

Terms of reference

Electricity Network Regulation Review

REVIEW

1 Electricity network regulation review - Terms of reference

The Australian Energy Market Commission (AEMC or Commission) has initiated a Review into electricity network regulation under section 45 of the National Electricity Law (NEL).¹

The energy transition is changing the ways in which electricity is produced, transported and consumed. Modernising the energy system is important to unlock benefits for both individuals and the broader economy. The purpose of this Review is to ensure that the economic regulatory framework governing electricity transmission and distribution Network Service Providers (NSPs) is fit for purpose going forward so that:

- Consumers continue to have access to safe and reliable electricity supply
- Consumers pay no more than needed
- The energy system supports the achievement of emissions reduction targets.

1.1 Background to the Review

Electricity is fundamental to modern life and plays a critical role in economic activity. The design of the electricity system has a direct impact on prices, reliability, emissions reduction and broader economic outcomes.

Electricity networks, which transport electricity between generators and consumers, are generally considered natural monopolies because a single service provider can provide core network services more efficiently and at a lower cost than multiple competitors. While beneficial to consumers, being the only supplier of network services in a geographic area means that NSPs are not subject to the same discipline that they would face if they operated in a competitive market. They may not, for instance, have strong incentives to deliver the services customers want at prices that reflect the efficient cost of supply. As a result, monopoly electricity networks operate under a highly regulated framework that ensures universal access to essential network services and promotes sustainable investment in critical infrastructure - in the long term interests of consumers.

The economic regulatory framework governing electricity networks determines the services that NSPs provide, the obligations and performance standards that apply to those services, how revenues are set and recovered, and the incentives that seek to promote efficient NSP behaviour and emulate what would occur in a competitive market. Given network costs represent a significant share of electricity bills, the effectiveness of the economic regulatory framework has a strong bearing on outcomes for consumers.

The electricity system is undergoing a period of significant structural change, alongside and supporting, the transition to net zero. The generation mix is evolving, with increasing penetration of renewable energy. Consumers are becoming more active participants through the uptake of consumer energy resources. Electrification is increasing electricity demand and changing patterns of network use. At the same time, the system is becoming more complex, with new operational and security requirements.

These developments are reshaping the role of electricity networks, the services they provide and their interaction with competitive markets. New technologies and service models are emerging

¹ Part 4 of the NEL sets out the functions and powers of the AEMC. Under Division 5 of Part 4, the AEMC has the power to conduct a review into the operation and effectiveness of the National Electricity Rules (NER).

that do not fit neatly within the existing framework. The boundaries between regulated network services and contestable activities are increasingly being tested. NSPs are increasingly expected to assist in coordinating energy services, and new technologies are challenging how the framework compensates for, and thereby incentivises, capital-based investments.

While a range of targeted reforms have been implemented in recent years, many of the challenges now emerging are interconnected and cannot be effectively addressed in isolation. A holistic review is therefore required to assess whether the economic regulatory framework for electricity NSPs continues to operate effectively and remains fit for purpose in promoting the long term interests of consumers.

1.2 Objective

The objective of the Review is to assess and, where appropriate, recommend changes to the economic regulatory framework for electricity networks to ensure it continues to promote the long term interests of consumers by supporting efficient investment in, operation and use of electricity networks.

1.3 Scope

We have balanced depth with timeliness in determining the scope of the Review. The Review will focus on the revenue setting elements of the regulatory framework in relation to regulated services.

More specifically, the Review will focus on four central policy areas that matter for consumers:

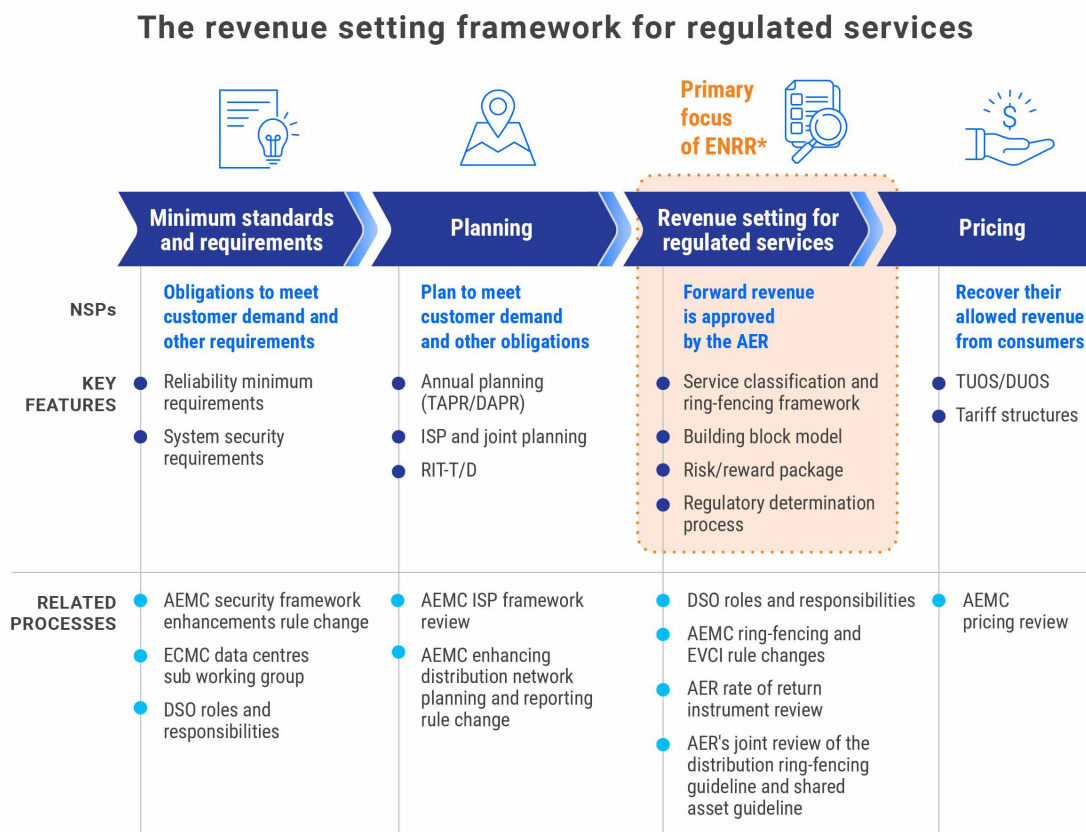
- What services do we need networks to provide in the future?
- How can the economic regulatory framework ensure that NSPs deliver these services efficiently?
- Does the economic regulatory framework support consumer outcomes through appropriate risk allocation and compensation of risk?
- Does the regulatory determination process support positive consumer outcomes?

The Review will not focus on aspects of the regulatory framework that fall within the areas of minimum standards and requirements for NSPs, network planning and network pricing. These aspects of the regulatory framework are either currently being considered or have recently been considered through complementary work by the AEMC or another body.

However, we acknowledge that there may be some interdependencies. For example, when considering network utilisation in the context of the Review, pricing will be a relevant consideration for the Commission. In these cases, we will build on the findings and recommendations of recent work programs rather than revisit any recent recommendations.

The scope of the Review will be refined following consultation. The Commission will seek stakeholder input on the identification and prioritisation of issues and assess key issues, risks and interdependencies in the current framework. It will then consider potential solutions and set out a recommended pathway for reform.

Figure 1.1: Primary focus of ENRR: The revenue setting framework for regulated services



* Some overlap with other areas is expected given the interconnected nature of the framework.

Source: AEMC

1.4 Our approach

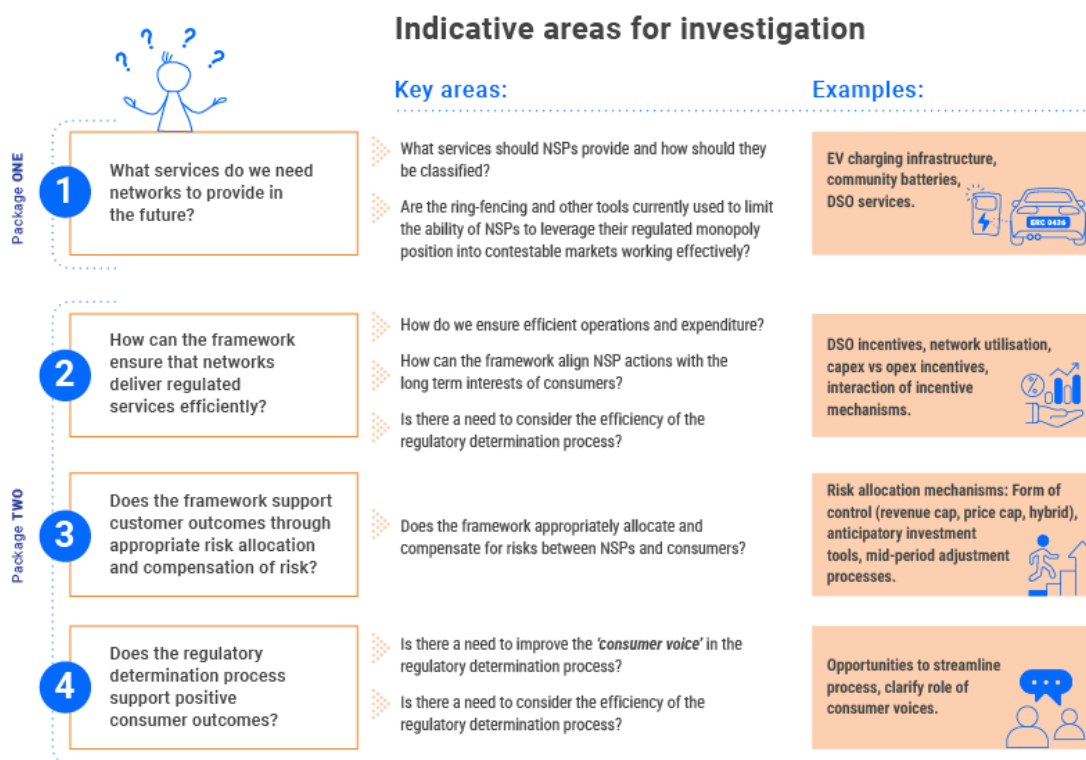
1.4.1 We will deliver the Review across two work packages

The Commission will adopt a structured, evidence-based approach that focuses on how the economic regulatory framework operates in practice and on whether it delivers outcomes that promote the long term interests of consumers.

The Commission will undertake the Review across two packages of work:

- **Package 1** will focus on policy area 1 in Figure 1.2. It will examine which services we need NSPs to provide in the future. In particular, it will focus on how different services provided by NSPs are classified, the ring-fencing and other tools currently used to ring-fence regulated network services from contestable services, and the treatment of assets used to provide regulated and unregulated services.
- **Package 2** will cover policy areas 2 to 4 in Figure 1.2. It will examine how the framework can best support efficient service delivery, whether it provides for appropriate risk allocation between NSPs and consumers, whether it appropriately compensates NSPs for the risk they take, and whether regulatory processes are efficient and support positive consumer outcomes.

Figure 1.2: Package 1 and Package 2 of the Review



Source: AEMC

We are also consulting on two rule change requests alongside Package 1 of the Review, as they, too, raise important questions about what services NSPs should provide and the form of regulation that should apply to new services. The two rule changes are:

1. **Enhancing competition in consumer energy resources and services in the NEM.** The rule change request from Nexa Advisory (Nexa) proposes changes to strengthen the ring-fencing arrangements that apply to distribution NSPs (DNSPs) by moving the obligations from an AER guideline to the NER, adding additional protections and limiting the circumstances in which waivers can be obtained.
2. **Enabling DNSP led electric vehicle charging infrastructure.** The rule change request from Energy Networks Australia (ENA) proposes changes to enable DNSPs to provide kerbside EV charging infrastructure (EVCI) as a regulated service (direct control service) with costs recovered from electricity consumers.

1.4.2 Prioritisation of issues

The Review will focus on selected areas of the economic regulatory framework based on the application of a policy prioritisation framework. This will ensure we balance the depth of the Review with the timeliness of delivery.

The policy prioritisation framework is based on the following criteria:

- **Materiality:** How significant is the issue and how strong is the evidence base? How much do consumers stand to benefit from addressing this issue?

- **Implementation feasibility:** Are practical solutions available? Can solutions be implemented by the AEMC through NER changes, or do they require agreement and coordination from other actors (e.g. Energy Ministers)? If coordination is required, how difficult will it be?
- **Other processes:** Is there another rule change process already underway, or are there formal review processes already established, that are better placed to review this aspect of the framework and efficiently address the identified issue?
- **Separability:** Is this an issue that is difficult to consider in isolation such that it should be considered through a holistic review of this nature? Or can it be separated and progressed through a stand-alone process that would likely lead to faster resolution of the issue (e.g. a rule change or other process)?

1.5 Engaging with stakeholders

The Commission will undertake a transparent process and seek stakeholder views to refine the scope of issues, test analysis and inform the development of reform options. In developing its advice, the Commission will work closely with consumer representatives, the AER, NSPs, industry and other stakeholders through a public consultation process.

The Commission's engagement strategy will include, but not be limited to:

- In person public forums/workshops
- One-on-one and multilateral engagement
- Working groups on specific issues
- A Senior reference group
- Formal consultation documents.

1.6 Key outputs and deliverables

The key outputs for each package are set out below.

Package 1 will include:

- a consultation paper published alongside these Terms of Reference
- a final report setting out findings and recommendations.

Package 2 will include:

- a consultation paper, published shortly after the consultation paper for Package 1
- an options paper
- a draft report
- a final report setting out findings and recommendations.

For each package, the final report will provide our overview of:

- recommended changes to the electricity economic regulatory framework
- advice on any recommended actions for regulators or market operators, for example, revisions to the NEL, guidelines or procedures
- information on gaps, or areas in which changes could be beneficial, in jurisdictional regulatory frameworks that are identified while undertaking the Review
- advice on implementation, including the timing and sequencing of required changes.

The Package 1 final report will also provide direction on how the Commission may apply its recommendations in the *Enhancing competition in consumer energy resources and services in the*

NEM and *Enabling DNSP led electric vehicle charging infrastructure* rule change requests. These rule change requests will then continue to draft and final determinations.