AEMC

Australian Energy Market Commission

INFORMATION

ENRR Package 2 Consultation Paper

We are consulting on the effectiveness of the current economic regulatory framework for electricity networks

This consultation paper is the first step for Package 2 of the Electricity Network Regulation Review (ENRR or the Review). The Review considers the important role of electricity network regulation in providing consumers with a low cost, reliable supply of electricity as the NEM transitions to a net-zero system. Network costs make up the largest component of power bills so ensuring the regulatory framework remains fit for purpose is critical to achieving outcomes in the long term interest of consumers.

We have identified three key elements of the current electricity economic regulatory framework for consultation:

- **Revenue determination process** – whether the process for setting an NSP's regulated revenue for a forward regulatory period is efficient, supports prudent and efficient expenditure proposals and ensures consumer views are appropriately reflected.
- **Incentives** – whether the framework aligns NSPs' decisions and behaviours with consumers long-term interests. Incentives can support innovation, efficient network utilisation, or seek to levelise NSPs selecting capital or operating expenditure solutions.
- **Risk allocation and compensation** – how risks are allocated between NSPs and consumers, and how NSPs are compensated for the risks they bear under the framework.

Submissions to the consultation paper are due by 24 September 2026.

We are investigating if the revenue determination process efficient

The AER determines the revenue an NSP can recover from consumers on a forward looking basis under the NEM's existing ex ante regulatory framework. This revenue determination process currently takes the form of a multi-stage propose-respond process. It is intended to support robust and transparent regulatory decision making, while ensuring outcomes reflect consumers' long term interest and preferences.

We propose to explore the following issues through the Review:

- **Efficiency of the revenue determination process:** The current revenue determination process is resource-intensive and can take several years to complete. In their most recent regulatory determination cycle, Transmission Network Service Providers (TNSPs) and Distribution Network Service Providers (DNSPs) spent an estimated ~$190 m on a combined basis to prepare their regulatory proposals, engage with their customers and other stakeholders and participate in the various stages of the determination process. We will explore if the process could be streamlined while maintaining robust regulatory oversight and stakeholder engagement.
- **Supporting good quality regulatory proposals and robust determinations:** One of the limitations of the ex ante approach is the information asymmetry between NSPs and the regulator. While the rules already allow the AER to scrutinise and, where appropriate, substitute expenditure forecasts, assessing future expenditure needs can be complex, particularly where uncertainty is high. The energy transition may increase this challenge, especially in relation to capital investment requirements. We will explore whether alternative approaches could help reduce information asymmetries, support better quality regulatory proposals and determinations, and ultimately lead to better consumer outcomes.
- **Ensuring consumer interests are effectively represented and reflected in regulatory proposals and determinations:** Engagement by NSPs with consumer representatives has improved over time. However, in our early consultation stakeholders have raised questions about how effectively consumer interests and preferences are reflected in regulatory

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proposals and determinations. We will consider whether the current framework provides appropriate opportunities for consumer input, how consumers can best be represented in the process (including the potential role of retailers) and whether consumer views are being effectively incorporated into regulatory outcomes.

We are interested to understand if the current incentives are driving NSPs to act in the long term interest of consumers

The existing regulatory framework uses incentive-based regulation to align the interests of NSPs with those of consumers. The framework is made up of a range of complementary incentives that are intended to operate as an integrated package. Some incentives are inherent to the ex ante framework while others are created through explicit incentive schemes. The specific areas we intend to explore further include:

- **Incentives on NSPs to undertake opex relative to capex:** A potential structural bias from NSPs to preference capex solutions over opex solutions is a long-standing concern with the regulatory framework. There are likely a range of possible barriers to Non-network Options (NNOs) including: financial incentives for NSPs to preference capex in some circumstances, interactions between the Capital Expenditure Sharing Scheme (CESS) and the Efficiency Benefit Sharing Scheme (EBSS), and operational and risk allocation considerations. The impact of any barriers to NNOs are likely to have an adverse impact on consumer outcomes as NNOs become increasingly cost-competitive and viable at both the transmission and distribution level.
- **Changes to incentive arrangements for DNSPs to perform new and evolving distribution system operator (DSO) roles:** Energy Ministers agreed in December 2025 that DNSPs should be formally assigned DSO responsibilities. DNSPs are already undertaking many DSO responsibilities, and we will explore whether the current framework adequately incentivises DNSPs to perform these roles in a way that maximises consumer outcomes.
- **Incentives to support efficient network utilisation:** Network utilisation is generally regarded as a measure of the efficiency and productivity of network infrastructure. Network utilisation is a proxy for improved consumer outcomes because, all else being equal, it indicates an increase in the use of the network relative to a set level of investment. We intend to explore the value of strengthening incentives to increase network utilisation to efficient levels, which will include consideration of the recommendations made under the AEMC's pricing review.
- **Incentives to innovate**: The framework creates relatively strong incentives for NSPs to pursue cost savings and outperform their expenditure allowances. However, it is also in the long-term interest of consumers for NSPs to make investments now in order to reduce costs into the future, such as investing in research and development (R&D) and innovation. We will to consider changes to the framework that could strengthen incentives for both TNSPs and DNSPs to invest in R&D and innovation.

We are considering the risk-reward package in terms of risks allocation and compensation

NSPs accept revenue and price regulation in exchange for a reasonable opportunity to recover their efficient and prudently incurred costs, including a return commensurate with the risks they bear. This supports efficient investment while protecting consumers from paying for inefficient costs. Efficient risk allocation is central to that outcome. That is, risks should be allocated to the party best placed to manage, influence or absorb them.

We propose to explore the following areas relating to risk allocation and compensation further as part of this Review:

- **The use of risk allocation mechanisms**. The energy transition is changing and potentially increasing some of the risks faced by NSPs and consumers, such as demand forecast risk. This raises the risks of under- or over-building network assets. NSPs are also increasing their use of intra-period adjustment mechanisms. This raises questions about the appropriate use and process for these mechanisms, as well as their impact on the overall ex ante incentive framework. We propose to explore whether the existing suite of risk allocation tools continues to allocate risk to the party best placed to manage it and whether risk allocation works across the framework in a cohesive way.
- **The appropriate use of anticipatory investment given the changes underway**. Anticipatory investment includes situations where an NSP incurs higher costs in the short term in order to achieve a more efficient total outcome over the long-term. Examples include undertaking

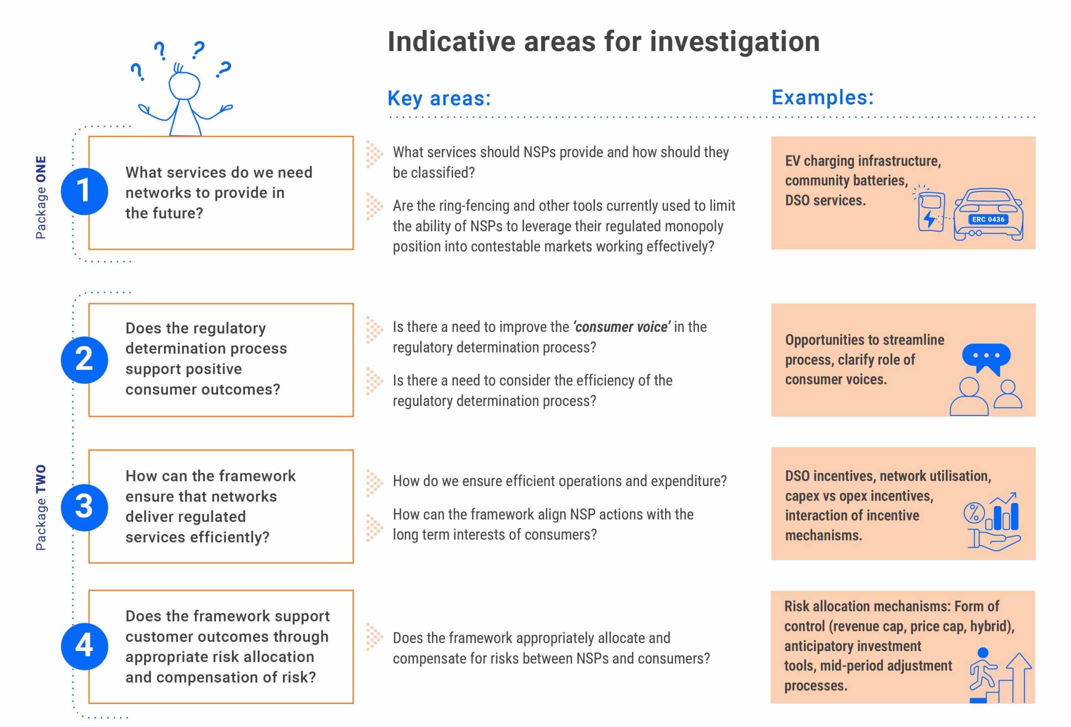
upgrade works earlier than needed in order to achieve economies of scale and better overall efficiency of the works. Anticipatory investment may become more challenging or risky in the context of elevated uncertainty. Conversely, in the context of expected increases in demand, it may present an opportunity to reduce overall costs to consumers.

- **The AER's flexibility in developing the rate of return instrument (RoRI) under the NEL**. The NEL prescribes the process that the AER must follow when developing the RoRI, which sets the regulated rate of return that NSPs receive. The NEL requires the same methodology apply to the rate of return for all TNSPs and DNSPs. We intend to consider the different challenges and risks faced by TNSPs vs DNSPs and consider whether these differences are (or can be) sufficiently accounted for using the risk allocation mechanisms mentioned above, or if a different approach to determining the rate of return might be warranted. In making our assessment we are cognisant of and plan to explore the practical challenges in determining appropriate rates of return for different entities as well as the legal implications that any change would likely involve.

This consultation paper initiates Package 2 of the Review

We have split the Review into two packages:

- **Package 1** focuses on the service classification and ring-fencing framework. In particular, it focuses 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 1 of the Review will conclude with recommendations on key policy principles.
- **Package 2** explores how the regulatory framework can support NSPs to deliver regulated services in the most efficient way, that is in the long term interest of consumers. Package 2 is planned to run until the end of 2027, with the next milestone anticipated in Q1 2027.



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