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**Australian Energy Market Commission**

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Dear Ms Armstrong,

**Electricity Network Economic Regulatory Framework Review – Approach Paper**

AGL welcomes the opportunity to comment on the *Electricity Network Economic Regulatory Framework Review, Approach Paper (Approach Paper)*, December 2016.

AGL is one of Australia's largest integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy, providing energy solutions to over 3.7 million customer accounts throughout eastern Australia. In 2015, AGL established a New Energy Services division, with a dedicated focus on distributed energy services and solutions.

AGL sees value in the annual review of the ongoing ability of the electricity network regulatory framework to achieve the national electricity objective in light of increased uptake of decentralised energy technologies. It will provide a useful stocktake of the progression, interaction and effectiveness of the suite of rule changes first embarked upon under the umbrella of the Power of Choice framework and now continuing in the Commission's technology work program and in a number of interrelated rule changes examining the ongoing suitability of the planning, investment and contestability frameworks within which networks operate.

The impetus for these changes is the recognition that consumers demand a more active role in the management of their own energy supply and new technologies are continually enhancing their ability to achieve this. These same technologies offer new opportunities for the efficient management of distribution networks but also require networks to make different investment decisions. It is important that the economic regulatory framework is sufficiently flexible to accommodate these changes, and encourage rather than inhibit customer choice and efficient investment in decentralised technologies.

An important part of this challenge involves ensuring that the model for recovery of network costs from customers is suitably adapted to the new environment. This is fundamental to addressing the most critical risk identified in the COAG Energy Council's 2015 'stress test' of the electricity network regulatory framework – namely, the potential for an increased uptake of decentralised electricity supply options to lead to asset under-utilisation and/or stranding, further leading to material increases in the price of electricity services for customers that remain connected to the grid.

AGL broadly supports the Commission's proposed approach to the first annual review, the areas of focus for the 2017 report and the areas identified as a key priority for future reforms. Naturally, the approach to this annual assessment will be required to evolve year on year to reflect modifications to the economic regulatory framework as they are implemented.

Although not directly stated in the Approach Paper, AGL understands that the review will need to assess many of the findings at the individual network level. This will enable the Commission to differentiate issues arising from the economic regulatory framework from outcomes arising due to particular industry structures or cultural attitudes present in some distribution network zones.

### **Pricing access to the grid**

Mechanisms for pricing access to the grid and the revenue model applying to distribution businesses are closely related issues. In an environment where decentralised technologies are offering partial substitutes to grid supplied energy, networks must have both the incentive and flexibility to introduce alternative pricing arrangements that maintain the relevance of the grid. At a time of flat or declining network demand, the potency of any such incentives would seem to be materially impacted by the form of control underpinning the network's revenue model. Linking revenue to utilisation is more likely to encourage networks to competitively price access to their networks and to introduce tariff innovations (such as rewarding distributed generation exported during network peaks, or 'by-pass' pricing customers for whom it would be economically feasible to go fully off-grid).

In 2014, the Commission made a rule requiring distribution businesses to gradually introduce more cost reflective network tariffs to their customers. AGL supports greater cost-reflectivity in network tariffs, however there are some constraints on the true cost reflectivity of the tariffs that networks are likely to introduce. These relate in part to the revenue cap that networks currently operate under, together with the spare capacity that exists in many networks (particularly in New South Wales). There is a question as to whether the policy intent behind the introduction of cost-reflective pricing can be achieved without a clear policy on the treatment of the existing regulated asset base.

Care in the design of the cost-recovery and network pricing frameworks is key to driving efficient network utilisation, efficient adoption of distributed energy technologies and managing potential equity issues that arise where those without the ability to adopt distributed generation technologies are left to bear a disproportionate share of remaining network costs.

### **Contestability of energy services**

The Commission is currently assessing a number of rule change proposals relating to the contestability of energy services and looking to strengthen the scope for the competitive delivery of non-network solutions.<sup>1</sup> The Commission, along with other policy review bodies, is also considering how the distribution network may need to evolve to facilitate greater uptake of distributed energy resources while maintaining the primacy of customer choice.

Underlying these proposals is the principle that, where feasible, contestability and the competitive delivery of services will lead to better price and service outcomes for consumers. The greater the proportion of network services and network spending that can be subjected to the rigour of the competitive market, the less work that the regulatory determination process has to do in terms of simulating efficient outcomes and overcoming information asymmetry issues. Future reviews of the effectiveness and suitability of the economic regulatory framework will play an important role assessing the progress and impact of changes resulting from these processes.

### **Operation of incentive schemes**

AGL agrees that the review should include consideration of the interaction of the underlying mechanisms by which networks recover operational and capital expenditure and the various incentive schemes that overlay this framework to encourage network businesses to perform better (achieve a reliable network at lower cost) than approved under 5-year regulatory

<sup>1</sup> National Electricity Amendment (Contestability of energy services) Rule 2016, December 2016; National Electricity Amendment (Contestability of energy services – demand response and network support) Rule 2016, December 2016; National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2016, October 2016

determinations. The interaction of these schemes with underlying business and financial drivers and cost recovery frameworks can be complex, and there remains information asymmetries between the regulator and regulated businesses.

This review should take a close look at the patterns of behaviour observed since the introduction of the various incentive schemes, and the strength of outcomes for consumers in terms of network cost, reliability and service levels. If this analysis indicates that the revenue and incentive schemes are not working effectively (or that outcomes are so obscured that it is difficult to assess their effectiveness), then this will lend weight to a consideration of alternative regulatory approaches for achieving efficient network investment and management in the customer interest.

### **Stakeholder consultation and case studies**

AGL agrees that direct stakeholder consultation and case studies will constitute a very valuable element of this review. Along with indicators, this will provide more direct evidence as to whether the theory underpinning different components of the economic regulatory framework is borne out in practice. For example, despite the introduction of the Regulatory Investment Test framework in 2013, if there are few RIT assessments falling in favour of a non-network solution, why is this? Is it due to cost? Misgivings about the capabilities of new technologies or demand management solutions? Reluctance to rebalance operational and capital expenditure? Perfunctory stakeholder engagement? etc. And is there anything in the economic regulatory framework that is contributing to these outcomes?

### **Indicators**

AGL acknowledges that the primary focus of the review will be on qualitative outcomes, but considers that quantitative indicators will offer an important empirical view of progress in certain areas. The following are additional indicators that might usefully be considered, especially if recorded over time and compared across the individual distribution networks:

- digital meter penetration;
- movement of customers onto cost-reflective network tariffs;
- average network utilisation at the sub-station level;
- percentage of non-network solutions delivered via unrelated third party providers;
- movement of services from 'direct control' to 'alternative control' classification; and
- incidents of network pricing below standard service prices, eg. where by-pass pricing may be required to maintain network utilisation.

Should you have any questions in relation to this submission, please contact Eleanor McCracken-Hewson, Manager Policy and Research, on 03 8633 7252 or myself on 03 8633 6836.

Yours sincerely,



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