21 August 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Review of distribution reliability outcomes and standards – Response to Issues Paper National Workstream

ActewAGL Distribution (ActewAGL) welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission's) Issues Paper on the national workstream of its review of distribution reliability outcomes and standards.

The Commission has emphasised the balancing of economic costs and benefits as a consideration in the design of an efficient framework for delivering reliability. ActewAGL supports this consideration and is pleased that the Commission has recognised that the optimal level of reliability may vary across jurisdictions. As noted in ActewAGL's letter to you on 13 July 2012 in relation to the Draft Report on the New South Wales (NSW) workstream, expert (and independent) studies conducted in the Australian Capital Territory (ACT) arrive at a very different finding than the Commission's draft finding of net benefits from reliability deterioration in NSW.

The primary benefit to be gained from a nationally consistent framework for reliability is likely to be the potential welfare improvement from more closely aligning the price-reliability balance with the preferences of consumers. ActewAGL understands that the Service Target Performance Incentive Scheme (STPIS) applied by the Australian Energy Regulator (AER) is intended to capture this benefit. By 2014, the STPIS will be in force in all National Electricity Market (NEM) jurisdictions. To the extent that the STPIS incentive rates accurately reflect customers' willingness to pay (or accept compensation) for changes in reliability in each jurisdiction, this scheme will internalise economic cost-benefit analysis within the reliability planning processes of distribution network service providers (DNSPs). In practice, incentives may be distorted by considerations relating to investments in long-term reliability and the process for adjusting reliability targets. However, there are clear benefits from synchronising and co-ordinating the regulation of reliability and price.

There are likely to be benefits from a close review of jurisdictional standards that relate to aspects of reliability included in the STPIS. Fundamental to the rationale for the STPIS is recognition that the optimal reliability level is unknown *a priori*. Application of the STPIS therefore suggests that minimum standards may best be used as safeguards, allowing for deterioration in reliability, but only where that can be proven to be efficient in the interests of the community. These standards should be defined in terms of outputs, rather than inputs, since DNSPs are best placed to determine how a preferred reliability level can be achieved at lowest cost.

ActewAGL agrees with the Commission's view that enhanced customer communications, rather than being mandated, should be introduced where expected benefits exceed costs. ActewAGL recognises that communication is valued by its customers. Research on willingness to pay commissioned by ActewAGL has quantified the value that customers place on being able to speak to a human operator when making phone enquiries in the event of a supply interruption. ActewAGL intends to investigate whether other potential communications options could be assessed in future valuation studies to inform benefit-cost analysis of those options.

Harmonisation of frameworks will come at a cost. Consideration should be given to additional implementation and recurrent costs that DNSPs may incur due to changed reporting requirements, including any required expansion of information systems. This consideration is particularly important in light of the increasing cost of other aspects of regulatory compliance.

Finally, ActewAGL notes that the Commission is yet to form a view on the most appropriate method for estimating the value placed by customers on changes in reliability. In the absence of adequate revealed preference data, ActewAGL supports the use of stated preference techniques, particularly choice modelling, in line with regulatory practice in the United Kingdom[1] and New Zealand.[2] In contrast to the "VCR" surveys developed Monash University's Centre for Electrical Power Engineering in 1997, choice modelling elicits values that are consistent with the economic concepts of compensating and equivalent variation. It captures the full economic cost of supply interruptions – both out-of-pocket expenses and non-financial costs, such as inconvenience to domestic customers. Importantly, it values reliability *ex ante*, before uncertainties have been resolved. The main criticisms of choice modelling have related to contexts where respondents have little or no experience with the good or service in question and where respondents have no incentive to answer carefully and truthfully. In the electricity reliability context, respondents have generally experienced some form of supply interruption and our experience confirms customers understand that price-reliability options could be enforced on the basis of survey findings, particularly if the survey has been commissioned by a utility or regulatory body. Well-designed choice modelling surveys will lead to robust results.

If you would like to discuss these matters further, please contact Ben McNair, Principal Economist on 02 6248 3386.

Yours sincerely

David Graham
Director Regulatory Affairs and Pricing

[1] For example, Accent 2008, Expectations of DNOs and willingness to pay for improvements in service, Report prepared for OFGEM, July.
[2] Electricity Authority 2012, Investigation into the value of lost load in New Zealand – Summary of findings, available at: http://www.ea.govt.nz/our-work/programmes/transmission-work/investigation-of-the-lost-load/