



Mr Neil Howes
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Australian Energy Market Commission
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Dear Mr Howes

NATIONAL ELECTRICITY AMENDMENT (NETWORK SERVICE PROVIDER EXPENDITURE OBJECTIVES) RULE 2013 – CONSULTATION PAPER

Thank you for the opportunity to comment on the *National Electricity Amendment (Network Service Provider Expenditure Objectives) Rule 2013 – Consultation Paper (Consultation Paper)*

CitiPower and Powercor Australia (**Businesses**) consider that there are likely to be practical difficulties if the Australian Energy Market Commission (**AEMC**) implements the proposed rule change relating to the Network Service Provider (**NSP**) Expenditure Objective.

The Rule Change Proposal has the potential to detrimentally impact on distribution network service providers (**DNSPs**). The Rule Change Proposal removes all discretion on the part of the Australian Energy Regulator (**AER**) to approve expenditure providing for reliability in excess of the jurisdictional standards, even where the AER considers that expenditure to be prudent and efficient and allowing the expenditure would promote the National Electricity Objective. For example, the AER would have no scope to allow expenditure pursuant to planning standards such as the Victorian probabilistic planning standard that would increase reliability above jurisdictional standards.

In addition, DNSPs would have limited scope to respond to consumer preferences, contrary to the recently introduced consumer consultation expenditure factor.

One of the matters to which the AER must have regard in deciding whether or not it is satisfied that expenditure reasonably reflects the expenditure criteria is "the extent to which the ... expenditure forecast includes expenditure to address the concerns of electricity consumers as identified by the Distribution Network Service Provider in

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the course of its engagement with electricity consumers" (clauses 6.5.6(e)(5A) and 6.5.7(e)(5A)). The AEMC introduced this factor to allow the AER to have regard to the extent to which DNSPs have considered consumer preferences.

The potential scope of operation of the new factor would be significantly reduced in the event the AEMC amended the NER in accordance with the Rules Change Proposal. The factor would be limited to operating in respect of matters other than reliability (as well as, to the extent the other standards and duties are affected by a rule change, those standards and duties). This would arguably frustrate the AEMC's intent in introducing the new factor.

Application in Victoria

The AEMC queries whether a different approach is required in Victoria, given the Victorian Government has allowed Victorian DNSPs to set their own reliability standards and reliability standards for planning are based on an economic assessment approach rather than a deterministic approach.¹

Given that the Victorian DNSPs' obligation is only one to use "best endeavours", the issue becomes as to what is the "amount ... required to comply with that *regulatory obligation or requirement*" for the purposes of the proposed limitation on reliability related expenditure allowances? Further uncertainty arises in this regard. The risk to Victorian DNSPs is that the AER will consider that a "best endeavours" obligation does not require the same level of expenditure as a mandatory standard in order for a DNSP to be compliant.

It is unclear whether the Consultation Paper recognises that the Victorian DNSPs are also required to use "best endeavours" to meet targets required by the distribution determination (i.e. the STPIS targets, which targets are set by the AER). Regardless, the same issues as outlined in relation to reliability standards published by the DNSP arise.

There is a further issue the Consultation Paper does not appear to recognise, which is that, in addition to being required to comply with the targets published by them and required by the distribution determination, the Victorian DNSPs are required to "otherwise meet reasonable customer expectations of reliability of supply".² This obligation would require the AER to form a view as to customer expectations of reliability of supply, which is not conducive to a straight forward application of the targets set for the purposes of the AER's STPIS or other reliability targets. Rather, the requirement would appear to require Victorian DNSPs (and the AER) to have an understanding of customer expectations and adjust the level of the reliability of supply accordingly. This does not sit easily with the Rule Change Proposal and is not clear whether the Rule Change Proposal would allow the AER to provide for the recovery of the costs associated with this obligation.

¹ Consultation Paper, pp10-11.

² It is not clear on the drafting of the Distribution Code whether the obligation to "otherwise meet reasonable customer expectations of reliability of supply" is a mandatory or "best endeavours" obligation. Regardless of the correct interpretation, the same comments can be made.

Treatment of safety, security and quality of supply

Regarding the scope of the rule change, the AEMC indicates that:³

"it would seem practical to give more weight and clarity to security and quality of supply standards in the NER as these measures appear to be closely related to reliability, and there appears to be clear definitions, understanding and obligations for them".

By contrast, the AEMC states:⁴

"There is also a question as to whether safety should be included in principle, ie whether it is appropriate that the NER provides for expenditure to only meet standards with respect to safety, which could be less than the expenditure required to maintain the existing levels of safety. This could be interpreted as a lowering of safety standards. For these reasons, it may appear inappropriate to treat safety in the same manner as the other aspects of performance."

The AEMC queries the extent to which it would be practical to give more weight and clarity in the NER to standards relating to quality, security and safety and whether there is any reason in principle as to why safety should be treated differently to reliability. However, the AEMC goes on to set out an alternative rule change in the Consultation Paper as follows:⁵

"An alternative solution to the problem raised by the proponent could be to actually remove objectives 3 and 4. If the existing objectives 1 and 2 are sufficiently clear, and objectives 3 and 4 do not add any value to objectives 1 and 2, this solution may be appropriate",

This Alternative Rule Change would mean expenditure allowances could be no more than expenditure required in order to meet or manage expected demand for standard control services and to comply with all applicable regulatory obligations or requirements associated with the provision of standard control services.

The AEMC's hesitation to treat safety in the same manner as the other provisions is, in the Businesses' view, well founded.

The Rule Change Proposal would mandate an approach to economic regulation under which the AER disregards the true costs associated with safety-related issues in conducting its cost-benefit analysis of expenditure allowances, thereby enshrining in the NER the very approach that was criticised by the VBRC in the wake of the February 2009 bushfires. The VBRC noted the AER's view that:⁶

"the AER does not take into account costs that are external to the distribution businesses - such as the costs borne by the community when a bushfire is caused by failed electricity

³ Consultation Paper, p14.

⁴ Consultation Paper, p15.

⁵ Consultation Paper, p17.

⁶ VBRC, Final report to the Governor of Victoria dated 31 July 2010 (**VBRC Final Report**), Volume 2, p157.

assets. In the Australian Energy Regulator's view, whether such 'external' costs should be taken into account is a question for policy makers."

The VBRC went on to comment on the AER's approach to the assessing expenditure proposed for safety programs as follows:⁷

"The Australian Energy Regulator's failure to factor in the costs to human life and property arising from bushfire as part of its cost-benefit equation means that real and substantial costs to the community imposed by bushfire are left out of the price determination process.

... Protection of human life must become the priority when evaluating distribution businesses' expenditure proposals. The economic regulatory regime must include mechanisms for ensuring that safety-related matters are properly reviewed so as to minimise the risk of bushfire being caused by the failure of electrical assets."

The Rule Change Proposal would not allow DNSPs to propose, or the AER to allow, expenditure that they considered would be justified on the basis of the risks to safety arising if the expenditure was not incurred.

As a consequence, DNSPs may be required to elect to either proceed with expenditure programs not funded through the distribution determination process or face increased exposure to damages claims from third parties. A clear example of the potential for damages actions is the civil class action against a DNSP currently on foot in respect of the Victorian bushfires of February 2009. The plaintiffs in that proceeding are arguing that negligence by that DNSP caused the fires. The plaintiffs are claiming that the DNSP:⁸

1. failed to undertake appropriate asset inspection;
2. should have fitted vibration dampers to the line; and
3. should have disabled its system of circuit reclosers in high-fire-risk areas on days of high danger.

The matters raised by the plaintiffs in the class action reflect the recommendations made by the VBRC in its Final Report. The recommendations arose out of the VBRC's conclusion that the standards in place in this regard were inadequate. For the purposes of the Victorian distribution determinations for the 2011-15 regulatory control period, the AER was not prepared to fund expenditure to give effect to the recommendations of the VBRC in the absence of a change in regulatory obligations or requirements. The proceeding is expected to run for nine months, with up to \$1 billion in claims at stake.⁹ The case demonstrates that, even where a DNSP is compliant with jurisdictional standards and regardless of whether funded to do so, a DNSP may be exposed to risk of negligence claims if it does not maintain its network with the duty of care required.

⁷ VBRC Final Report, Volume 2, p158.

⁸ Melissa Fyfe, "New evidence challenges cause of Kilmore firestorm", *The Age (Melbourne)*, 4 March 2013, <http://www.theage.com.au/victoria/new-evidence-challenges-cause-of-kilmore-firestorm-20130303-2fetu.html>.

⁹ Melissa Fyfe, "New evidence challenges cause of Kilmore firestorm", *The Age (Melbourne)*, 4 March 2013, <http://www.theage.com.au/victoria/new-evidence-challenges-cause-of-kilmore-firestorm-20130303-2fetu.html>.

With regards to quality and security, the Businesses have not identified any issues which suggest they should not be treated in the same way as reliability. Similar issues as are identified in respect of reliability and safety may arise in respect of quality and security.

Conclusion

In the first instance the Businesses advocate no change to the NER.

Recognising however the potential pressure to make changes, the Businesses would suggest that the SCER's proposed paragraph (a1) be amended as follows:

- (a1) If a *Distribution Network Service Provider* is required to comply with a standard that relates to reliability associated with the provision of standard control services imposed by a regulatory obligation or requirement ~~that relates to reliability associated with the provision of standard control services~~, then for the purposes of paragraph (a), the amount that the *Distribution Network Service Provider* includes in its *building block proposal* to achieve each of the objectives in subparagraphs (a)(3) and (a)(4) as those objectives relate to reliability of the supply of those *standard control services* or those parts of the *distribution system* that are subject to that *regulatory obligation or requirement*, must be no more than an amount it considers is required to comply with that *regulatory obligation or requirement*.

These amendments are limited to clarifying the objectives to address the concerns as perceived by the SCER and AEMC. Such an approach is preferable to making wholesale amendments to the NER, which may give rise to the risk of unforeseen consequences, with potentially significant implications for investment in electricity networks.

Please do not hesitate to contact Elizabeth Carlile, Regulatory Policy Analyst, on (03) 9683 4886 or ecarlile@powercor.com.au if you would like to discuss the positions presented in this submission.

Yours sincerely



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