7 June 2018

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

Dear Mr Pierce,

RE: AEMC Consultation Paper – *National Electricity Amendment (Establishing values of customer reliability) Rule 2018* (Reference ERC0231)

Endeavour Energy appreciates the opportunity to provide feedback to the AEMC's consultation paper – *National Electricity Amendment (Establishing values of customer reliability) Rule 2018*. A rule change request was made by the COAG Energy Council to establish the AER's responsibility to estimate the Value of Customer Reliability (VCR) and requirements to regularly review and publish VCRs and a VCR methodology.

This request follows the recommendations of the AEMC's 2013 review of the national framework for distribution reliability. Under the rule change, the AER will be required to develop a single methodology to estimate VCRs across the NEM which are to be adjusted annually (e.g. for inflation). Further, the AER's methodology should reflect the range and geographic locations of customers and be updated at least every five years.

As proposed by COAG, the AEMC considers that the rule change request is non-controversial meaning it is subject to an expedited process. The AEMC considers the rule change is unlikely to have a significant effect on the NEM as VCRs are already widely used and this rule change simply clarifies and formalises the responsibility and process for determining and updating VCRs.

Overall, we support establishing a formal process for developing and updating VCRs given their importance and widespread use in the NEM. Networks and other stakeholders would benefit from a clear and transparent methodology and process for determining VCRs on a consistent basis. In response to the consultation paper our key points are as follows:

- Methodology for calculating VCRs: we support the AEMC's draft rule which seeks to provide guidance on the objectives of the methodology rather than being overly prescriptive. We strongly support requiring the VCR to reflect the range of customer classes and geographic locations. In addition to this, we suggest the proposed rule also requires the AER to consider high consequence events in developing the methodology. This is important to provide both flexibility and certainty that the resulting VCR will be suitable to use and accurate in a variety of circumstances.
- Timing of VCR calculations: we support the 31 December 2019 deadline for publication of the first VCRs. We consider this to be a minimum timeframe based on the length of AEMO's 2014 study, the complexity of the task and the need for consultation in developing the methodology. We are concerned by COAG's request that the first review be completed in time to apply to our 2019-24 regulatory determination. It is unlikely this is possible and if it were we would require additional time to update our planning framework and capital expenditure

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forecast if significant changes were made. We support a five yearly review of the VCRs and annual updates for mechanistic adjustments like CPI.

- Process for developing and updating methodology: We support the VCR methodology being developed in accordance with the Rules consultation procedures and that the methodology and VCR estimates are both published. We are also supportive of AEMO and the Reliability Panel being specifically consulted with (where the AER is the responsible party) given their respective experience and role.

Both the COAG rule change request and the AEMC's consultation paper nominate the AER as the responsible party for establishing VCRs. This was based on the recommendations of the AEMC's review of the national framework for distribution reliability. The rationale was that the responsibility was a logical fit with the AER's role given VCRs are a key input in the service target performance incentive scheme (STPIS).

We note that since AEMC's 2013 review, the role of VCRs has broadened considerably. Over the last several years VCRs have been used; by jurisdictional regulators to set reliability targets, as a key input in most regulatory investment test assessments and as a key factor in regulatory resets to assess major capital projects and overall capital forecast. This means that in addition to setting an incentive scheme parameter, the AER would be put in a position of setting a key input into asset management decisions which it will subsequently have to assess. This circularity in decision making is inappropriate and may reduce stakeholder confidence in the VCR measure.

In addition to consistency and transparency, an independently calculated VCR will also be important in providing stakeholders with confidence in the VCRs. Given the changes which have occurred since the 2013 review, further consideration for establishing VCRs should be given to the other parties identified in the consultation paper. We recommend AEMO given their independence from the determination process. AEMO is the most qualified and knowledgeable party after conducting the only comprehensive national examination of VCRs in the NEM in 2014. This would also obviate the need to amend NER clause 3.9.3A(e)(4) which indirectly identifies AEMO in connection with VCRs.

Attachment 1 provides our responses to the questions raised in the consultation paper. If you have any queries or wish to discuss this matter further please contact Patrick Duffy, Regulatory Strategy Manager at Endeavour Energy on (02) 9853 4375 or via email at patrick.duffy@endeavourenergy.com.au.

Yours sincerely,

Jon Hocking
Manager Network Regulation
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ATTACHMENT 1: RESPONSE TO THE CONSULTATION PAPER QUESTIONS

Question 1 - Responsibility for establishing VCRs

1.1 - Is it important to have one national body responsible for establishing VCRs?

Assigning responsibility to a single national body would establish clear accountability for the development, review and publication of VCR methodology and estimates. Formalising this responsibility within the NER will help promote a more consistent application of a common VCR methodology, thereby promoting a key objective of both the rule change request and the AEMC's Review of the national framework for distribution reliability.

We consider the nominated body would need to have sufficient resources and expertise to engage with a range of residential and business customers to ascertain values placed on reliable grid supply from different customer types across all NEM jurisdictions. To prevent dispute and limit departure from the VCR estimates, there would also need to be wide acceptance from industry and stakeholder groups on the relative independence of the responsible body.

1.2 - Is the AER the appropriate body to be responsible for updates to the VCR? If not, which body should be responsible for this task, and why?

The consultation paper nominates the AEMC, AEMO, the AER and the Reliability Panel as the four independent national bodies that could potentially be given responsibility for establishing VCR methodology and values. Of these nominated bodies, we consider AEMO is best positioned to assume this responsibility primarily on the basis they are the only organisation to have demonstrated proficiency in undertaking the proposed process. Assigning responsibility to AEMO would:

- formalise their current authority as the preeminent VCR experts;
- enable them to leverage from their experience and established processes to refine the methodology and enhance the effectiveness of VCR for reliability setting and efficient asset management;
- avoid costly procedural duplication and transitional delay; and
- ensure a continuation of widely accepted approach to deriving VCR estimates which may be placed at risk if other bodies have differing views regarding the application of VCR, particularly where it relates to regulatory processes.

Additionally, AEMO's technical expertise provides critical understanding of how different customer classes might use and value reliable supply under a range of outage situations. This would be particularly important in shaping the surveys which elicit from customers values that most accurately reflect their sentiment towards balancing supply reliability and cost.

For these reasons, we consider assigning responsibility to AEMO would most efficiently and effectively meet the objectives of the rule change request.

We understand this would be a departure from the recommendations of the AEMC's 2013 review of the national framework for distribution reliability. At that time, VCR was predominantly relied upon to set the incentive rates used for the STPIS and allowing the AER to assume responsibility seemed logical and consistent with its role as administrator of the STPIS. However, as Regulatory Investment Test (RIT) assessments have evolved and most recently expanded to include replacement projects, the role of the VCR has since expanded to become a critical input into network planning and asset management decisions.

As the economic regulator, the AER assesses proposed network expenditure in line with the requirements set out in the NER and its own expenditure assessment guideline. This is done from an independent and balanced perspective considering the long-term interests of customers whilst having regard to the obligations and needs of NSPs. Under the proposed rule change, the AER would become both the assessor of proposed network investment expenditure and provider of a critical metric used by networks to support the efficiency of this expenditure.

To preserve confidence that VCR estimates truly reflects the feedback of surveyed respondents, we consider these two functions should not be assigned to the same body. Doing so could render VCR updates susceptible to disputes from stakeholders who may question the basis on which departures from the current accepted methodology have been made. This in turn would encourage several alternate methodologies and estimates of VCR to be applied in contrast to the objective of developing a single and nationally consistent methodology. AEMO's relative independence from the regulatory determination process enhances its suitability as the body to assign VCR responsibility.

Furthermore, we note that much of the variation in VCR methodology and values discussed in AEMC's 2013 review and in the rule change request predates AEMO's comprehensive VCR review. Since AEMO's VCR report was published in 2014, their methodology and estimates have been largely accepted by NSPs across all NEM jurisdictions in undertaking cost-benefit analysis and preparing capital works programs. This suggests widespread consensus on the robustness and reasonableness of AEMO's methodology and trust in AEMO as the custodian of the VCR.

Question 2 – Methodology

2.1 - Should the NER provide an objective for the AER in calculating VCRs? If so, should the objective be to calculate fit for purpose VCRs for the current and potential uses of VCRs? Are there any other objectives that should be explicitly stated?

We agree with the AEMC that developing VCR estimates is likely to be a complex task and as such, it would be beneficial for the NER to provide objectives or principles to help guide the VCR development rather than extensive prescription.

Nevertheless, we do believe the NER should be amended to include requirements of the responsible body that would somewhat limit the degree of discretion afforded.

2.2 - Should the NER guide the AER in determining the VCR methodology? If so, how?

With the exception of nominating the AER as the responsible body, we largely support the AEMC's draft rule change as detailed in Appendix A of the consultation paper.

For the responsible body to adequately understand how VCR is currently (and could potentially be) used in asset management decisions, it would be important to involve NSPs into developing the methodology. Therefore we particularly support the inclusion of the requirement to undertake consultation in accordance with the Rules consultation procedures.

Clause 8.12(c)ii of the indicative rule change includes a requirement for the AER to have regard to the range and geographic locations of retail customers in each network. We are concerned that this condition may not prevent the views of different customer types in different locations to be lost through aggregation.

For the VCR to be an effective tool, it is imperative that a range of estimates be developed reflecting the contrasting values placed on reliable grid connection by different customer types so that an appropriate VCR can be applied suitable to the specific situation. The requirement to publish multiple VCR estimates for different customer types in each NEM jurisdiction should be made more explicit in the NER.

Additionally, we believe it would be appropriate to amend the NER to allow NSPs to substitute regional VCR values for localised estimates when it can be clearly demonstrated that they better reflect consumer sentiment with regard to the composition of customers and is supported by sound evidence.

2.3 - Should the NER guide the AER regarding the methodology for annual adjustments to VCR estimates? If so, how?

We consider the methodology for annual adjustments to VCR estimates should be derived through extensive industry consultation and, as per our response in 2.2, we welcome the AEMC's draft rule which includes the requirement to undertake consultation in accordance with the Rules consultation procedures.

Of equal importance to VCR accuracy is the stability of the VCR. Given the long planning horizons of NSPs, changes to VCR values should be reasonably modest over time so that investment decisions are not distorted by unanticipated fluctuations. We believe the NER should promote VCR stability when making annual adjustments.

Question 3 - Timing for first review

3.1 - Is 31 December 2019 the appropriate date for the AER to be required to have published the first estimated VCRs? If not, what should the date be?

We share the AEMC's concern that it would be difficult for the responsible body to publish an updated methodology and estimates following consultation made in accordance with the Rules consultation procedures in time for the next round of regulatory determinations. With the AER's next final regulatory decisions expected in April 2019, we believe any attempt to publish revised VCRs within the next 10 months will be problematic and risks a hastily developed and potentially flawed methodology.

Furthermore, we believe it would be consistent with recent efforts to improve information transparency in the determination process to afford NSP's the opportunity to develop and submit a regulatory proposal cognisant of the methodology and estimates that will be used by the AER to inform its final decision. Given that we have already submitted our regulatory proposal to commence the determination cycle, this would require the AER to publish the updated methodology and estimates by September 2018 at the latest to allow sufficient time for us to revisit investment decisions and evaluate the impacts of the revised VCR values.

Also, on the basis that AEMO's comprehensive VCR review took 18 months to complete, we expect that a robust updated VCR methodology developed by a party other than AEMO would require a similar length of time. We believe 31 December 2019 resembles a more realistic and reasonable timeframe to ensure VCR updates are considered and avoid producing adverse customer outcomes.

Question 4 - Timing of subsequent reviews and updates

4.1 - Do stakeholders agree that a five yearly review period is an appropriate review cycle for updating VCRs?

We agree that a review cycle of five years is appropriate. This would be consistent with the typical length of a regulatory control period and will ensure NSPs will have access to up-to-date 'reset' VCR estimates prior to submitting their revenue proposals.

4.2 - Is an annual adjustment of the VCR required?

Yes. Currently, inflation based escalation is used to correct the VCR for inflation. We would support a continuation of this approach in the revised methodology on the basis it provides a relatively stable and predictable VCR estimates that continue to reflect customer sentiment.

As RIT assessments often extend beyond 12 months, it is conceivable that confusion may arise as to which VCR value to apply to a project assessment. An updated methodology would need to provide clarity to overcome potential complications and uncertainties.

As a possible solution, we propose that the annual adjustments (whether it be inflation based or otherwise) be provided at the time of the VCR methodology review. This would provide greater certainty that would facilitate efficient long term investment planning.

Question 5 - Initial process

5.1 - Should the AER be required to consult with specific parties when determining the methodology for the initial estimation of VCRs? If so, who?

If the AEMC elect to make a rule change assigning VCR responsibility to the AER, we agree that the AER would need to consult directly with AEMO. This would facilitate the recommendations of the AEMC's Review of the national framework for distribution reliability which states that the AER would be required to initially use AEMO's VCR methodology as a starting point and that AEMO's VCRs should be used until it is considered that the measures need to be re-estimated.[1]

Additionally, for the AER to have regard to current and potential uses of VCR in reviewing the methodology, we believe they would need to consult with all NSPs to gain a clear understanding and appreciation of the practical applications of the VCR in network planning and asset management.

5.2 - Should the AER be required to follow the Rules consultation procedures in developing the VCR methodology?

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[1] AEMC, Review of the national framework for distribution reliability, September 2013, p. 49.

We agree with the AEMC that the Rules consultation procedures should be followed by the AER in developing their VCR methodology. As the AEMC's draft indicative rule change does not oblige the AER to have regard to AEMO's methodology, it would be particularly important for a thorough process of industry consultation be undertaken so that an improved methodology can be developed in an informed, inclusive and collaborative way.

We believe this would be an ideal opportunity to work towards addressing some key concerns and limitations in the way VCR is currently measured and used. For instance we consider the VCR can be improved by investigating ways to:

- incorporate the increasing value customers are placing on their connection to the grid for the purposes of energy trading. Currently VCRs are based on the value of energy delivered which is becoming less relevant as customers become increasingly involved in energy generation. We believe VCRs would be more useful if they reflected the value placed on reliable access to the grid as the enabling platform for energy trading and other related services.
- overcome the limitations of the current methodology of capturing participants willingness to pay for high impact, low probability events. We consider the social and safety impacts related to prolonged and widespread outages could be better reflected in VCR estimates.
- develop VCRs that capture and preserve the high value placed on supply reliability for specific customer segments (e.g. hospitals, medical precincts) who would be severely and adversely affected by supply interruptions which do not become diluted through aggregation.

We anticipate a number of stakeholders would similarly seek to become actively involved in helping the AER to develop an improved methodology that builds on the work done by AEMO. Applying the Rules consultation procedures would provide assurance that the AER will engage with the industry through a process that would likely yield a well-considered and robust methodology.

<u>**Question 6 - Subsequent review process**</u>

6.1 - Should the AER be required to follow the Rules consultation procedure for updates to VCR methodology?

To ensure stakeholders have sufficient opportunity to engage with the AER prior to subsequent updates of the VCR methodology and estimates, we consider the Rules consultation procedures should apply. This will enable stakeholders to provide the AER with valuable input that might otherwise be overlooked when reviewing the effectiveness of proposed changes to the methodology.

6.2 - Should the AER be required to consult with specific parties when reviewing and updating the methodology? If so, who?

We do not consider the AER should be required to consult with specific parties (including AEMO) beyond developing their initial methodology and VCR estimates. Parties interested in contributing to methodology reviews and updates should be afforded equal opportunity through the Rules consultation procedure.

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6.3 - If the Rules consultation procedures are to be followed for updates to VCR methodology, is it reasonable for minor or administrative amendments to be made outside of the Rules consultation procedures?

We consider it reasonable for minor administrative amendments that would not impact the methodology or VCR estimates to be permitted outside of the Rules consultation procedures.

6.4 - Should subsequent reviews take into account the previously determined methodology?

It would be appropriate for the previously determined VCR methodology to be used as a starting point to which improvements can be made and incorporated into an updated methodology.

6.5 - Is it appropriate for reviews of the methodology to occur on a five yearly basis? If not, what would be an appropriate review cycle?

We consider a five year review cycle is appropriate.

<u>Question 6 - Publication requirements</u>

6.1 - Should the AER be required to publish estimates and the methodology, both when initially determined and when any updates or adjustments occur?

Yes. This would be consistent with a general trend towards improving transparency by all parties within the regulatory framework.

<u>Question 7 - Amendment s.3.9.3(A)(e)(4)</u>

7.1 - Should clause s3.9.3A(e)(4) be amended to replace AEMO with the AER?

If the AEMC makes a rule change that allocates responsibility to the AER, the proposed amendment would be justified.

<u>Question 8 - Issues specific to the Northern Territory</u>

8.1 - Is a differential rule required in the Northern Territory? If so, in relation to which parts of the indicative rule and why?

We agree with the AEMC and consider a differential rule is not required for the Northern Territory.