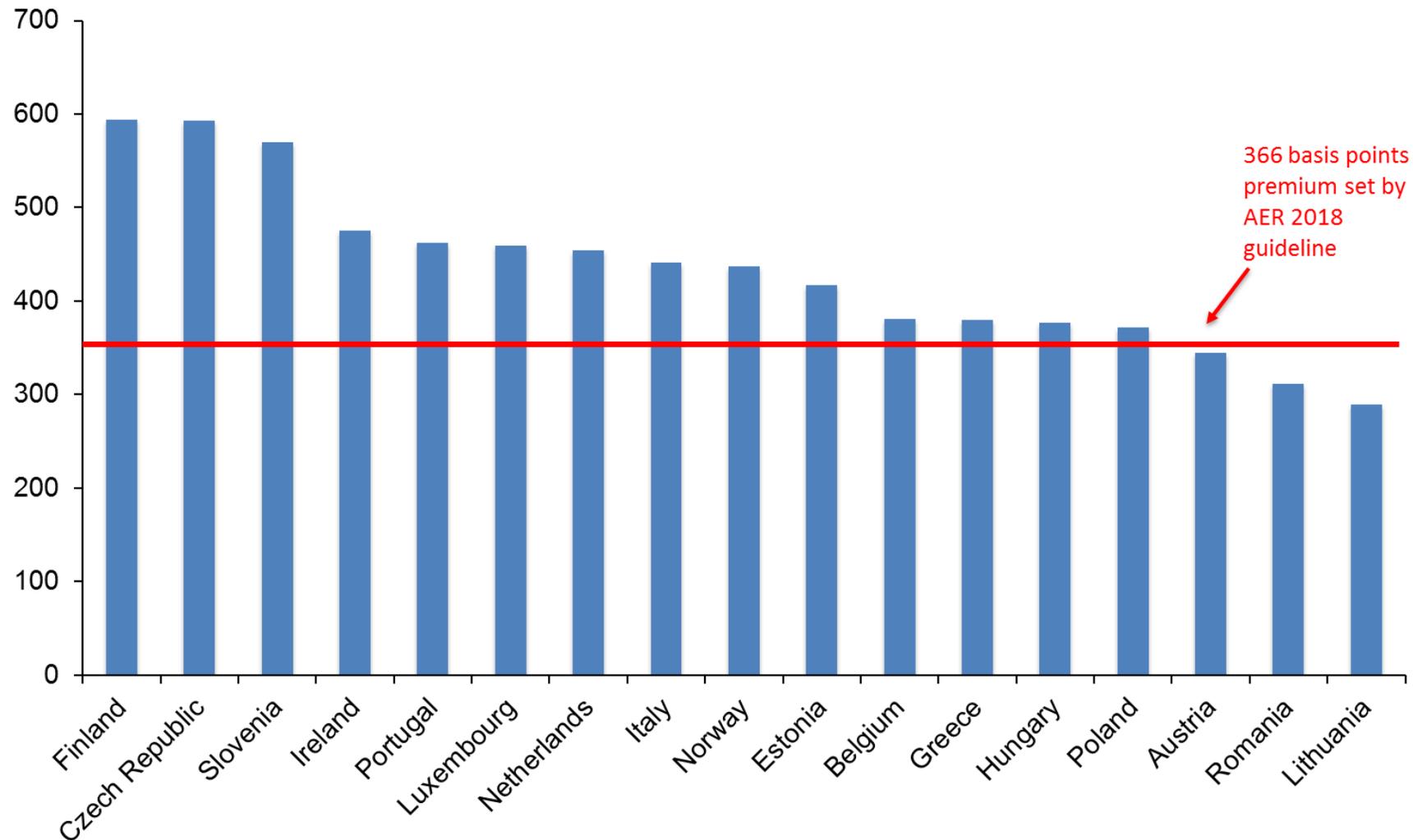
Regulated Electric & Gas Networks
Proposed changes to Australia's regulatory rules are credit negative for regulated energy networks

Figure 6: Preferred Australian asset type to invest in



Australia has moved sharply to a low regulated return on equity jurisdiction

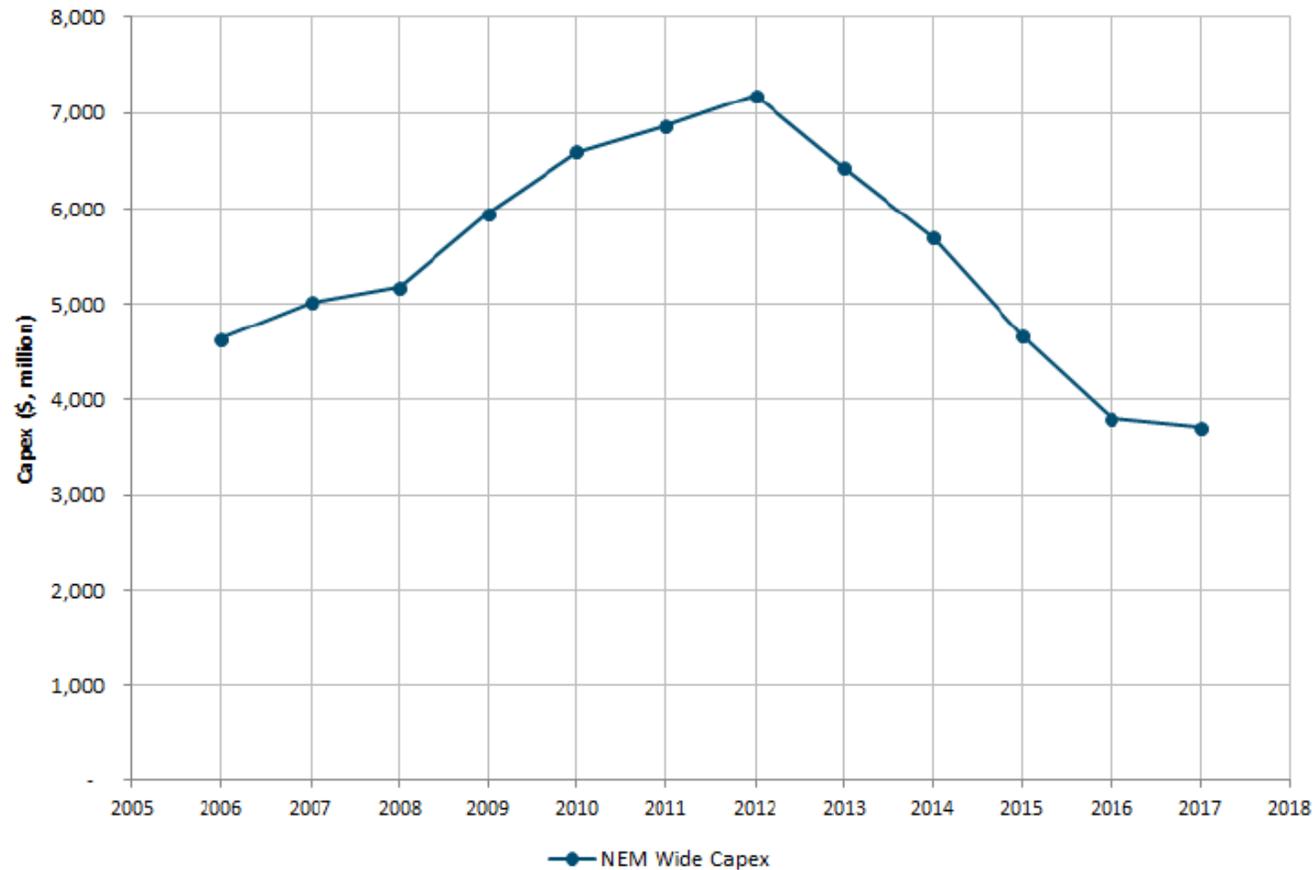
Premium in allowed cost of equity over the risk-free rate (basis points)



Focusing on future challenges

Network capital expenditure lowest since 2006

Combined distribution NSPs capital expenditure in NEM (AEMC 2018)

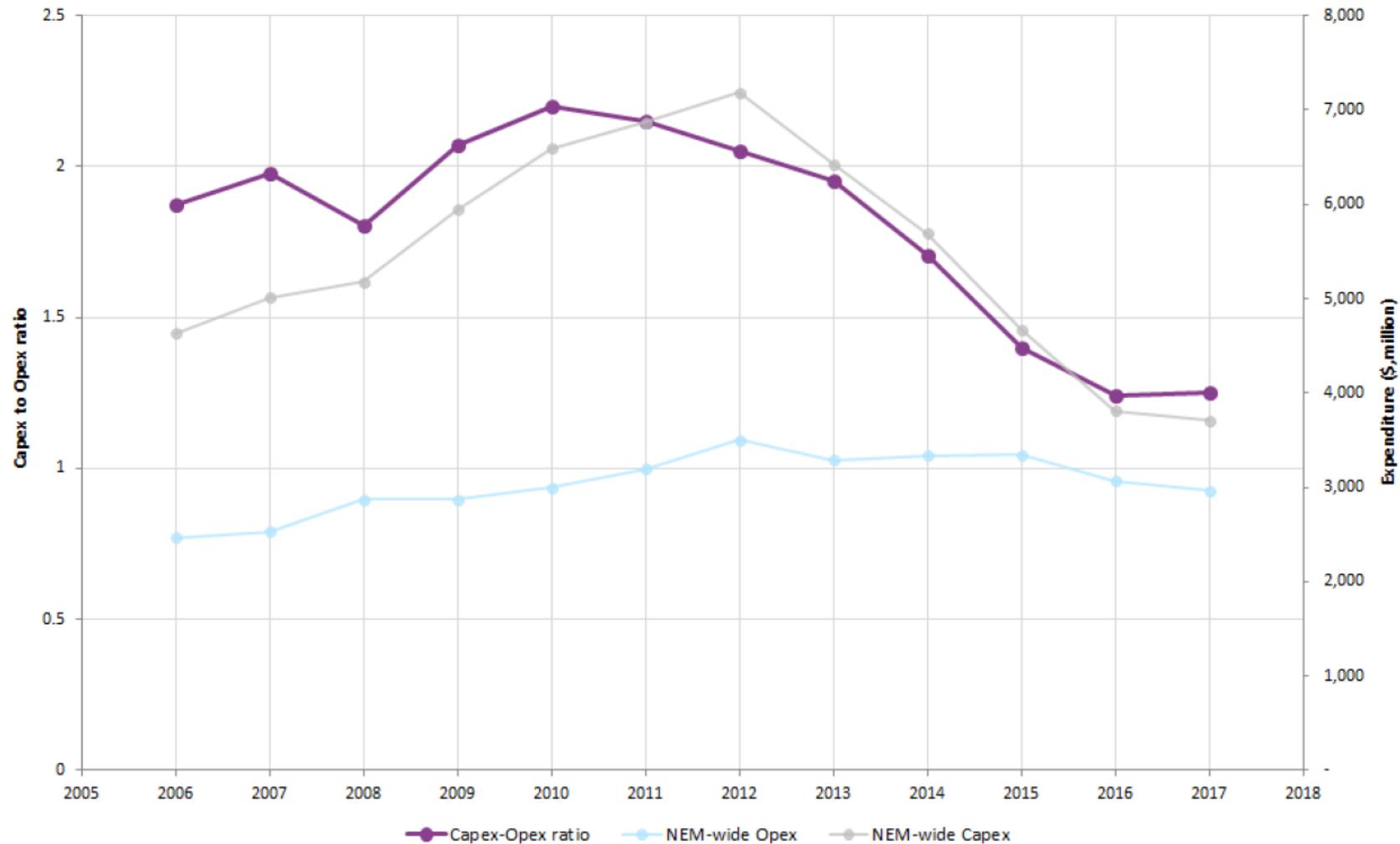


Source: AER

Note: values in 2017 real dollar terms.

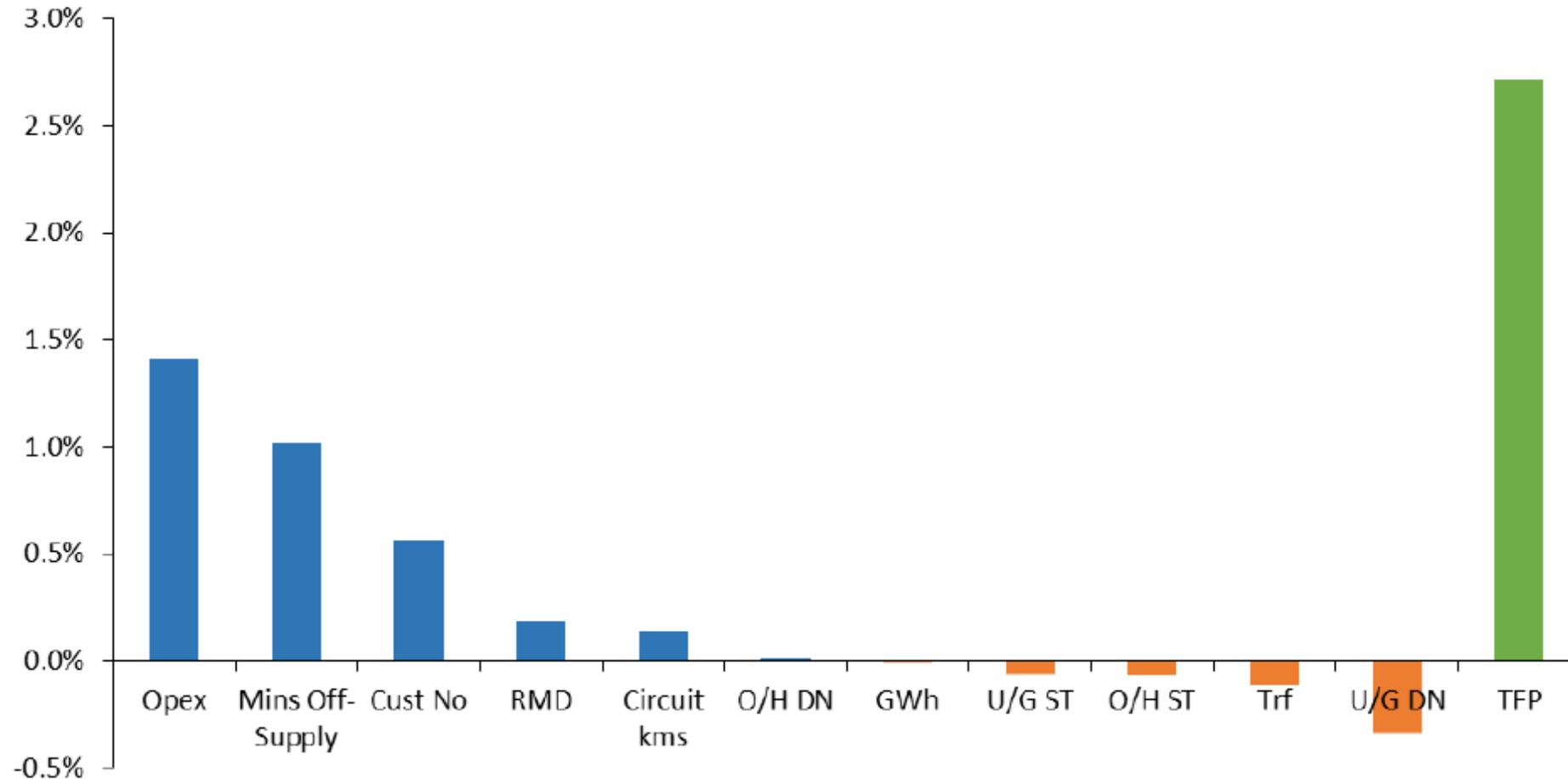
Ratio of capital expenditure to operating expenditure lowest since 2006

Combined distribution NSPs opex-capex ratio for NEM (AEMC 2018)



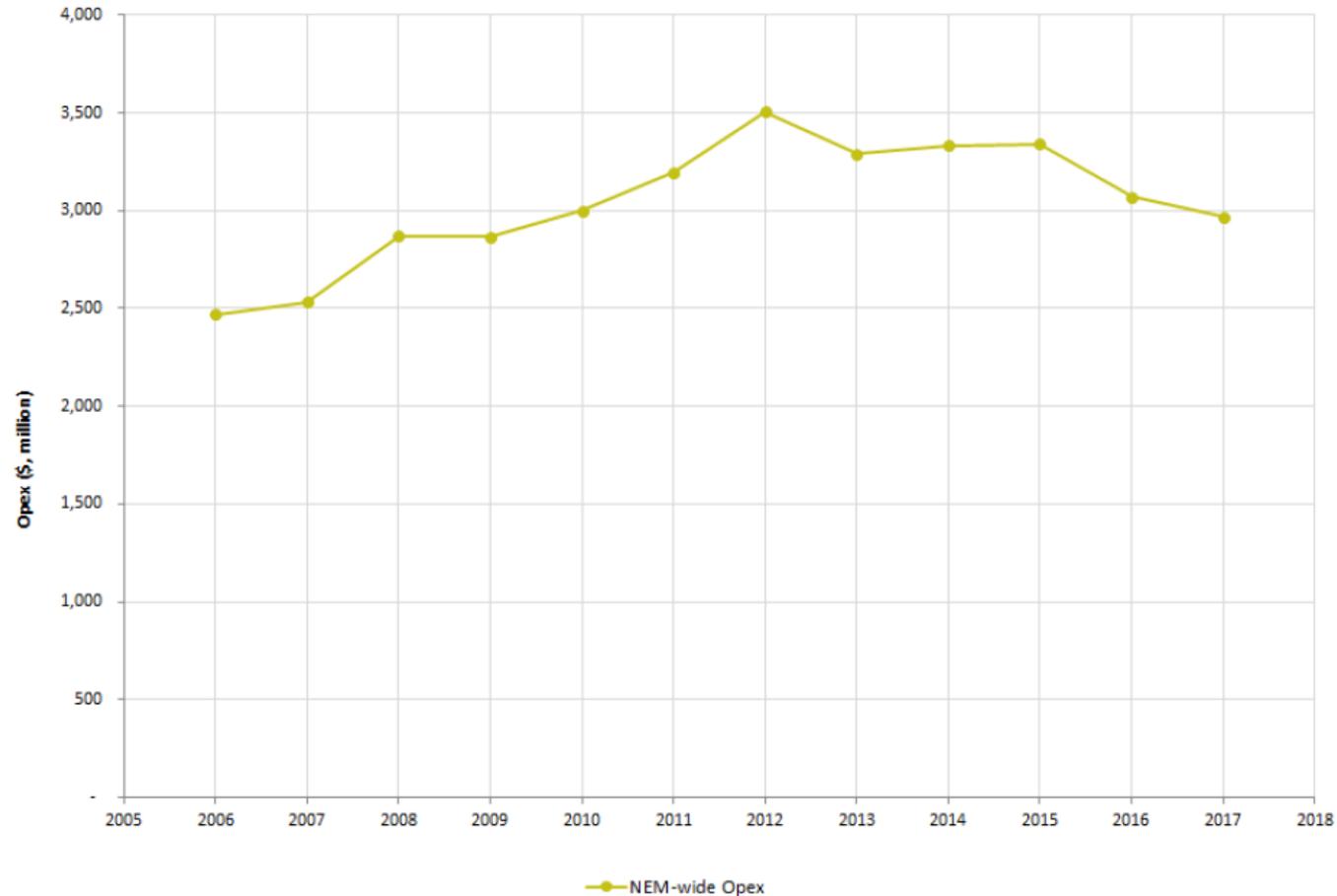
Incentive framework driving the right outcomes

Delivering energy more reliably to more customers at lower opex cost (AER 2018)



Incentive framework driving the right outcomes

Combined distribution NSPs operating expenditure in NEM (AEMC 2018)



Source: AER

Note: values in 2017 real dollar terms

DER and network regulation: some propositions

- 1. Issues of network capacity and two-way flow capabilities assuming greater importance to customers** – for customers avoiding unnecessary costs remain important, but constraints on connection or accessing their DER value streams will be increasingly salient and valued component of network performance for customers
- 2. This provides opportunity to deliver more customer-centric regulatory frameworks** – with consumers seeking network capabilities that maximise value from distributed resources, and a grid that is shaped to serve these evolving needs
- 3. How framework deals with the investments to enable transformation that maximises customer benefit will be critical** – this can unlock more effective network utilisation helping deliver affordability for customers, as well as promoting greater connection and avoiding network constraints impacting on DER export
- 4. Continuing pricing reform is critical to getting fair, affordable and valued outcomes for customers**
- 5. Flexible treatment of new services and tests of competition will be critical** – as competition for some network services strengthens
- 6. Approach of ‘layering on’ greater complexity and additional one-off ‘fixes’ to the current framework has diminishing returns** – for effectiveness of regime, clarity and power of incentives, and confidence of stakeholders in a transparent well-understood and stable regime
- 7. Roles and responsibilities of participants needs careful thought** – different operating frameworks will have different impacts, and have different implications of role of networks as a platform → AEMO and ENA Open Energy Networks consultations

Alternative approaches

Exploring and testing alternative approaches

- » Any reform has best opportunity to succeed where there is multi-staged process of consultation and engagement
- » Should explore and test alternatives – standing still not an option
- » Regulatory sandbox concept enables voluntary testing at small-scale
- » Support:
 1. Testing of alternative revenue-setting approaches against criteria clearly based on the National Electricity and Gas Objectives and Revenue and Pricing Principles;
 2. Greater opportunities for regulatory framework to give effect to robust direct engagement between customers and networks on customer outcomes that are valued and how network business plans can deliver these;
 3. Focus on opportunities to voluntarily trial and refine such approaches, rather than a single ‘monolithic’ application of new approaches



Monitoring framework performance

Getting the measuring stick right



- » Support continued AEMC monitoring of existing measures
- » Potential additional metrics to help stakeholders identify the performance of the regulatory framework in a period of significant change to a more distributed and ‘two-way’ grid
- 1. **Expenditure on network monitoring and control** – which can promote more effective network utilisation of existing infrastructure, which can support affordability outcomes
- 2. **Impacts on customer outcomes and investment** flowing from the implementation of the 2018 Rate of Return guideline
- 3. Longer term **network financeability under different market trends**, including a continuation of the currently observed trend towards greater use of operating expenditure
- 4. How **electricity distributors’ steps toward fully enabling the ongoing energy transition are approached by the AER** and how the costs and benefits are/should be assessed at a customer and community level

Summary

1. Review is a key avenue to test and explore alternative approaches – standing still is not an option
2. Collaborative trials and regulatory sand-boxes provide the opportunity to test and evolve new approaches
3. Exploration and comparison of new and evolving approaches, not a ‘big bang’ application of one model to all networks, should be the focus
4. To measure whether the framework is performing, need to broaden the metrics to reflect changing network roles and customer expectations for connecting to and using the grid