



OCTOBER 2013

DELIVERING THE RELIABILITY
THAT **CUSTOMERS CHOOSE**

Options to reform network reliability



OPTIONS FOR REFORM OF DISTRIBUTION NETWORK RELIABILITY

Key features	AEMC separate reliability process	Alternative integrated reliability process
Independent regulator approves reliability targets	✓	✓
Investment based on customer value of reliability	✓	✓
Reserve role for jurisdictions to require additional targets (eg. high-impact, low probability events & worst performing feeders)	✓	✓
Distribution networks responsible for customer relationship. Customer engagement is timely and in an integrated, not fragmented, manner.	x	✓
Maximises benefits to customers.	x	✓
Distribution businesses incentivised to improve reliability performance at efficient cost.	x	✓
Best practice, integrated decision making on reliability and cost trade offs.	x	✓

For further information, and ENA's submission to the AEMC Consultation Paper, 9 August 2013, visit the ENA website at www.ena.asn.au

RELIABILITY OUTCOMES THAT DELIVER FOR CUSTOMERS

Australia's electricity network businesses support reform of the regulatory framework for electricity network reliability performance.

Together transmission and distribution networks support a national framework which ensures that:

- » reliability spending occurs efficiently to provide the service that customers value, with customers engaged in a meaningful and timely manner;
- » there is independent oversight of the way reliability targets are set while maintaining a continuing customer relationship with the distribution network businesses;
- » the framework provides the flexibility and incentives for distribution networks to innovate to improve customer outcomes.

Australian governments have previously agreed that reform is needed to ensure that in the future customers can be confident that spending on electricity distribution network reliability reflects their willingness to pay. Energy Ministers have tasked the Australian Energy Market Commission (AEMC) with developing a national reliability framework and methodology. A consultation paper and a final report on electricity distribution network reliability have been published and a final report on transmission reliability is expected to be released in early November 2013.

In December 2013, Energy Ministers were to report to the Standing Council on Energy and Resources (SCER) on their willingness to transfer responsibility for the proposed new national reliability framework to the Australian Energy Regulator (AER).¹ Recently, the AEMC has proposed that SCER proceed through an interim stage prior to consideration and full implementation of the reform of network reliability.²

Networks see value in the work to be undertaken in the interim stage, both in its potential to improve existing arrangements and in contributing to the future reform of network reliability. ENA welcomes the opportunity for industry to contribute to the development of nationally consistent definitions for network reliability.

In addition, in the interim stage the AER would be given responsibility for estimating the value of customer reliability. This is an opportunity for SCER to consider the proper resourcing of the measurement of the value of customer reliability (VCR), given the importance of VCRs in a national reliability framework based on the choices of customers about reliability and cost.

The AER should be sufficiently resourced and able to call on expertise in non-market valuation methods to ensure that VCR measures are robust over time and sufficiently granular to reflect the range of customer experiences.

OPTIONS FOR REFORM OF NETWORK RELIABILITY

The starting point for reform of network reliability is consensus that there should be greater consideration of the value placed on reliability by customers, and that investment should be more efficient. Investment in reliability is efficient when the costs of network reliability investment are less than the benefits, as valued by customers.

The ENA supports some aspects of the AEMC's proposed reform of network reliability. In particular we support the AEMC's proposed framework for transmission networks and for sub-transmission assets within a distribution network.³ Where the AEMC and the ENA differ is on the proposed reform of distribution network reliability.

The AEMC proposes a separated process for setting reliability targets for distribution networks in advance of investment. The AEMC's process is built on multiple agencies undertaking activities which need to be aligned. Customer engagement is also fragmented as customers are consulted a number of times, by multiple agencies, on their reliability and cost trade-offs at different stages of the process. This process is represented in Figure 1 in this document.

The ENA proposes a simpler alternative process which is in line with international best practice and integrates the setting of reliability targets with the revenue determination process under the independent AER. State Government jurisdictions could continue to have a role, if they choose, in setting additional targets beyond those approved by the independent regulator, but cost implications and merits of those targets would be made explicit for customers in integrated regulatory consultation. The simpler alternative process is represented in Figure 2 of this document.

This document has been prepared by the ENA to engage customers, policy makers and other stakeholders on the options for network reliability reform. The ENA supports national reforms which provide for effective customer engagement and the transparent and independent oversight of distribution reliability targets through an integrated regulatory process. The current proposal would not be in the best interest of customers because the reliability performance of electricity distribution networks is too important to customers for targets to be set in isolation from other regulatory consultation on network expenditure.

1 Standing Council on Energy and Resources, "Electricity, Putting Consumers First", December 2012

2 AEMC, Final Report, Review of the national framework for distribution reliability, p. v

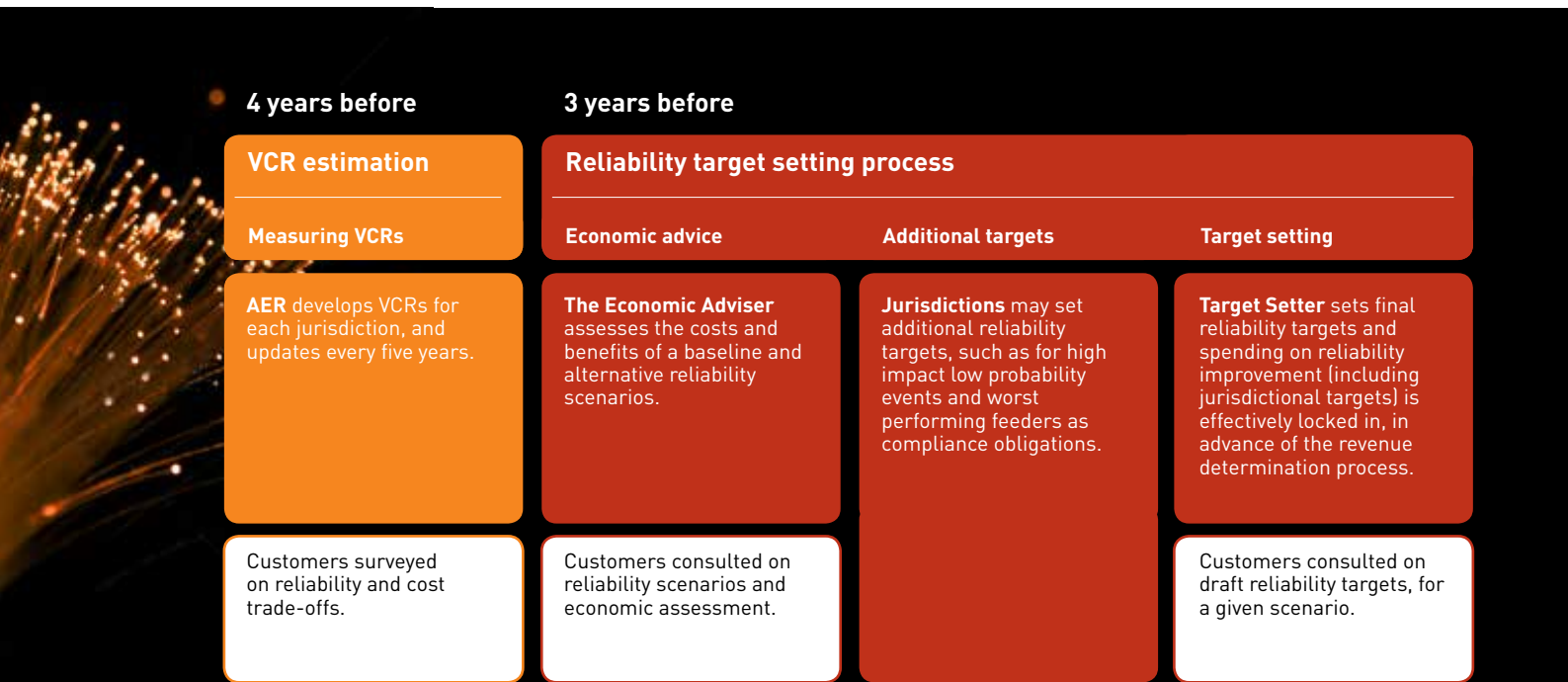
3 The ENA, together with Grid Australia, has argued for a differentiated approach to transmission and distribution network reliability. ENA and Grid Australia support the AEMC's approach for transmission networks. See ENA's submission to the AEMC review process at <http://www.ena.asn.au/publications/submissions-and-letters/>.

THE AEMC MODEL : A SEPARATE RELIABILITY PROCESS

To achieve independent oversight of reliability targets which drive investment, the AEMC process creates a separate Target Setter, informed by an Economic Advisor. Every five years, multiple actors such as the AER, the Target Setter, the Economic Advisor and Jurisdictions would all assess similar issues relating to the 'trade off' between reliability performance and cost outcomes as perceived by customers.

An unclear, fragmented process for customer engagement would result in these multiple parties interacting with customers in multiple processes about similar issues. This has the potential to be a more frustrating environment for customers seeking meaningful engagement.

FIGURE 1 THE AEMC MODEL : A SEPARATED RELIABILITY PROCESS



ISSUES

VCR measurement across the NEM is at an early stage of development and potentially could produce volatile outcomes driving real swings in reliability spending.

It is not clear how compliance obligations created by jurisdictions would be made transparent to consumers, along with information on the effect on network pricing.

Australia's annual spending on distribution reliability improvement is expected to be small for the foreseeable future (less than 5% of total capital spending). However, the AEMC process would see the assessment of reliability service and expenditure disconnected from the economic regulation process which governs 95% of network expenditure.

The Target Setter would in effect "lock in" the investment spending required in advance of the regulatory determination process. Under the AEMC approach a new national reliability target setting process would need to be designed in detail, developed and tested for support with all jurisdictions. As the AEMC has recognised in recommending an interim stage for consideration by SCER, it could be some years before a national framework for distribution network reliability could be agreed by jurisdictions and implemented.

2 years before

Regulatory determination process

Framework & approach	Regulatory proposal	Final determination
<p>AER publishes framework and approach for guidance on the determination of revenue and prices for the next regulatory period.</p>	<p>Distribution networks submit expenditure proposals to the AER including reliability improvement spending already locked in with target setter.</p>	<p>AER makes final determination of allowed revenue including revenue for meeting reliability targets.</p>
<p>Stakeholders consulted on framework and approach, <u>except reliability targets</u>.</p>	<p>Networks consult with customers on all aspects of regulatory proposals <u>except spending on reliability improvement</u></p>	<p>Stakeholders consulted on final determination.</p>

FIVE YEAR REGULATORY CONTROL PERIOD COMMENCES

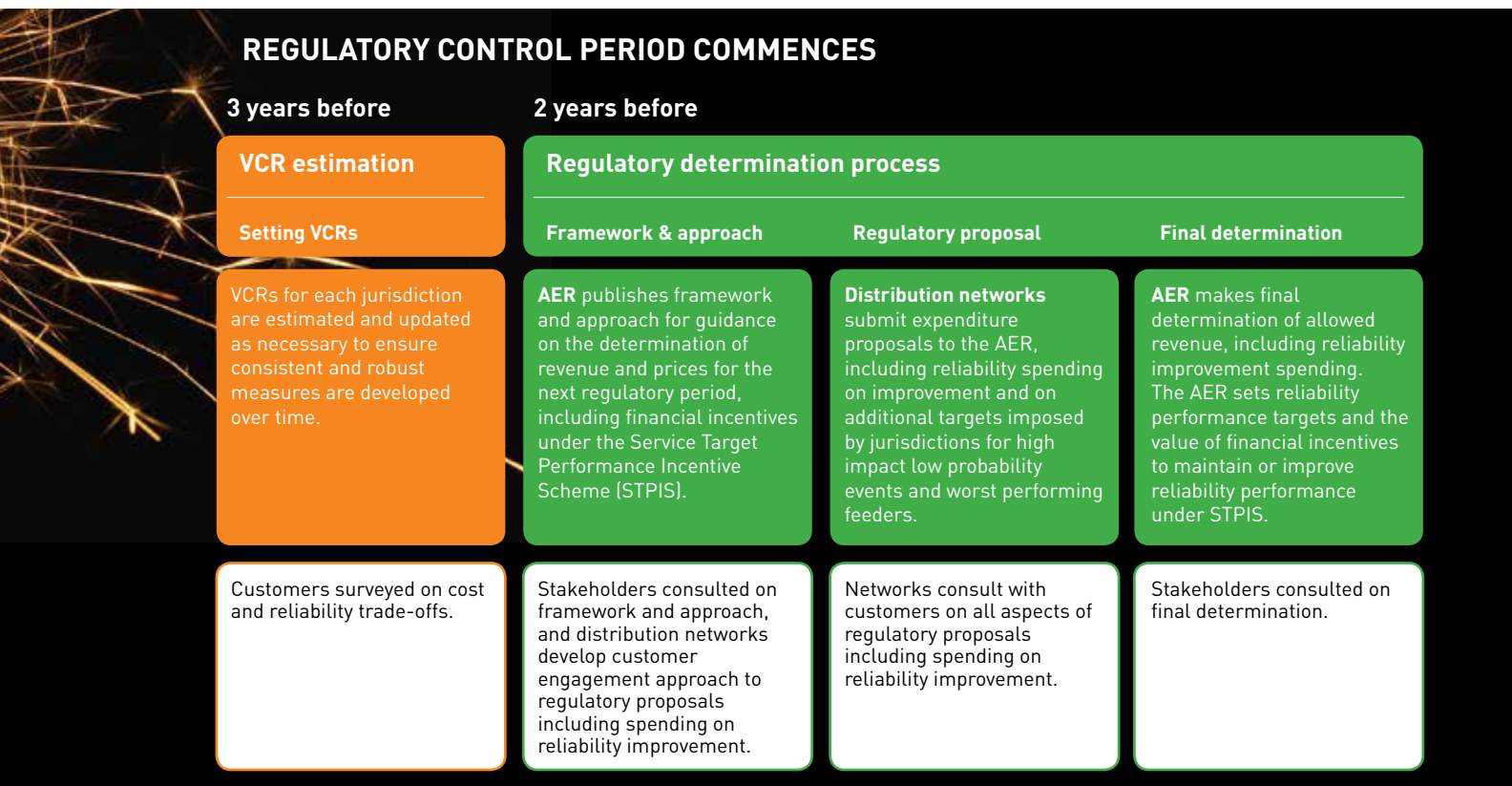
It is unclear how the AER could continue to administer STPIS as an incentive mechanism under the AEMC process.

A SIMPLER ALTERNATIVE : AN INTEGRATED RELIABILITY FRAMEWORK

Under an integrated reliability framework the AER, as the independent regulator, would approve reliability performance targets and assess the efficiency of proposed spending on reliability in an integrated way in the regulatory determination process.

Jurisdictions could set additional targets as compliance obligations, to be taken into account by the AER in the regulatory determination process. This could include targets for areas of high economic importance or service requirements for customers in worst performing feeder areas.

FIGURE 2 INTEGRATED NATIONAL DISTRIBUTION RELIABILITY FRAMEWORK



ISSUES

ENA supports the AER's view that "Given the increased significance of the VCR in the proposed framework, it is also important that the arrangements for determining the VCR are robust. The arrangements should support a cycle of continuous improvement in VCR estimation."

The customer engagement framework for regulatory proposals must include consideration of reliability performance and proposed jurisdiction compliance obligations. Customer engagement (in line with AER draft guideline) will be timely, explain the role of consumers in the engagement process, and be clear and meaningful on the reliability issues.

Regulatory proposals include an integrated and transparent assessment of the cost and reliability trade offs for customers. Customers can consider reliability spending in the context of all cost drivers when providing their feedback on the regulatory proposal.

The contribution of financial incentives to encourage an efficient level of reliability outcomes over time, is a key outcome of the regulatory determination process.

However, under the national reliability framework jurisdictions would be required to make explicit the justification for these additional targets including the economic costs and benefits and the effect on pricing for network customers.

The AER would continue to set financial performance incentives which currently encourage distribution network businesses to improve reliability performance efficiently. Under this approach, distribution networks achieve more efficient reliability outcomes over time as they are rewarded or penalised by the amount that customers value the changes in reliability.

Customers benefit by receiving improved reliability where they are willing to pay for it - or through lower prices if reliability performance falls.

The current financial incentive scheme (the Service Target Performance Incentive Scheme or STPIS) has been in place since 2008, and currently covers the majority of distribution networks (and will apply to the remaining two jurisdictions - NSW and ACT - from 2014). The AER has proposed to undertake a review of the effectiveness of STPIS in the next twelve months. The outcomes of this review could be beneficial to customers through the further development and potential modification of STPIS, as part of a national reliability framework.

FIVE YEAR REGULATORY CONTROL PERIOD COMMENCES

Annual assessment

Reliability performance

Incentive payments

Distribution networks are rewarded financially for meeting reliability targets and financially penalised for a failure to meet targets.

ISSUES

STPIS is designed to encourage distribution networks to improve reliability performance where customers are willing to pay for these improvements.

The AER benchmarks reliability performance annually and approves incentive payments (or penalties) under STPIS that are subsequently reflected in annual network tariff proposals (with a 6 to 12 month lag).



LIMITATIONS OF THE AEMC APPROACH

The benefits and costs of the AEMC's separate reliability framework and the simpler alternative of an integrated reliability framework need to be assessed against the National Electricity Objective.

It is ENA's view that there are four fundamental limitations with the AEMC's approach.

- 1. Customer engagement hasn't been considered holistically.** Multiple consultation by different bodies about the same reliability/cost trade offs does not achieve a better for customers than integrated consultation in a regulatory determination process. In effect under the AEMC approach customers would be consulted on reliability, but not in the context of total network spending and reliability trade-offs. This undermines the electricity distribution networks' direct customer relationship at a time when policy makers argue there needs to be a cultural change to a greater customer focus.
- 2. The model relies on producing new targets for every feeder every five years which is overly prescriptive and costly** given most network businesses report being in 'maintenance mode' for projected reliability spending. Annual spending on reliability improvement (and achieving security standards) in electricity distribution networks is falling and currently is less than 5% of total expenditure.
- 3. The marginal cost of delivering reliability outcomes is likely to be higher under the AEMC approach** as tried and tested network costs are more readily independently validated in the economic assessment process. Under the alternative approach, distribution networks will seek out innovative, less expensive solutions to maintaining or improving reliability performance and recover costs through financial incentive payments.

- 4. The AEMC's separate approach is inconsistent with international best practice.** In line with international best practice, the national framework for electricity distribution network reliability should integrate decision making on price and reliability holistically within the regulatory determination process.

ENA recommends best practice national reliability framework

The ENA proposes that Energy Ministers consider an **incentives** based national framework for reliability that is **integrated** with the revenue determination process under the **independent** AER. This is consistent with international best practice and is more efficient, effective and of greater benefit to consumers than the separate regulatory process proposed by the AEMC.

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