3 March 2023

Public Interest Advocacy Centre

Sebastian Roberts
Network Expenditure
Australian Energy Regulator

Submitted electronically

Dear Mr. Roberts,

PIAC submission to Review of incentives schemes for networks draft decision

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to respond the Review of incentives for networks draft decision (the Draft).

PIAC supports the intent to promote efficient investment in, operation, and use of networks in the long-term interest of consumers. However, we are disappointed the Draft does little to address fundamental issues with incentive schemes which have resulted in sector-wide over-compensation for average or below average performance and efficiency[1]. The key consideration of regulation is efficient investment and operation in the interests of consumers. As such, incentive schemes must focus on improving consumer outcomes rather than the relative performance of inputs such as expenditure.

We consider it inappropriate for incentive schemes to financially reward network service providers (NSPs) that have average or relatively low levels of total productivity or performance. Changes should be made to the rules regarding the overall impact of incentive schemes to tie these more closely with productivity benchmarking and integrate them with the overall efficiency performance of networks they intend to improve.

Forecast allowances can never be an accurate or reliable representation of the costs an NSP incurs during a regulatory control period, nor can such allowances be free of forecast error. We consider these fundamental issues which cannot be practically overcome. While the AER suggests the overall accuracy of their forecasts will improve over time as they gain a better understanding of how each NSP operates, NSPs continue to have a financial incentive to overstate their efficient costs and are rewarded regardless of the reason for the underspend.

1 See https://ieefa.org/resources/regulated-electricity-network-prices-are-higher-necessary

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We are concerned that existing arrangements obfuscate the source of Capital Expenditure Sharing Scheme (CESS) payments as it remains unclear whether payments reflect:

- genuine efficiency gains by network businesses that could not have been anticipated during the regulatory reset process;
- capital shifting between regulatory periods (deferrals);
- switching between expenditure types that results in lower ongoing costs for consumers (capex-opex swapping); and/or
- forecast error by the AER when determining the regulatory allowance it provides to network businesses for their capital expenditure.

It is unrealistic to expect the AER to establish the source of capex underspends given information asymmetries between it and NSPs. The onus should be on NSPs to prove that there has been a genuine overall efficiency gain. Until NSPs can provide such evidence to the satisfaction of the AER, the CESS should not apply at all.

The introduction of a tiered sharing ratio to the CESS does not address these issues and stands to derisk poor proposals by lowering the penalty that underperforming NSPs would incur if they over-spend their capex allowance. The AER states,

> the tiered rate proposed will reduce incentives for NSPs to overstate their expenditure requirements by reducing CESS payments (compared to the current CESS) when outperformance is high.

We disagree with the AER's assessment. The tiered rate incentivises NSPs to reduce the extent to which they overstate expenditure requirements, not the underlying incentive to over-forecast, which they continue to be rewarded for under the proposed change.

We do not consider the draft decision in the long-term interests of consumers and question the merit of retaining incentive schemes that are overly generous to networks and of little demonstrated benefit to consumers. This review should be an important opportunity to examine the role and performance of incentives in delivering better outcomes for consumers. PIAC encourage the AER to further consider more substantial responses to the issues identified by stakeholders in the course of this review.

PIAC welcomes the opportunity to discuss these matters further with the AER and other stakeholders.

Yours sincerely

Jan Kucic-Riker
Policy Officer, Energy and Water

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