



## 2018 Economic regulatory framework review

AEMC commences second review of the economic regulatory framework for electricity networks

**This information sheet sets out the scope and approach to the AEMC's second annual review of the economic regulatory framework for electricity networks. The review report will be published in July 2018.**

### Purpose of the review

The annual review of the economic regulatory framework for electricity networks is part of the AEMC's work to support the continual evolution of the energy sector. In light of the significant growth in decentralised energy resources, the review will examine whether the economic regulatory framework is robust, flexible and continues to support the efficient operation of the energy market in the long term interest of consumers. We do this by monitoring changes and developments in the national electricity market (NEM) and where necessary, recommend changes to the economic regulatory framework to the COAG Energy Council.

The standing terms of reference for this review is available on our [website](#).

We will also use the annual review to conduct economic analysis and modelling that officials and other review bodies task us to do. For example, the 2018 review will implement one of the recommendations from the *Independent Review into the Future Security of the National Electricity Market* to conduct financial modelling to test whether distribution network businesses have a preference for capital investments in network assets over operational expenditure on demand-side measures and if so, consider alternative models.

### Scope of the 2018 review

The 2018 review will focus on the following three areas:

- Annual monitoring of network service providers' (NSPs') expenditure and performance
- Financial incentives for NSPs in providing economically regulated services
- Arrangements for distribution network access and connection for distributed energy resources

Each of the focus areas is discussed further below.

#### Annual monitoring

In this part of the review, we will work closely with the Australian Energy Regulator (AER) to monitor trends in NSPs' expenditure and performance as well as grid usage overtime. A key outcome of this monitoring is to establish whether NSPs' expenditure (both in amount and type) are responding to the changing usage pattern of the electricity grid.

We will work with the AER to monitor the progress of network pricing reform. We consider implementation of these reforms will provide an essential foundation for future reforms that would support energy market transformation.

We will also continue to monitor the development and uptake of new technology and new business models in the NEM to inform our assessment on whether changes to the economic regulatory framework are required to support the energy sector's continual evolution.

### Financial incentives for NSPs providing economically regulated services

In recent years, reforms such as the introduction of the capital efficiency sharing scheme and demand management incentive scheme have strengthened incentives for NSPs to seek alternatives to traditional network solutions. Despite these reforms, stakeholders remained concerned that NSPs have an inherent bias to prefer capital expenditure over operating expenditure. These concerns were raised in a variety of forums such as the Finkel Review, the *Contestability of energy services – network support and demand response* rule change request submitted by the Australian Energy Council. The COAG Energy Council has also commissioned KPMG to prepare a report on optimising network incentives.

We recognised these concerns in our 2017 review and undertook to conduct a review of the financial incentives that NSPs face in delivering economically regulated services under the existing regulatory framework in the 2018 review. The Finkel Review also recommended the AEMC commission financial modelling to test whether distribution network businesses have a preference for capital investments in network assets over operational expenditure on demand-side measures. The Finkel Review further recommended that if our analysis demonstrates that there is a bias towards capital expenditure, the COAG Energy Council should direct us to assess alternative models for network incentives and revenue-setting, including a total expenditure approach.

The 2018 review will therefore include assessments of the incentives network businesses face when deciding on the following service delivery methods:

- capital or operating expenditure
- long or short asset life
- network or non-network solutions
- in-house or third party provision.

The 2018 review will also examine frameworks that overseas regulators have adopted as a result of findings that their previous regulatory frameworks did not provide balanced incentives for service delivery methods. We have already commenced work in this area and commissioned Frontier Economics to investigate total expenditure regulatory frameworks in overseas jurisdictions in. Frontier Economic's report can be found on the review project [webpage](#).

### Distribution network access and connection arrangements for distributed energy resources

In 2017, we undertook the *Distribution Market Model* research project to examine how distributed energy resources might drive an evolution to a more decentralised provision of electricity services at the distribution level. The project also explored whether changes to the regulatory framework, operation of distribution systems and market design are needed to enable the evolution to occur in a manner consistent with the National Electricity Objective (NEO). Network access and connection arrangements for distribution energy resources was one of the issues discussed in the final report.

The 2018 review will continue the work on network access and connection arrangements for distributed energy resources started by the *Distribution Market Model* research project. We will commence a holistic assessment of access and connection arrangements in relation to distributed energy resources. As part of this assessment, we will examine what the nature of a customer's contract with a distribution network service provider (DNSP) regarding load and export should be in the future – whatever that may be.

## Review timing and consultation

### Stakeholder consultation

We will be seeking stakeholders' views through stakeholder workshops in March/April 2018. The workshops will focus on the areas of NSPs' financial incentives and network access and connection charging for distributed energy resources. Details on the workshops will be made available on our website closer to the events.

### Review timing

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Review initiation	February 2018
Stakeholder workshops	March/April 2018
Final report publication	Mid-July 2018

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