



Annual reporting on the economic regulatory framework for electricity networks

The AEMC has received the Terms of Reference from the COAG Energy Council tasking it to conduct annual monitoring and reporting on the effectiveness of the economic regulatory framework for electricity networks in responding to increased uptake of decentralised energy supply.

Purpose of the annual monitoring and report

The purpose of the annual monitoring and reporting is to build on previous policy advice provided by officials to the COAG Energy Council on the adequacy of the economic regulatory framework in achieving the National Electricity Objective (NEO) in a range of potential future scenarios.

The annual reporting is also intended to provide the COAG Energy Council early warning of changes in market conditions that may warrant reforms to the economic regulatory framework. The AEMC's report is required to include indicators to help inform its monitoring and assessment.

The focus of the annual reporting will be whether the framework governing the economic regulation of electricity distribution and transmission networks is sufficiently flexible and robust to continue to achieve the NEO in an environment with increased decentralised supply. The AEMC will monitor market developments in relation to the potential increase in decentralised energy supply and their effect on the economic regulation framework's ability to support continued efficient investment, operation, and use of electricity services for the long term interest of electricity consumers.

Consumer choices will continue to shape the future development of the energy market. It is not possible to know whether certain scenarios will occur, and the purpose of the AEMC's work is not to predict exactly how the market is likely to develop in the future.

Issues that could be examined by the annual reporting include:

- Whether the framework provides sufficient incentives for network businesses to make efficient planning, investment and pricing decisions in changing circumstances.
- Whether the framework allows and incentivises network businesses to adapt their business models to respond to changes in the market.
- Whether the framework is sufficiently flexible to enable the Australian Energy Regulator enough discretion to adapt its approach as necessary to respond to changing circumstances.

The 2016 Report – process and timeframe

As 2016 is the first year of the annual reporting, the AEMC will commence the 2016 monitoring and reporting process by publishing an approach paper and its preliminary views on risks affecting the effectiveness of the economic regulatory framework. This will be published by 1 December 2016 and the AEMC will be consulting with stakeholders on the proposed approach on monitoring, assessment framework, proposed indicators and information sources. The final report for 2016 will be published by 1 July 2017.

Background and rationale for monitoring

The production and consumption of electricity in Australia has changed significantly in recent years. Traditionally, the role of transmission and distribution networks was to transport electricity in one direction from large centralised power stations to consumers. Changes in technologies, consumer preferences and innovative business models and financing arrangements have meant that consumers are increasingly generating their own electricity. As a result, networks now have an important role in facilitating two-way flows of energy to and from consumers and integrating a range of new decentralised energy resources. This trend is likely to continue in the coming years with the uptake of new technologies such as battery storage.

In light of these changes, the COAG Energy Council directed officials to conduct a stress test of the electricity network economic framework to assess its ability to deliver the NEO under possible future scenarios.

The stress test was completed in 2015 and identified two scenarios that could present potential risks:

- **New consumer choices driving an evolution.** This scenario sees strong growth in new innovative alternative services such as off-grid and smart technologies. Such services are primarily met by third party service providers.
- **Energy generation move from centralised to localised.** This scenario sees strong growth in decentralised distribution supported by reliable storage displacing the traditional centralised supply model. Under this scenario, a significant proportion of customers could go 'off-grid'

The most critical risk identified by officials was the potential for an increased uptake of decentralised electricity supply options to lead to asset under-utilisation and/or stranding if network businesses do not take appropriate action to respond to these changes. Under the current structure of network prices (prior to the implementation of the AEMC's recent rule change on cost-reflective network prices), this scenario could lead to material increases in the price of electricity services for customers that remain connected to the grid.

While no major weaknesses in the current regulatory framework were identified, officials considered it important to monitor and assess early signs of the above scenarios eventuating and the regulatory framework not appropriately managing the issues.

The COAG Energy Council therefore tasked the AEMC to monitor and report annually on the status of market developments and the ability of the electricity network economic framework to continue to deliver the NEO in the event of an increase in decentralised supply options.

The standing Terms of Reference for this review can be found on the AEMC website.

For information contact:

AEMC Director, **Ed Chan** (02) 8296 7839
AEMC Adviser, **Rachel Armstrong** (02) 8296 7821

Media: Communication Manager, Prudence Anderson 0404 821 935 or (02) 8296 7817

8 September 2016