Response to the Australia Energy Market Commission's Draft Decision on changes to the National Electricity Rules proposed by the Australian Energy Regulator and the Energy Users Rule Change Committee

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INTRODUCTION

UnitingCare Australia provided a substantial submission to the Australian Energy Market Commission's (AEMC) Network Rule Change Directions Paper. We appreciate the significant attention paid to the concerns raised in our submission, regarding the interests of small consumers and that the "Commission has found that the NER and NGR can be improved and strengthened". We welcome the opportunity to comment on the AEMC's Draft Decision on changes to the National Electricity Rules.

We regard this rule change as one of the most important since the establishment of the National Electricity Market (NEM), as it has the opportunity to significantly influence the cost of electricity faced by small consumers, particularly low income and vulnerable consumers across the entire NEM.

Our original submission to the inquiry urged the AEMC to make the rule changes proposed by the Australian Energy Regulator (AER) and the Energy Users Rule Change Committee (EURCC).

Key Contextual Issues

Network spending ultimately impacts on small consumers across the NEM, particularly low income and vulnerable consumers. As network expenditure grows, more costs are passed through to the energy bills of small consumers. The network charges included in small consumer's bills are one component of energy costs that householders can't influence through behaviour change, improvements to the energy efficiency of their housing or their household appliances. The regulatory and policy settings that allow passing on the costs of network expenditure to small consumers has negatively impacted on their capacity to pay energy bills.

UnitingCare Australia has a number of concerns about the proposed Network Rule Change:

- Recent energy price rises are extraordinary, and the Commission has not treated this issue with the seriousness and urgency it requires.
- While expenditure forecasts have been attributed to growing peak demand, ageing assets and 'catch-up' investment, the government-owned network companies have historically spent much more than those owned privately on these costs of doing business.
- The design of regulation is partly responsible for creating cost burdens on consumers, particularly small consumers, rather than governance and implementation of the rules.
- While consumers bear network costs, businesses are receiving benefits, like higher corporate valuations for privately-owned companies, and profits, taxes and fees for government-owned service providers.
- The Australian Energy Regulator needs better ability to set a benchmark for what is spent on capital (capex) and operational expenditure (opex).
- Under the current rules it is up to the regulator (AER) to prove to a network service provider (NSP) that the NSP's proposal is wrong, rather than for that provider to prove to the regulator that its proposal is right.
- The regulator does not have access to the same level of information as the network business in making forecasts, so it is harder to interrogate and substantiate their claims.
- The incentives to be efficient with capital expenditure are too weak.
- That the 'rate of return' on investments should be determined by the regulator, rather than network businesses themselves.

Changes Proposed by the AEMC to the National Electricity Rules

The AEMC expects the draft determination and draft rules will:

- "improve the strength and capacity of the regulator to determine network price increases so consumers don't pay any more than is necessary for the reliable supply of electricity and gas."
- clarify "the AER's powers to undertake benchmarking, including requiring the regulator to publish annual reports on the relative efficiencies of network businesses."
- include "changes to the rate of return provisions in the gas and electricity rules, namely how the rate of return on capital is set."

(Source: Fact Sheet from AEMC website)

The rule changes are intended to allow the regulator to better estimate rates of returns on investment for new expenditure, and allow a range of ways to create incentives for the most efficient forms of investment. The AEMC says the rule change proposal removes ambiguity about the power the regulator has to interrogate, review and amend network businesses' proposals for expenditure.

Commentary on the Draft Determination

UnitingCare Australia is supportive of these changes in principle, and understands that significant effort has been taken by the AEMC to design rules that will ensure consumers receive a reliable supply of electricity at the lowest possible price. However, we are concerned that the decisions in the draft determination are unlikely to result in noticeable differences in the decisions that the AER will make in future, compared to what they would have made if the Rules were left unchanged. We therefore consider that these changes will not necessarily reduce electricity prices in future compared to what they otherwise would be under the existing Rules. This would not meet our objective, to ensure that the best possible outcome is obtained for small consumers, particularly low income and vulnerable households.

UnitingCare has facilitated dialogue around this rule change within the Small Consumers' Roundtable, and as part of this process engaged a consultant, CME, to provide advice to the Roundtable on the original Directions Paper, and on the current Draft Determination. The discussions within this group and the report produced by CME have led us to the view that further changes are needed to deliver on the objectives outlined by the AEMC. UnitingCare Australia has reproduced the full text of the CME advice to the Small Consumers Roundtable in this submission, with some minor editing, to place it on the public record.

The report below indicates which aspects of the rule change are likely to deliver on the objectives outlined by the AEMC, and identifies a number of gaps and risks in the proposed rule change.

The report also outlines changes that could be made to strengthen the rule change, both in it's wording and in its implementation.

UnitingCare Australia would welcome the opportunity to meet with you to discuss further modifications to the rule change that would ensure it delivers on the objectives the AEMC has identified, and that UnitingCare Australia strongly supports.

This document is slightly edited version of a report commissioned by UnitingCare Australia using a grant from the Consumer Advocacy Panel. The report was written by Carbon + Energy Markets *(CME) and was prepared for consideration by members of the Small Consumers' Roundtable, setting out CME's assessment of the Australian Energy Market Commission's (AEMC) Draft Decision on proposals from the Energy Users Rule Change Committee (EURCC) to change the National Electricity Rules (NER), and also on proposals from the Australian Energy Regulator (AER) to change the National Gas Rules (NGR) and the NER.*

EXECUTIVE SUMMARY

In its Draft Decision, the AEMC has made three main decisions on changes to the National Electricity Rules proposed by the AER and the EURCC:

1. It rejected the EURCC's proposal that Government-owned service providers should receive a return on debt based on the cost of debt.
2. It proposed that if the AER rejects an NSP's capex or opex proposal, it is no longer required to determine a substitute amount "only to the extent necessary" and "on the basis of the regulatory proposal".
3. It proposed that the AER has discretion to determine the allowed rate of return subject only to the principle that it should reflect the cost of capital of a benchmark efficient firm.

On the first decision, if the AEMC had accepted the EURCC's proposal, it is likely to have reduced the revenue recovered by government-owned electricity network service providers by around $1bn per year. Assuming this change had taken effect in 2010, the average prices charged by those service providers would have been around 14% lower than they were.

The AEMC has rejected the EURCC's proposal for a number of reasons the main reason being their view that it contravenes the Competition Principles Agreement, as the state governments have chosen to implement it. The Author disagrees with the AEMC's reasoning, as set out in this report.

The AEMC's second decision (listed above) is a useful elimination of an ambiguity and should help to ensure that the AER will feel less constrained by NSPs' proposals, in setting capex and opex allowances.

The third decision would be significant if it was the case that the AER was significantly constrained by the Rules in setting the Weighted Average Cost of Capital (WACC). However, other than with respect to the determination of the risk free rate and debt risk premium for electricity network service providers, the Author does not believe this to be the case.

This is because the evidence shows that the AER made similar WACC decisions when it was unconstrained by the Rules, as it did when it was subject to the constraints in Chapters 6 and 6A in the Rules. Specifically the AER has had full discretion in setting the WACC for gas pipelines and gas distributors, and the ACCC had similar discretion in the determination of the WACC for transmission network services providers (before 2006).

Therefore it cannot be concluded that additional regulatory discretion for the AER in the determination of the WACC will *necessarily* make any difference to future decisions by the AER, on the level of the WACC.

In addition to these three decisions, the AEMC has also decided a number of less significant changes (elimination of a debateable ambiguity in relation to benchmarking, allowing ex-post adjustment of capex allowances, requiring the AER to publish seven new guidelines on various issues, lengthening the regulatory decision process and putting additional steps into the process, requiring greater transparency on late submissions and the withholding of

information claimed to be confidential, and encouraging the AER and NSPs to provide more information to consumer advocates).

An assessment of these less significant decisions follows:

1. It is questionable whether the elimination of (debatable) ambiguities in the Rules' obligation in relation to benchmarking will make much difference – the Rules already say clearly that the AER must have regard to benchmarks in setting expenditure allowances.
2. The merits of ex-post adjustment of capex are debatable, and may not be helpful.
3. The publication of additional guidelines and the lengthening of regulatory decision processes are unlikely to simplify regulatory decisions and will not necessarily lead to better decisions.

The desire of the AEMC to empower consumers is commendable. However, the provisions that the AEMC has made to encourage greater engagement by the AER and NSPs with consumers are unlikely to empower consumers in regulatory processes to any significant extent.

In summary, the AEMC's Draft Decision is unlikely to result in noticeable differences in the decisions that the AER will make in future, compared to what they would have made if the Rules were left unchanged. Therefore, these changes will not necessarily reduce electricity prices in future compared to what they otherwise would be under the existing Rules.

The following sections outline each area of the AEMC's Draft Decision, followed by an assessment of each draft decision.

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1. RATE OF RETURN FRAMEWORK

The AEMC has proposed that the AER has full discretion to determine the rate of return for each NSP subject to a general requirement that this return be based on a benchmark efficient NSP. The AER is also required to determine non-binding guidelines – to be revised at least every three years. The purpose of these guidelines is to provide some predictability to the AER's approach and to allow stakeholders to engage constructively in regulatory debates, without necessarily having to be involved in the same debates during each regulatory determination.

Assessment

The AER has (and always has had) complete discretion to determine the allowed rate of return for gas network service providers. Until the revised arrangements for Chapter 6 took effect, it had similar discretion in the determination of the allowed returns for transmission network service providers.

Since the revised Chapter 6 and new Chapter 6A took effect, the AER has had less discretion in electricity, but still a substantial level – other than in the determination of the risk free rate and debt risk premium. There are other relatively less significant differences between the arrangements in chapters 6 and 6A.

To inform an assessment of what greater freedom for the AER in this area might deliver, outcomes in the AER's regulation of gas pipelines and also of transmission network service providers until the revised Chapter 6 took effect, have been compared with the outcomes that have been delivered since the implementation of Chapter 6 and Chapter 6A.

In total this covers 40 regulatory determinations that the ACCC and then the AER has made since 2000, for "covered" gas pipelines, gas network service providers, electricity transmission network service providers and electricity distribution network service providers.

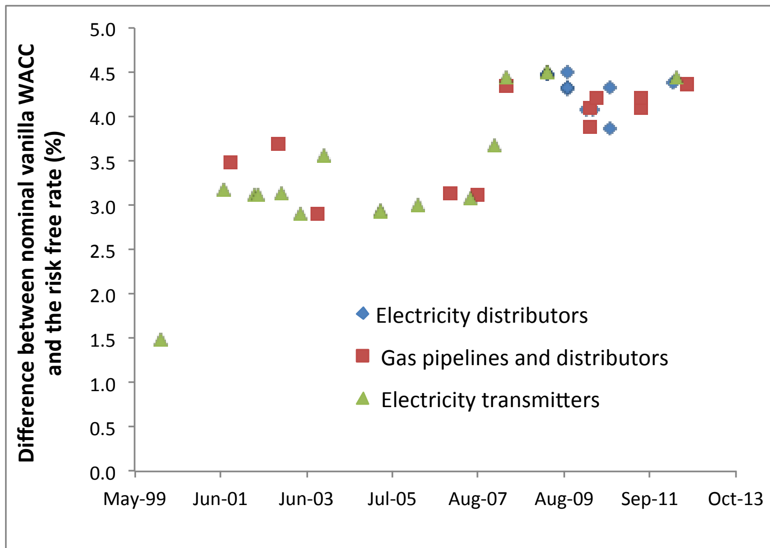
The analysis is of the difference between the nominal vanilla weighted average cost of capital (WACC) less the Risk Free Rate. Some of these WACC decisions were varied on appeal to the Australian Competition Tribunal (ACT). This report uses the AER and ACCC's decisions not the ACT's varied values, because we are interested in understanding the AER's decisions not the ACT's decisions.

The results of this analysis are presented in Figure 1 below.

A number of conclusions can be drawn from this analysis.

- Comparable WACC were determined by the ACCC for gas pipelines and distributors and electricity transmission network service providers.
- Comparable WACC were determined by the AER for gas pipelines and distributors and electricity transmission and distribution network service providers.
- The step up in the determination of the WACC since 2008 corresponds to the implementation of the arrangements in Chapter 6 and Chapter 6A of the Rules. But there were no changes in the determination of the WACC for gas network service providers and yet the AER has determined a WACC for gas network service providers that is comparable to that for the electricity network service providers.

Figure 1. Difference between the nominal vanilla WACC and the risk free rate in all network service provider decisions by the AER and ACCC



Source: AER and ACCC regulatory decisions

This analysis supports the conclusion that the AER's concern that it has not had sufficient discretion in the determination of the WACC of electricity network service providers is hard to sustain.

This assessment demonstrates that greater discretion for the AER in the determination of the allowed return, though generally desirable, has not influenced WACC determinations in the past and so may not do so in future.

2 RETURN ON DEBT

The Energy Users Rule Change Committee (EURCC) proposed changes to the allowed return on debt. The AEMC distinguished between the EURCC's proposal to have the return on debt contingent on ownership (private and government), from the EURCC's proposed changes to the methodology for the calculation of the return on debt.

For the former, the AEMC has disagreed with the EURCC that the return on debt for government-owned service providers should be calculated differently to privately owned service providers. The rest of this section explains and critiques the AEMC's reasoning.

For the latter, the AEMC has agreed that there is a problem, and has decided to strike out the current Rules provisions on the method for the determination of the risk free rate and debt risk premium. It has also decided that the AER should determine the return on debt using whatever approach it considers appropriate.

The AEMC has decided that the Rules should not determine a different allowed return on debt for government owned NSPs, compared to their privately owned peers. It provided various reasons for this. The Draft Decision (DD) provides no new reasoning beyond what the AEMC set out in its Directions Paper, however the DD has a different emphasis on various issues, and clarifies and further reinforces the AEMC's Directions Paper reasoning in various areas:

The AEMC's reasoning in the DD to support its conclusion is as follows:

1. There would be allocative inefficiency if the states do not charge (and users do not pay) competitive neutrality fees.
2. Tax-payers would be subsidising electricity users if there was no competitive neutrality fee.
3. The income taxes that state governments receive on the profits of their NSPs should not be counted as a return on equity (and hence by implication state governments are not receiving extra-ordinary returns on their investment in NSPs).
4. There is competition for the services provided by NSPs and hence the Competition Principles Agreement should apply to NSPs; and
5. Irrespective of the merits of any other argument, the state governments say that the Competition Principles Agreement as they have interpreted it applies, and so whatever fees they calculate pursuant to this agreement, can be recovered from users in regulated charges.

These arguments need to be scrutinised. The rest of this subsection sets undertakes some assessment of this.

Allocative inefficiency

The AEMC suggests that unless competitive neutrality fees are charged, the return on debt will be "artificially" low. It then says (page 85) that "'*faced with an artificially lower rate of return, the service provider may view capex solutions as comparatively lower cost to non-network solutions*". By implication, if competitive neutrality fees are not charged, the AEMC suggests NSPs will overspend (what the AEMC calls "*over-investment*" on page 86).

But later on the same page, the AEMC contradicts this by arguing, that "*it is arguably more likely that reducing the rate of return for state-owned service providers in the way proposed by the EURCC could lead to under-investment by the relevant service providers because the state governments may choose to restrict their access to debt capital*".

These arguments are internally inconsistent – how can the elimination of debt fees result in under-investment and over-investment at the same time?

Leaving aside this internal inconsistency, the AEMC may have ignored the reality that NSPs (that the governments own) are accountable to their government owners and so the cost of debt that they might see (after debt fees payable to their State Treasuries) is not relevant in their investment decision-making.

To expand on this point, NSPs' investment decisions are made by Boards, appointed by the state governments and whose task it is to represent the interests of the governments. These governments (and their appointed Board representatives) can be expected to consider the interests of their shareholder when approving the investments of the NSPs that they govern. In other words they can be expected to make decisions that align the interests of the NSPs that they govern, with the interests of the shareholder whose interests they have fiduciary duties to promote.

In this context, competitive neutrality fees are simply a form of transfer payment, and Boards can be expected to see through them to the underlying economic substance – which is the difference between the cost of debt to the Government and the return on debt that the AER allows NSPs to recover in their regulated revenues. The relevant issue therefore is the size of the difference between the allowed return on debt (that the regulator determines for the NSP) and the actual cost of debt raised by the state government treasuries.

If NSPs are rewarded with a higher return on debt than is the cost to their governments to provide that debt, then the government shareholder (and its representatives the NSPs' directors) have an incentive to encourage their NSPs to increase their debt.

The existence of competitive neutrality fees is simply a matter of how the government extracts the surplus that arises from the difference between the return on debt and the cost of debt: if there is no fee, NSPs' attributable profits will be higher (and the states have a claim on these profits and income taxes thereon). If there is a fee, the attributable profits will be commensurately lower but the government gets the fee. Exactly the same income accrues to the government in both cases, and their attitude to investment by their NSPs should be exactly the same in both cases.

It follows from this analysis that the relevant allocative efficiency issue is the gap between the cost of debt and return on debt, not the existence (or absence) of competitive neutrality fees. Therefore such fees (or their absence) can not be expected to have any meaningful impact on allocative efficiency.

Tax-payers would be subsidising electricity users if there is no competitive neutrality fee

The Government, on behalf of tax-payers, provides the equity and debt capital that funds the NSPs that they own. The argument of whether tax-payers (the government) are funding electricity users or vice versa therefore needs to have regard to all the pecuniary benefits that the government, as an investor, receives on its investment in its NSPs.

The EURCC's proposal document analysed the situation in NSW (based on data provided by the NSW Auditor General) and calculated that from its electricity transmission, distribution and retail businesses, the NSW government received a return of 28.3% on its equity in these business in 2010.

Of this, the competitive neutrality fee on debt (from the distribution and retail businesses – and almost all of this will been from the distribution businesses) accounted for $221m, or a 5.3% equivalent return on the Government's equity in its distributors.

If it is assumed that this fee was not charged, the rate of return on equity would decline to 23%. This is still more than twice the rate of return on equity that the AER considers to be reasonable, in its determination of the Weighted Average Cost of Capital. In what sense

then, is it reasonable to suggest that taxpayers would be subsidising electricity users if there is no competitive neutrality fee?

Income taxes that state governments receive on NSP profits should not be counted as a return on equity

Whether or not income taxes should be counted as a return on equity is not directly relevant to the treatment of the return on debt. Its value in the discussion is however whether such tax returns should be classified as a return on the government's equity in its NSP. If so, this strengthens the case that the governments should not also profit on debt costs through competitive neutrality fees.

On the advice of its consultants (SFG), the AEMC concluded that the return received by governments as a shareholder (as dividends) should be compared with the risk borne as a shareholder and that taxation revenues received as the taxing authority should have no part in this comparison.

This argument seems implausible. Income taxes arise from the profits that NSPs deliver, and when the government owns the NSPs, these profits accrue to the state government because the Australian Constitution precludes the Commonwealth from taxing state-government activities. The fact that NSPs don't incur risk to earn the income tax is irrelevant. As the owner, the state government is entitled to both the profit and the tax on the profit. If the government ceased to be the owner it would be entitled to neither. To argue, as the AEMC does on the advice of SFG, that a dollar received by the government through income tax on the profits of its NSP is different to a dollar received by the government from the dividends on the NSP's profits, is to argue that administrative form should triumph over economic substance.

There is competition for the services provided by NSPs and hence the Competition Principles Agreement should apply to NSPs

The AEMC argues (on page 86) that state owned "electricity service providers" are in competition with "the gas sector" and "other electricity networks" although strangely it considers this to be the case mainly in QLD, less so NSW and does not mention what might be the case in the rest of the NEM.

By implication the AEMC suggests that the Competition Principles Agreement should apply (because the NSPs compete) and hence competitive neutrality fees should be included in the prices for their services. However, the AEMC reaches the opposite conclusion on competition amongst NSPs (on page 167) where it concludes "*the NSP is a monopoly business and does not therefore compete directly with other businesses*"

The argument that there is a meaningful level of competition in the services provided by monopoly network service providers is questionable. The AEMC's latter conclusion (that there isn't) is sound, and the former should be discounted, and with it the rationale for the application of the Competition Principles Agreement to NSPs

The Competition Principles Agreement applies because the states say that it does

The AEMC says (on page 81) that "*the most important factor to recognise is that state-owned service providers that are subject to the NER are required to pay debt neutrality or government guarantee fees to the jurisdictional government (via state treasuries) as part of the application of the competitive neutrality principles. These fees are mandated in various state legislation and code of practice instruments*".

By implication, the AEMC suggests that it has no discretion in this matter and that even if it agreed with the EURCC's arguments there is nothing it can do about it because state-owned NSPs have obligations imposed on them by their jurisdictional government owners. By implication, whatever obligations the state governments impose on their NSPs, the AEMC is required to accept.

This is inconsistent with the approach that the AEMC has taken on similar issues. For example, the AEMC has proposed regulations to deal with related-party contracts that privately-owned NSPs might enter into, to protect users from value-shifting that could be achieved through this. Competitive neutrality fees extract value from NSPs and pass it to their government owners. They are, in substance, just like transfer pricing arrangements that might be negotiated between related parties. The AEMC is right to guard against such transfers in related party contracts. Competitive neutrality fees are no different.

The National Electricity Law requires the AEMC to create and administer rules that serve the long term interest of consumers. At face value this says that the AEMC's task is to set rules that ensure that users can not be forced to bear charges unless they are in their long term interest. In this case, the AEMC's evaluation of competitive neutrality fees must rest on the argument that such fees are in the long term interest of consumers, not that the states have imposed them. The AEMC's draft decision has not done this.

In summary the AEMC's rejection of the EURCC's proposal is not in the long term interest of consumers.

3. CAPEX INCENTIVES

The AEMC has decided several changes to the arrangements for regulatory incentives in respect of capex. The main changes proposed are as follows:

- The AER is able to undertake ex-post reviews of actual capex, and if it considers actual expenditure above the amount allowed in the regulatory control has been inefficient, to then ensure it is not included in the regulated asset base.
- The AER can decide whether to use actual or forecast depreciation in its calculations.
- The AER is allowed to design capex efficiency benefit sharing schemes.

Of lesser significance, the AEMC has decided that the AER can preclude inefficient related party margins or capitalised opex from being rolled into the RAB

Assessment

The AEMC has decided that the AER should have a significant degree of freedom in designing capex incentives. This extends the freedoms that the AER already has, such as to introduce an Efficiency Benefit Sharing Scheme, but which it has not used.

In principle, regulatory discretion in the design of incentives is important. Incentive design is complex and it is essential that the regulator is able to learn from past experience. The ability to adapt incentives in response to evidence is difficult if Rules impede such evolution. In principle therefore, the AEMC's proposals in this area are desirable and necessary.

However, the only area in which there is a significant departure from the current arrangements is in respect of the opportunity afforded to the AER to consider ex-post capex reviews, and to exclude some expenditure from the regulated asset base, if the AER considers that such expenditure has been inefficient.

There are arguments for and against "ex-post optimisation". The argument for it – in terms of its impact on efficiency – is that the threat that the regulator will assess expenditure as inefficiently incurred, acts as a discipline on expenditure by network service providers. This is because there will be a reduction in financial returns if investors rather than consumers are left to carry the burden of inefficient expenditure. Adverse ex-post assessments can also be expected to carry significant reputational risk for the NSPs' executives.

Government owned service providers have historically spent more that the capital expenditure allowances in their regulatory controls. Energy users have been burdened with almost all of the additional expenditure. Would such overspending have occurred if regulators had been able to use ex-post expenditure assessments?

The main argument against the adoption of ex-post controls is that network service providers can be expected to demand that the additional risk associated with ex-post assessment will increase their investment risk and hence require compensation through higher allowed returns on equity. It is not clear that the AER will be able to resist this argument. Therefore what might be gained through greater discipline on expenditure will be lost on higher allowed rates of return.

In addition, ex-post expenditure assessments are very demanding to do. A reasonable ex-post adjustment must focus on the information available to NSPs at the time they committed expenditure, and must be able to conclude that the NSPs had failed to reasonably take account of that information and hence had spent more than they should have. This is a lot to ask of a regulator.

Our concern therefore is that the threat of ex-post adjustment may turn out to be an idle threat, but which NSPs will be able to capitalise on, by claiming that it increases investment

uncertainty and hence is a basis to allow higher regulated rates of return. In this case, the inclusion of ex-post expenditure assessments will do more harm than good. On balance the author is inclined to this view.

4. DETERMINATION OF OPEX AND CAPEX ALLOWANCES

The AEMC has made two changes in this area. The first is to strike out clause 6.12.3(f) from Chapter 6. This is a significant change. The second is to take out the words "circumstances of the relevant NSP" in relation to benchmarking.

Assessment

Clause 6.12.3(f) (which is in Chapter 6, but not 6A) says that if the AER refuses to approve part of an NSP's proposal it must determine a substitute amount "only to the extent necessary" and "on the basis of the regulatory proposal". The AER has suggested that this has constrained their ability to set an efficient level of expenditure.

The extent to which this has constrained the AER is debatable. However the Author agrees with the AEMC that this clause serves no useful purpose. The AER should be able to determine an efficient expenditure allowance subject to general requirements, and the Author can see no reason why it should be constrained to make adjustments based only on NSPs' proposals. This is the origin of our significant concern about "onus of proof" (the clause elevates the NSP's proposal to the status of the document against which changes by the regulator are to be referenced). The AEMC's draft decision addresses this concern, and their draft decision means that NSP's proposals no longer have such special, referential status. The Author agrees with this important change.

The excision of the requirement that the AER must have regard to the "circumstances of the relevant NSP" in its benchmarking is helpful, albeit that it is debatable whether this existing clause has impeded the AER. This requirement does not distinguish between endogenous factors (which benchmarks should ignore) and exogenous factors (which they shouldn't). Excising this requirement will avoid wasteful argument, and may perhaps embolden the AER in developing and using benchmarks.

5. REGULATORY PROCESSES

The AEMC has made what it calls "incremental" changes to the current regulatory determination process. Other than the consumer empowerment related changes discussed in the next section, these are:

To extend regulatory decisions by six months:

- requiring NSP to identify confidentiality claims, and the AER to report on these claims;
- requiring the AER to report on its website where it receives late or out-of-scope material from NSPs';
- increasing the time for NSP to prepare revised regulatory proposals;
- introducing a discretionary cross-submissions stage; and
- commencing regulatory determination six months earlier.

Assessment

These changes seem reasonable and may address some concerns about the abuse of regulatory processes by NSPs and of their claims to confidential information. However, as the AEMC notes, these changes are "incremental" and should have no great value in affecting future regulatory outcomes.

6. CONSUMER ENGAGEMENT

The Executive Summary of the Draft Decision has a section entitled "consumer engagement and participation" that describes various actions that the AEMC suggests should be taken "*to attempt to address a lack of focus on consumer engagement and participation*". There is no section of the Draft Decision specifically dealing with this, but it is covered within a section entitled "regulatory determination process".

The AEMC's proposals are that:

- NSPs must say how they have engaged with customer representatives in their regulatory proposals, and the AER must take this into account when setting the extent to which NSPs have engaged with consumers in preparing their forecasts;
- The AER should publish an Issues Paper after receiving the regulatory proposal to "*assist consumer representatives to focus on the key preliminary issues*";
- The AER must publish a benchmarking report to inform consumers on the relative efficiency of NSPs.

Assessment

Neither the EURCC nor the AER made proposals to change the Rules to improve consumer engagement. These proposals have therefore been developed by the AEMC independently of any rule change proposals. The focus by the AEMC on the need to improve consumer engagement is commendable. However, the provisions that the AEMC has made to encourage greater engagement by the AER and NSPs with consumers are unlikely to empower consumers in regulatory processes to any significant extent.

The first area – requiring NSPs to report on customer engagement and then requiring the AER to take account of this - is potentially meaningful. It is possible to imagine an outcome consistent with this proposal, in which NSPs and user representatives engage with each other with a view to reaching a negotiated settlement on prices and services. The AER's task would then be to verify that this was a fairly negotiated settlement, that the parties to the negotiation represented their respective constituencies, and that the resulting settlement served the public interest. This "negotiated settlements" approach is commonly used in the regulation of NSPs federally in Canada and the U.S, and in some states of the U.S. and provinces in Canada (for example Florida, California and Alberta).

However, it is not clear that this is what the AEMC has in mind. The AEMC's intention for consumer engagement may be that it would like to see the AER and NSPs undertake "consultation" and the provision of information so that consumers are better informed about the NSPs' proposals and the AER's decisions, presumably so that the resulting decisions (and price rises) win greater acceptance amongst consumers. Assuming that this is the AEMC's intention then this proposal is perhaps useful. But it should not be imagined that this constitutes what might be considered to be "engagement" in the commonly accepted meaning of the word.

The objectives of the second and third areas are not clear. Perhaps it would be better to require the AER to demonstrate that it has sought to understand consumer preferences and their willingness to pay, rather than to require them to "assist" consumers to focus on what the AER considers to be the key issues. Similarly, while asking the AER to produce annual benchmarking reports is useful, it may be more useful to ensure that consumers are resourced to do this themselves.

In fairness to the AEMC, arrangements for the empowerment of consumers in regulatory processes are an issue for policy makers not regulatory institutions. Genuine empowerment of consumers will inevitably change the roll that regulators play, and regulators should not be the decision-makers in evaluating fundamental changes in this area.