Department of State Development, Business and Innovation

1 Spring Street
Melbourne Victoria 3000
Australia
GPO Box 2392
Melbourne Victoria 3001
Australia
Telephone: (03) 9651 9999
Facsimile: (03) 9651 9770
www.dsdbi.vic.gov.au
DX210292

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Mr John Pierce
Chair
Australian Energy Markets Commission
PO Box A2499
South Sydney NSW 1235

Dear Mr Pierce,

SUBMISSION TO AEMC CONSULTATION PAPER: REVIEW OF THE NATIONAL FRAMEWORKS FOR NETWORK RELIABILITY

The Victorian Department of State Development Business and Innovation (DSDBI), as the agency responsible for energy market development in Victoria, is pleased to respond to the proposals for expressing, setting and reporting on electricity transmission and distribution reliability set out in the Consultation Paper.

DSDBI strongly supports reforms to strengthen the regulatory frameworks that govern electricity network business outcomes. Given the costs of delivering different levels of reliability and the value that consumers place on reliability, it is important that these networks deliver levels of service consistent with the preferences of consumers.

While the Consultation Paper's proposed approaches to network reliability can be seen as an advance on approaches based on input standards that are not clearly linked to the value of customer reliability (VCR), DSDBI believes the proposed national framework precludes significant benefits associated with the current Victorian arrangements.

The key issue is the role of *ex ante* reliability (or redundancy) standards in managing network reliability. The Victorian probabilistic approach to regulating transmission and distribution networks focuses on the economic assessment process for each project, coupled with a performance incentive mechanism for electricity distribution networks that is directly linked with the VCR. Ultimately, this approach provides a stronger and more dynamic focus on achieving economically efficient outcomes than the framework set out in the Consultation Paper.

It is exactly this dynamic focus that has allowed Victoria to avoid the price shock to consumer bills seen in other States driven by changes in reliability standards. The Victorian approach adapts to changing market conditions and therefore ensures investment in networks is driven by need and not other factors such as externally imposed deterministic requirements.

State Government Victoria

Although the setting of outputs based reliability standards for electricity distribution networks based on a transparent economic assessment is an advance on an inputs based approach that requires specific levels of redundancy, the setting of deterministic standards is still an inflexible approach that may give rise to inefficient outcomes.

The AEMC's specific proposal makes provision for a mechanism to update reliability targets within a regulatory control period under certain circumstances, but the need for such a mechanism is an acknowledgement of the limitations of deterministic standards. Furthermore, establishing such an update mechanism would increase the costs of standard setting for businesses, regulators and consumers. It also detracts from transparency and certainty benefits that the AEMC cites in support of its proposed approach.

DSDBI is also concerned with the AEMC's focus on the setting of standards as a central element in managing distribution network reliability. As the Productivity Commission's recent report on *Electricity network regulatory frameworks* asserts, as long as an incentive system (such as the Service Target Performance Scheme) provides incentives that are correctly aligned with the value that customers place on reliability 'Businesses will tend towards supplying levels of reliability that reflects customer preferences, regardless of the target set'. [1]

The setting of *ex ante* reliability standards is therefore not of critical importance to achieving efficient outcomes. Instead, if considered over the longer-term, an incentive mechanism based on historical performance will progressively push reliability outcomes to efficient levels and facilitate a steady and predictable alignment of reliability outcomes with consumer preferences.

As the Consultation Paper notes, the same approach to reliability cannot be applied to transmission networks due to the difficulty of observing the actual reliability performance of transmission networks at any point in time. Once this is acknowledged, it immediately raises questions about the value of seeking to achieve high levels of consistency between the approach to the management of network reliability across transmission and distribution networks.

The case for consistency in terms of process is further weakened because the levels of reliability experienced by nearly all consumers are largely determined by the reliability performance of distribution networks. As the AEMC itself notes, 'In practice, it may be difficult for TSNPs to seek responses from their customers on the aspects of reliability that are particularly important to them as supply interruptions on transmission networks are rare'.[2]

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[1] Productivity Commission 2013, *Electricity Network Regulatory Frameworks*. Report No 62 Canberra. Page 569.

[2] AEMC, 2013, *Review of the national frameworks for transmission and distribution reliability*, Consultation Paper, 12 July 2013, Sydney Page 42.

Therefore, a formal open public consultation process could be enhanced by encouraging advocacy of consumer interests in the context of transmission reliability from an expert group, such as the recently established Australian Energy Regulator Consumer Challenge Panel.

DSDBI strongly supports active reforms that engage and empower consumers within electricity markets. Consumer consultation processes need to be relevant to the actual experience of consumers with the supply of electricity. DSDBI notes that consumer consultation on distribution business planning and revenue determination proposals are likely to be more engaging because they are more directly relevant to the levels of reliability that consumers will actually receive.

The Consultation Paper's proposed approach requires the setting of an N-x redundancy standard for each transmission connection point, with the possible addition of output based requirements to provide standard setters with greater flexibility to tailor standards to the preferences of customers and the local conditions at each transmission connection point. DSDBI believes that the same objections apply to use of deterministic standards for electricity transmission networks as for distribution networks. In the case of transmission networks, however, these objections assume a greater significance because of the relatively small numbers of augmentations that take place and the higher cost of transmission network infrastructure.

As the AEMC proposed approach requires the setting of an economically determined standard at each connection point, it is not clear what practical value, in terms of the effort required or in terms of transparency for consumers, there would be in setting *ex ante* standards, rather than relying on an economic cost-benefit assessment of each augmentation project.

Indeed, the setting of a deterministic standard could create significant inflexibilities that lead to scenarios where investment levels diverge from otherwise efficient outcomes derived from the cost-benefit approach. This could lead to costs being imposed on customers as a result of inefficient over-investment in network infrastructure. In these circumstances the application of a deterministic standard would be inconsistent with the National Electricity Objective.

On this basis, DSDBI considers that it is preferable not to proceed with a deterministic approach and instead to focus on probabilistic planning approaches that deliver efficient and dynamic outcomes for consumers.

As the AEMC notes in its Issues Paper, *Review of the national framework for transmission reliability* the economic efficiency of the Victorian model for transmission reliability 'is dependent on the quality and application of the project assessment' and that this is addressed by AEMO undertaking all transmission planning and procurement for augmentations to the

network.[3] What this illustrates is that the mechanisms for the management of reliability cannot be readily separated from issues of industry structure and that any national framework for network reliability must be relevant to each of the industry structures operating the NEM. Given the differences between industry structures across NEM jurisdictions, it is not clear that there will be a single satisfactory approach to the management of network reliability in the absence of reforms to produce greater consistency of industry structure across jurisdictions.

If you or your staff would like to discuss the issues raised in this submission, please contact Mr Greg McLeish, Manager Supply Security by email at greg.mcleish@dpi.vic.gov.au or by phone on (03) 9658 4925.

Yours sincerely

Mark Feather
Executive Director
Energy Sector Development Branch

[3] AEMC, 2013 *Review of the national framework for transmission reliability*, Issues Paper, 28 March 2013, Sydney Page 19