



AGL Energy Limited

T 02 9921 2999

agl.com.au

ABN: 74 115 061 375

Level 24, 200 George St

Sydney NSW 2000

Locked Bag 14120

MCMC

Melbourne VIC 8001

Australian Energy Market Commission
Level 15, 60 Castlereagh Street
Sydney NSW 2000

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Electricity Network Regulation Review — Package 2

AGL Energy welcomes the opportunity to comment on Package 2 of the Australian Energy Market Commission's Electricity Network Regulation Review.

Customers are powering Australia's energy transition. Households and businesses have invested billions of dollars in rooftop solar, batteries, electric vehicles and electrification, transforming the role consumers play in the energy system.

Increasingly, the lowest-cost solutions to network and system challenges will come not only from new infrastructure, but from the ability of customers to generate, store, shift and manage energy. The success of the next phase of the transition will depend on whether regulation enables these customer-led solutions to compete fairly with traditional network investment.

AGL's recommendations are directed toward a single objective: better customer outcomes. The guiding purpose for the AEMC's review must be to deliver lower costs, greater choice and more reliable outcomes for consumers by ensuring customer resources, competitive markets and network investments can compete on their merits.

Overview

AGL supports improvements to the electricity network regulation framework that deliver better outcomes for consumers through lower costs, greater choice, stronger competition and more efficient investment. As customers play an increasingly active role in the energy system, the framework should ensure network investment, customer resources and competitive services can compete on their merits to meet network and system needs at lowest cost while maintaining reliability.

AGL has four key positions.

- Consumers should be protected from inefficient network investment through stronger scrutiny and accountability for major projects. Claimed competition benefits should be independently substantiated, with proportionate accountability for networks where controllable errors or under-delivery leave consumers paying for benefits that are not realised.

- Customers should benefit from a technology-neutral and expenditure-neutral framework that gives network and non-network solutions a fair opportunity to compete. The AEMC should develop and consult on a broad UK-style TOTEX model to improve expenditure neutrality and reduce the current preference for capital investment. This should be supported by consistent assessment of network and non-network risks and early market testing, so the lowest-cost reliable solution has a genuine opportunity to compete.
- Consumers should not bear risks that networks or competitive providers are better placed to manage. Risk should be allocated to the party best able to control or mitigate it, with each party remaining accountable for its decisions. Consumers should not bear the cost of contestable investments that competitive providers would undertake at their own risk, or of network under-delivery arising from matters within the network's reasonable control.
- Economic regulation should preserve competition and support independent, evidence-based decision-making. As networks increasingly interact with competitive markets and customer-led energy services, the AER Board should maintain an appropriate mix of regulatory, consumer and competition expertise. AGL recommends requiring at least two members to have substantial experience in competition law, competition policy or the economic assessment of competition and market power because current statutory appointment requirements do not specifically require that expertise.

Revenue determination process

Process improvements should not come at the expense of expenditure scrutiny

AGL supports practical improvements that reduce unnecessary time and cost in the revenue determination process. However, a faster process should not mean less rigorous assessment of whether proposed expenditure is prudent and efficient. The AER must retain sufficient time and information to test network forecasts, assess whether lower-cost non-network options are available, and allow consumers and other stakeholders to challenge proposals. Where the AER relies on external advisers, it should require transparent conflict-of-interest declarations and safeguards addressing current or recent commercial relationships with regulated businesses. The costs of the determination process are small relative to the long-term costs consumers may bear if inefficient expenditure is approved. Process reform should therefore preserve the scrutiny needed to identify the lowest-cost option that can reliably deliver the required service and ensure consumers do not fund inefficient expenditure.

Network investment benefits must be subject to greater scrutiny

Cost and benefit forecasts for major network investment, particularly new transmission, have not always provided a sufficiently reliable basis for approval. Cost forecasts have often proved too low, while forecast benefits have been overstated or insufficiently linked to the investment. Because consumers fund these assets over

several decades, weaknesses in the supporting analysis can create material and persistent costs.

The AEMC should require consistent and transparent cost and benefit forecasts, including disclosure of material assumptions, sensitivities and the link between each claimed benefit and the proposed investment. Forecasts should assess credible network, non-network and competitive alternatives on a comparable basis. Consequences should apply where materially inaccurate information results from deficiencies in analysis, modelling or disclosure that the network could reasonably have avoided. These consequences are detailed below.

Project EnergyConnect illustrates the importance of these requirements. It is not clear whether loop flow conditions were properly accounted for in the forecast benefits. Those conditions should have been properly modelled and transparently reflected in the benefits assessment. However, the inadequacy of the published assessment means stakeholders cannot determine whether this occurred or how materially it affected the forecast benefits.

HumeLink illustrates the risk of allowing claimed competition benefits to determine whether a major network investment passes a cost-benefit assessment. Its 2021 RIT-T identified approximately \$491 million in net benefits, compared with only \$39 million excluding competition benefits. This means approximately \$452 million of the result depended on those claims. While ACCC and AER reports at the time found wholesale markets were concentrated, neither found concerning or sustained exercises of market power or concluded that competition was ineffective. The assessment therefore lacked a sufficiently clear evidentiary basis for competition benefits of that scale.

Claims that an investment will improve competition should be supported by independent analysis identifying the material competition problem and explaining how, and to what extent, the investment would address it. Increasing the number or diversity of participants should not, by itself, be treated as an increase in effective competition. The AEMC should amend the National Electricity Rules to require this analysis before competition benefits can be relied on to justify regulated network investment.

Approval-stage scrutiny should be complemented by accountability after delivery. The 2022 *AEMC Material change in network infrastructure project costs rule*, made following a joint request by AGL and other proponents, requires reconsideration of whether the preferred option remains the most net-beneficial after a material change following completion of the RIT. An enhanced ex post review framework would extend the same discipline to actual project delivery and realised benefits.

Major projects should be subject to published ex post benefits-realisation reviews comparing actual costs, delivery timing, capability and realised benefits with the forecasts used for approval. Reviews should cover the formal regulatory investment

test and material claims made outside it and explain material variances, so lessons inform future investment decisions.

Government policy, market conditions and climate may affect benefits in ways networks cannot control. However, where benefits are not realised because of late delivery, reduced capability, deficient modelling or departures from network assumptions, the network should bear a share of the resulting cost. For a material benefits shortfall attributable to the network, the AER should be able to reduce future regulated revenue by a proportionate amount under a predefined sharing mechanism. This would strengthen forecasting discipline without making networks bear risks they could not reasonably manage.

Retailers should have a greater role in revenue determinations

AGL supports retailers playing a more prominent role in representing consumer preferences in revenue determinations. Retailers have direct customer relationships and experience translating network costs and service outcomes into customer value propositions. They are therefore well placed to provide evidence on affordability, customer preferences, emerging energy needs, likely behavioural responses to changes in prices, tariffs and services, and the practical effects of network proposals on different customer groups. Retailer participation should complement consumer advocacy and the AER's independent assessment, while helping ensure network expenditure reflects outcomes customers value and are willing to fund.

Incentive arrangements

The AEMC should develop a broad UK-style TOTEX model for Australia

AGL considers that the current framework increases costs for consumers by favouring capital investment over lower-cost operating expenditure and non-network solutions. The limited uptake of non-network options provides practical evidence of this problem. Only one successful non-network option has been accepted through the RIT-D since it was introduced in 2013.

At the transmission level, the scale of synchronous-condenser investment provides further evidence of the framework's preference for regulated assets. By mid-2025, final transmission investment assessments in Queensland, NSW and Victoria had selected preferred solutions that, taken together, involved 32 synchronous condensers by 2035. Transgrid subsequently reduced the requirement on its network from ten to eight large-unit equivalents after anticipated costs increased by more than 30 per cent, delivery timeframes lengthened and forecast coal-retirement dates changed. The resulting expansion of the role for non-network solutions illustrates the importance of testing network and non-network options on an equivalent basis and retaining flexibility before committing consumers to long-lived regulated assets. Networks should bear avoidable costs arising from changed or cancelled procurement commitments where those costs result from matters within their reasonable control, rather than automatically passing them through to consumers.

The way a network need is defined can favour capital investment before alternative solutions are properly considered. For example, uncertain future demand may be framed as a need for additional network capacity, leading to early commitment to a long-lived asset rather than testing whether the need could be deferred or met through a flexible non-network solution. This can prevent network and non-network options from competing on an equivalent basis and leave consumers paying for higher-cost, underused or stranded assets.

The AEMC should develop and consult on a broad UK-style TOTEX model for Australia to reduce the current preference for capital investment. The objective should be expenditure neutrality rather than TOTEX as an end in itself. A well-designed model would combine expenditure allowances and apply a predetermined capitalisation rate, making cost recovery less dependent on whether expenditure is classified as capex or opex. This could place owned assets, operating expenditure, contracted flexibility and third-party services on a more comparable footing and reduce the additional incentive to favour capex where the allowed rate of return exceeds the return required by an efficient benchmark business. It would not remove the need to set the allowed rate of return efficiently or maintain strong expenditure scrutiny. The model should help networks choose the lowest-cost option capable of reliably meeting each network or system need.

A TOTEX model would improve expenditure neutrality, but it would not by itself ensure that network and non-network options compete fairly. Network and non-network risks must also be assessed consistently. Contracted services may involve counterparty, participation and performance risks, while owned assets create construction, delivery, underutilisation and stranding risks. Unlike long-lived network assets, opex-based and contracted solutions can often be scaled, varied or discontinued as needs change and better information becomes available. This flexibility has option value because it reduces the risk that consumers are locked into underused or stranded assets where forecast demand does not materialise. Efficient contracts may also require certainty beyond one five-year control period, provided recovery remains conditional on service delivery and effective contract management.

At the distribution level, batteries, electric vehicles and controlled-load hot water can provide flexibility where clear signals and rewards are available, particularly when retailers or aggregators orchestrate large numbers of customer resources as a portfolio. However, much of the potential flexibility of customer energy resources remains underused, limiting their ability to compete with conventional network investment. Giving these options a genuine opportunity to compete can lower network costs and allow customers to share in the value of their flexibility.

The AEMC should also require networks to test the market before committing to material investment. Retailers, aggregators and other providers should have timely access to usable information on network needs, capacity, constraints and relevant operating requirements, as well as a genuine opportunity to propose customer-led

flexibility, storage or other non-network solutions before the preferred option is substantially developed. These reforms should be prioritised over further targeted incentives that leave the underlying expenditure bias in place.

Interoperability should support customer choice, competition and innovation

Customer Energy Resources (CER) can only compete effectively with traditional network investment if customers are able to participate through consistent and interoperable market arrangements. As customers invest in solar, batteries, electric vehicles and flexible demand, interoperability will become increasingly important to ensuring those investments can deliver value across retail, wholesale and network services.

The objective for interoperability is to support customer choice, competition and innovation while reducing unnecessary barriers to participation. Interoperability is a key enabler, not the goal itself. Regulatory frameworks should establish a minimum set of consistent requirements to enable customers, CER, retailers, aggregators and networks to work together effectively, without prescribing a single technology pathway, communications architecture or business model. Competition and innovation are more likely to emerge from open and flexible frameworks than from highly prescriptive approaches.

National consistency in data exchange, flexibility service arrangements and customer participation can reduce costs and improve scalability. Equally important is ensuring customers remain free to choose how their assets participate in the energy system and that retailers and aggregators can continue to act as the primary customer interface, helping customers access multiple value streams from their investments.

As flexibility markets and Distribution System Operator (DSO) capabilities develop, interoperability and competitive neutrality should be treated as foundational design principles. Reforms should support open, non-discriminatory participation and ensure that customer resources can compete fairly with traditional network solutions while preserving innovation and consumer choice.

DSO costs should be recovered through normal arrangements, not incentives

Efficient costs incurred by DNSPs in performing defined DSO obligations should be assessed and recovered through the normal regulatory framework. The formal assignment of DSO responsibilities does not, by itself, justify an additional incentive payment. Paying networks to perform functions for which they already receive efficient cost recovery risks consumers paying once through the expenditure allowance and again through the incentive.

Defined DSO obligations should be funded through the ordinary regulatory framework. A separate incentive should only be considered after those obligations are settled and if evidence shows that efficient flexibility, active network management or non-network solutions would otherwise be underprovided. Any incentive should

apply only to measurable outcomes substantially within the DNSP's control and should include both rewards and penalties, so consumers do not fund additional payments without corresponding accountability for poor performance.

DSO obligations should also require DNSPs to enable retailers, aggregators and other service providers to offer competitive flexibility responses, rather than encourage DNSPs to deliver those services themselves. This should include timely access to usable capacity and constraint information, operational data exchange, interoperable processes and non-discriminatory access arrangements. These obligations would preserve competitive pressure and help ensure consumers receive efficient and innovative flexibility services without unnecessary regulated investment.

Network utilisation is a useful indicator, not an appropriate incentive measure

AGL does not support a dedicated incentive for network utilisation. Utilisation can indicate network efficiency, but it is not a consumer outcome and remains an imperfect proxy for whether services are delivered at lowest cost. International experience provides limited evidence of material consumer benefits. Efficient service delivery and lower network expenditure should remain the objectives.

AGL supports broader utilisation reporting beyond maximum demand relative to maximum capacity, including more granular data below the zone-substation level where practical. Better reporting could identify spare capacity, local constraints, two-way flows and changes over time. This would allow proposed investment to be tested against existing network capacity and help distinguish genuine local constraints from broader demand forecasts that may overstate the need for new assets. It would also make essential data available to support competitive flexibility markets that use spare capacity where this lowers total system costs. Network pricing and competitive flexibility responses are more direct mechanisms for improving utilisation than an additional payment to networks.

If the AEMC nevertheless considers an incentive is needed, it should proceed only after other reforms are implemented and there is clear evidence that another mechanism is needed. The metric should focus on increased use of uncongested capacity because rewarding higher peak utilisation could drive unnecessary investment. Any incentive should be symmetrical, linked to lower expenditure or improved service, and limited to outcomes the network can materially influence.

Innovation incentives are not required for networks

AGL does not support a dedicated innovation incentive for TNSPs or DNSPs. Existing performance and expenditure incentives should remain the primary drivers of network innovation. Competitive providers are better placed to test new technologies and services because they bear the costs of failure and must win customers through price, service and performance. This review should therefore focus on removing barriers to competitive non-network solutions rather than creating a regulated payment for innovation.

Risk allocation and compensation

Consumers should not bear risks that others are better placed to manage

AGL agrees that increasing uncertainty creates additional risks and opportunities to improve how the regulatory framework allocates them. Risks should be allocated to the party best able to control or mitigate them, while ensuring each party remains accountable for the consequences of its decisions. This should reduce the total cost of risk ultimately borne by consumers.

Network participation in contestable markets unnecessarily exposes consumers to investment risk. Ring-fencing waivers, network-owned batteries and similar arrangements can allow networks to recover the cost of failed or underused investments from consumers, while competitive providers bear those costs themselves. Contestable services should therefore be supplied competitively, with regulated network ownership permitted only where a clear market failure has been demonstrated.

Consumers also bear too much risk when network investment is approved using inaccurate cost and benefit forecasts. Networks should bear more of this risk where errors or under-delivery are within their reasonable control. As proposed above, ex post benefits-realisation reviews and proportionate revenue adjustments should provide that accountability.

Intra-period adjustments should remain targeted exceptions. Pass-throughs, contingent projects and reopeners transfer forecasting and delivery risks to consumers. Additional recovery should be limited to risks that could not reasonably have been anticipated, controlled or managed, with transparent processes and stakeholder scrutiny.

Anticipatory investment must not increase the risk of network overinvestment

AGL supports reforms that enable efficient anticipatory investment while guarding against network overinvestment. Investing too late can increase costs or reduce reliability, while investing too early can leave consumers paying for underused or stranded assets. Anticipatory investment should therefore require measurable consumer benefits, transparent evidence and an evidentiary threshold proportionate to the investment's size, uncertainty and irreversibility.

Assessments should compare credible non-network options and favour staged or modular investment where feasible. Flexibility has value because it allows a solution to be deferred, expanded, reduced or replaced as better information becomes available. Limited early works or procurement of long-lead-time equipment should be assessed separately from commitment to the full project and approved only where they preserve options or materially reduce delivery risk.

Differentiated rates of return require evidence of materially different systematic risk

AGL is open to differentiated rate of return arrangements for TNSPs and DNSPs if their systematic risk profiles materially and persistently diverge. Differences in operational roles, project scale or delivery complexity are not sufficient on their own because these may be business or project specific risks better managed through expenditure allowances, contingent projects, pass-throughs or other targeted mechanisms. Any change to the RoRI should be supported by evidence that the relevant risk is non-diversifiable, affects the return required by investors and differs materially between transmission and distribution businesses. The burden should be on proponents of differentiated returns to demonstrate that any increased risk is systematic and not already compensated through the broader regulatory framework. Otherwise, differentiated returns could increase consumer costs without improving efficient investment.

AER governance

The AEMC does not determine the AER's governance arrangements. However, Board capability affects how matters considered in this review are administered in practice. The AEMC should identify any governance implications arising from the review and refer them to Energy Ministers for consideration.

At least two AER Board members should have substantial competition experience

Competition expertise will become increasingly important as network regulation interacts more closely with competitive markets and customer-led energy services. Networks increasingly seek to provide services that may also be supplied by generators, retailers, aggregators, storage providers and other competitive businesses. However, current statutory appointment requirements do not specifically require competition expertise on the AER Board. The AER Board would therefore benefit from substantial expertise in competition law, competition policy and the economic assessment of competition and market power.

This expertise would strengthen decisions on ring-fencing waivers, cost allocation, network participation in contestable markets, wholesale market conduct and whether competitive alternatives can efficiently meet an identified network need. It would help the AER distinguish legitimate monopoly functions from services that should be provided competitively, reducing the risk that regulated investment displaces lower-cost competitive solutions or transfers risks to consumers that market participants would otherwise bear. AGL considers that at least two of the five AER Board members should have substantial experience in competition law, competition policy or the economic assessment of competition and market power. Requiring two members would provide continuity and depth across the Board's work, support informed challenge and avoid reliance on a single member for competition-related judgments.

Conclusion

Customers are not spectators in the energy transition: they are its purpose and a driving force. Households and businesses are investing their own money in solar, batteries, electric vehicles, electrification and flexibility, creating new opportunities to lower costs and improve the performance of the energy system.

The purpose of economic regulation has not changed: it exists to protect consumers where monopoly services are required and to preserve competition where competitive markets can deliver better outcomes. As customer participation grows, these objectives become even more important.

The challenge for this Review is not simply how to regulate network businesses, but how to ensure regulation continues to protect consumers, preserve competition and allow customer-led solutions to compete fairly with traditional network investment.

The future framework must reward the solutions that deliver the greatest value to consumers.

For any questions about this submission, please contact Anton King at aking6@agl.com.au.

Yours sincerely,

Ralph Griffiths
General Manager
Policy & Market Regulation