

30 November 2011

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear John,

Review of Distribution Reliability Outcomes and Standards: NSW Workstream

SP AusNet welcomes the opportunity to lodge this submission in response to the Commission's Issues Paper, which commences its review of distribution reliability outcomes and standards. SP AusNet understands that the review follows a direction from the Ministerial Council on Energy (MCE), and the Commission will manage the review through the following workstreams with overlapping timetables:

- a review of the distribution reliability outcomes in NSW ("NSW workstream"); and
- a review of the frameworks across the NEM for the delivery of distribution reliability outcomes ("national workstream").

The principal purpose of the NSW review is to respond to concerns raised by the NSW Government that the current distribution reliability standards in NSW may be leading to inefficiently high levels of network investment. The NSW workstream is, therefore, intended to inform possible changes to existing reliability standards in advance of the next distribution price review, which is scheduled to commence in May 2013.

The Commission's Issues Paper explains on page 3 that the objectives of the two workstreams are substantially unrelated:

"While there are some links between the two workstreams, their objectives are fundamentally different. The NSW workstream will provide advice on the costs and benefits of alternative outcomes or levels of distribution reliability in NSW, while the focus of the national workstream is on the frameworks or approaches to determining distribution reliability outcomes across the NEM."

The Commission also explains on page 7 that the NSW workstream will only consider incremental changes to the existing (deterministic) reliability standards, rather than contemplating fundamental change:

"As the timeframe for the NSW workstream is constrained, significant changes to the expression and structure of the existing outcomes in the distribution licence conditions cannot be considered. If fundamental issues with the expression and structure of the existing outcomes emerge during the NSW workstream, these issues and options for change, could be considered during the national workstream."

SP AusNet fully accepts and supports the NSW Government's examination of distribution reliability standards in NSW, especially given the importance of appropriately balancing network reliability and prices to customers. In addition, given the linkage between reliability standards and network investment, SP AusNet also recognises the importance of resolving the issue of NSW reliability standards prior to the start of the AER's next review of electricity distribution prices in that state, so that the consequences can be addressed in the next regulatory period.

Given the particular focus of the NSW Government, SP AusNet understands the rationale for attempting to separate the NSW workstream from a broader consideration of distribution reliability standards across the NEM. There are, however, some linkages between the two workstreams that may create practical issues for the Commission's review. In particular:

- The MCE has asked the Commission to produce a paper on best practice national and international approaches to delivering distribution reliability outcomes in January 2012. The Commission has said that this paper will be used for both the NSW workstream and the national workstream, even though the NSW workstream will only consider incremental changes to the existing reliability standards.
- The Commission has said that the NSW workstream will not contemplate fundamental change to the expression and structure of reliability standards in that state. It therefore seems likely that NSW will retain a deterministic approach to reliability standards, rather than adopting a probabilistic approach as currently adopted in Victoria. If a deterministic approach to reliability standards is confirmed in NSW, this raises questions as to whether a nationally consistent approach (which is the subject of the national workstream) could encompass the adoption of a probabilistic reliability standard.
- NSW distributors may not have certainty regarding the reliability standards that will apply in the forthcoming regulatory period if the Commission's forthcoming paper on best practice approaches, or the national review conclude that a probabilistic standard is the most appropriate approach.

SP AusNet raises these concerns because we recognise the significant potential benefits of a probabilistic approach to reliability. In particular, a probabilistic approach that explicitly and thoroughly considers the marginal costs, risks and benefits of improved reliability, thereby ensures that the resulting investment is economically efficient. Furthermore, the same concepts have also been incorporated in the AER's service target performance incentive scheme (STPIS). The AER explained the rationale for this incentive scheme as follows¹:

"While the regulatory regime as a whole encourages a business to improve its operating and capital efficiency, the STPIS is designed to ensure that this increase in efficiency is not at the expense of deterioration in service performance for customers. Further, the STPIS is designed to encourage a business to improve its service performance where customers are willing to pay for these improvements. The AER considers that in so doing the STPIS plays an important part in balancing the incentives on regulated businesses to ensure outcomes are consistent with the national electricity objective in section 7 of the National Electricity Law (NEL), in terms of efficient price and non-price outcomes for the long-term benefit of users."

¹ AER, Electricity Distribution Network Service Providers, Service Target Performance Incentive Scheme, Final Decision, May 2009, page 3.

SP AusNet has consistently supported the application of an STPIS because it provides economically efficient signals to distributors that reflect the value to customers of improving reliability. The consistency in the design of the STPIS and the economic principles that underpin probabilistic planning ensures that:

- all network investment is efficient in accordance with the National Electricity Objective; and
- distortions are avoided that would otherwise arise if some investment decisions were determined by considerations of marginal costs and benefits, while other decisions were driven by deterministic reliability standards.

In contrast to probabilistic planning and the design of the STPIS, deterministic reliability standards seek to apply 'rules of thumb' that may or may not reflect the underlying economics of improved reliability. As the National Electricity Objective specifically focuses on efficient investment, SP AusNet regards probabilistic planning as the strongly preferred approach if a national distribution reliability standard were to be established.

In light of the above comments, SP AusNet would be concerned if the Commission's limited review of the deterministic reliability standards in NSW inadvertently precluded the possibility of adopting a probabilistic planning standard or probabilistically assessed standards applied deterministically on a national basis.

SP AusNet's view, however, is that the forthcoming NSW distribution determination could readily accommodate the adoption of a nationally consistent probabilistic reliability standard, even if such a standard were to be put in place after the commencement of the next regulatory control period for DNSPs in NSW. This is because clause 6.6.1 of the Rules provides for the pass through of specific costs during the regulatory period, if the costs arise from a change in a regulatory obligation or requirement. This provision could, therefore, provide a mechanism for the NSW distributors to accommodate a significantly different reliability standard if this were the conclusion of the Commission's national workstream.

In addition to the above observations, SP AusNet would also like to comment on the following factors that the Commission intends to take into account in assessing the alternative approaches to reliability standards²:

- historic levels of distribution reliability performance;
- indicative costs of achieving the distribution reliability outcomes, where information is available;
- the extent to which the distribution reliability outcomes reflect community expectations and willingness to pay;
- the strength of the governance arrangements (for example, whether the body who sets the outcomes is independent from the body which must meet the outcomes);
- the level of transparency in relation to how the distribution reliability outcomes are set and applied; and

² Australian Energy Markets Commission, Distribution Reliability Outcomes and Standards, Issues Paper: NSW Workstream, 3 November 2011, pages 23 and 24.

- the level of accountability of DNSPs in relation to compliance with the required outcomes.

Although the MCE has requested that the Commission considers the National Electricity Objective in this review³, this objective is only implicitly reflected in the above factors. SP AusNet submits that the Commission's assessment of alternative approaches to reliability standards should give primacy to the National Electricity Objective.

We look forward to participating constructively in the next stage of the Commission's review. If you have further questions regarding the submission, please contact Tom Hallam, Manager Economic Regulation on 9695 6617.

Yours Sincerely,



Alistair Parker
Director Regulation and Network Strategy

³ Ibid, page 9.