6 December 2018

Dr Kerry Schott
Chair
Energy Security Board

By email: info@esb.org.au

Dear Kerry,

Re: Strategic Energy Plan consultation on proposed metrics

We have read with interest the recent consultation document on the proposed metrics for the Strategic Energy Plan (**SEP**). We welcome the development of a SEP to provide a clear strategic focus for the COAG Energy Council's work and to provide clarity and direction to market bodies and market participants. This will be a positive contribution to the current energy policy environment. We also support the development of metrics to measure progress against the SEP which will be reported in the Energy Security Board's (**ESB's**) annual Health of the *National Electricity Market Report.*

We are very focussed on maintaining an investment environment in the energy and regulated infrastructure sectors that supports an efficient and fair cost of capital to deliver network capital investments to consumers which are necessary to meet the service expectations (including security of supply and reliability) in the long-term interests of consumers, as well as improving affordability by reducing the cost of providing services valued by consumers.

Efficient long-term investment requires a stable and predictable policy and regulatory environment and an opportunity to earn a reasonable return on our investments. It is challenging to source the significant investment in energy networks required to not only to keep the lights on but also to facilitate an efficient transition to a reliable and secure low emission energy system at least cost, at a time when the regulatory, political and sovereign risks are at unprecedented levels and growing.

Therefore, we consider that strong independence and governance must be recognised as a key component in the plan. The role and importance of strong governance processes appears to have been de-valued in more recent policy processes and political interventions. As investors in long term energy assets, understanding the process and framework for making changes, and the role and powers of the decision makers, is critical to understanding the risks we face in these investments.

The Australian Energy Market Agreement (**AEMA**) established strong governance in the energy sector to support energy market reforms. The objectives of this agreement were to:

- strengthen the quality, timeliness and national character of governance of the energy markets to improve the climate for investment;
- streamline and improve the quality of economic regulation across energy markets to lower the cost and complexity of regulation facing investors, thereby enhancing regulatory certainty and lowering barriers to competition; and
- create a stable framework for efficient investment in new generation and transmission capacity.[1]

These objectives remain relevant today. This agreement promotes stability, transparency and supported independence of the energy institutions to prevent the longer-term interests of all consumers from being

[1] Commonwealth and state governments of Australia, *Amendments to the Australian Energy Market Agreement*, 9 December 2013, p.9.

Level 29, 225 George Street, Sydney NSW 2000 ABN 36 114 940 984
t +61 (0)2 9086 3600 f +61 (0)2 9086 3666 e info@sparkinfrastructure.com w www.sparkinfrastructure.com

put at risk by short term politics. We welcomed the COAG Energy Council's agreement to re-commit to this agreement as part of the Finkel recommendations. However, we have not observed adherence to the AEMA in practice. For example, the changes implemented to make the rate of return guideline binding changed the powers of energy institutions with the effect of considerably increasing the discretion of the AER whilst reducing its accountability (by removing limited merits review and subsequently narrowing judicial review rights).

We consider that the SEP can reinvigorate the commitment to the agreement by including metrics that require the strength and adherence to governance processes to be measured and monitored. We also consider that it is appropriate to include metrics for the accountability of the AER given the reduced access by stakeholders to judicial review on rate of return matters, and no review of the merits of its decisions. This might include measuring the confidence of stakeholders in the process, consultation effectiveness and independence of the AER as well as progress on the review of the AER's performance by a panel of experts agreed to by the COAG Energy Council (recommendation 4.4 of the Review of Governance Arrangements for Australian Energy Markets[2]):

> *"The AER should be reviewed every three to five years by a panel of experts appointed by the COAG Energy Council. The experts should be collectively experienced in regulation and have in-depth knowledge of all sides of relevant markets (consumers, industry and government).*"[3]

Indeed, measuring progress against COAG Energy Council agreements and outcomes once policy is implemented could be a key feature of the metrics included in the SEP. For example, the outcomes expected with the introduction of contestability in metering compared to those expected at the time the policy was implemented such as the timeliness and cost of metering services. This information is invaluable when considering future policy decisions and initiatives, particularly relating to the regulations and rules relating to new and innovative services provided by network service providers.

We would expect metrics to be outcome focussed, signal whether an outcome is beneficial or not, measure outcomes rather than inputs and to be consistent with the measures identified when the policy was implemented. They should also include measures of expected future impacts as well as current progress. This will improve accountability of policy makers to identify and track expected outcomes and ensure incentives are not distorted away from the original policy intent.

We have also identified the following metrics as relevant to assessing performance against the SEP objectives:

1. Do clear policy statements exist with identified objectives, expected outcomes and metrics that can be tracked over time and is a process in place to track the metrics?
2. Have governance frameworks and processes been adhered to, for example, has the decision maker been identified, is the process understood and transparent, has consultation been undertaken, are reasons for decisions identified and transparent?
3. How many times have Australian governments and regulators intervened without following expected governance processes (for example, as laid out in the Australian Energy Market Agreement) or relying on existing market mechanisms?
4. Have the changes to legislation, rules and regulation been supported by regulatory impact statements and cost benefit assessments?
5. Do changes in regulated rates of return reflect observed and material movements in market conditions?

[2] http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Review-of-Governance-Arrangements-Response-Table%20-%20January%202016.pdf

[3] Vertigan, Yarrow and Morton, Review of Governance Arrangements for Australian Energy Markets, Final Report, October 2015, p. 76.

6. Are appropriate review rights available to stakeholders to ensure accountability and quality of decisions and decision-making processes of regulators?
7. Are processes for independent review of energy institutions in place and undertaken regularly?
8. What is the extent and level of subsidies in the industry, and are the subsidies achieving the desired effect?
9. Is the contribution to costs, and movements in costs, across the energy supply chain transparent?
10. Are investments occurring at efficient levels as identified by regulators and planners, for example, are regulated network service providers delivering the level of efficient investment supported by the AER in determinations and identified by AEMO in the Integrated System Plan?
11. Is investment occurring in response to increases in market prices and in a timely manner?
12. Is wholesale trading prices, and price volatility, reducing?
13. What is the progress on the recommendations and activities agreed by COAG Energy Council agreements?
14. What are the expected long-term impacts on the consumers of the decisions made in relation to price, reliability, and security?

We also recommend revisiting the metrics that refer to affordability to ensure that these can be influenced appropriately by the energy sector and do not mask the impacts of subsidies or other elements of the economy that contribute to household income or other household expenses. This would diminish the power of the metrics to assess the performance of the energy sector and reduce accountability of other policy areas to achieving this shared goal.

Please do not hesitate to contact myself or Sally McMahon (Spark Infrastructure Economic Regulatory Adviser) to discuss further (phone 0421057821).

Yours sincerely,

Rick Francis
Managing Director & CEO
Spark Infrastructure

Level 29, 225 George Street, Sydney NSW 2000 ABN 36 114 940 984
t +61 (0)2 9086 3600 f +61 (0)2 9086 3666 e info@sparkinfrastructure.com w www.sparkinfrastructure.com