Ref: 20190212TG:CB

13 February 2019

Jessica Robinson
Energy Retail Market Monitoring
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
NSW 1240

Dear Ms Robinson

Draft Terms of Reference – Electricity Distribution Reliability Standards – December 2018

Thank you for the opportunity to provide comments on the draft terms of reference for the review of electricity distribution reliability standards. Essential Energy supports initiatives to improve affordability for New South Wales electricity customers.

There are however some issues that warrant further consideration in the development of the terms of reference. These are summarised below and reflected in suggested changes to the draft terms of reference in Appendix A to this letter.

Issues regarding the timing of this review

Essential Energy has some concerns regarding the timing of this review relative to other processes that are currently underway.

First, the AEMC is reviewing the regulatory frameworks for stand-alone power systems. Bringing customers supplied by means other than the traditional grid into the definition of the distribution network will require further review of reliability standards. This is because the reliability standards for these off-grid customers will need to be defined. The uncertainty regarding these arrangements is likely to continue during the timeframe of this review.

Second, the economic regulatory framework that currently applies is also under consideration. Regulatory processes such as the AEMC's *Electricity network economic regulatory framework review* is currently underway and is looking at whether the economic regulatory framework is robust, flexible and continues to support the efficient operation of the energy market in the long-term interest of consumers. Changes in network incentives would have an impact on the investment decisions of networks and would have implications for how networks choose to operate to meet their reliability standards.

Finally, there is a long lead time to see reductions in network charges as a result of a change in reliability standards. Many changes to reliability standards would see a substitution of capital expenditure with operating expenditure. Reductions in capital expenditure have minimal impact on customer prices as depreciation and the return on the investment is achieved over the life of the asset – 40 to 50 years in most instances. However, operating expenditure has a larger impact on customer prices as it is received dollar for dollar by the distribution business within the regulatory period.

Changes to reliability standards therefore have a limited ability to lower network costs as the reduced reliability standards would only result in lower network costs once assets need to be replaced.

Network improvement plans and the AER's regulatory determinations for the 2019-24 regulatory period

When considering options for reducing network charges IPART should have regard to the network improvement plans already underway within distribution businesses, as well as the recent regulatory proposals for the upcoming 2019-24 regulatory period. This would avoid duplication and the imposition of requirements that would be met regardless as a result of internal processes to improve efficiency.

Essential Energy is transforming to deliver better value to customers. This is impacting all aspects of our operations and the way we think about balancing risk and expenditure. We have already seen significant sustainable reductions in our operating expenditure and capital expenditure whilst also ensuring our obligations in inspection, maintenance and vegetation management have been met.

The improvements being made within New South Wales distribution businesses are driven, in part, by the strong incentives imposed by the economic regulatory regime.

The AER, in its most recent economic benchmarking report, noted that New South Wales distribution businesses have restructured to improve operating expenditure efficiency and reduce staffing levels since 2015. In recent regulatory proposals for the upcoming 2019-24 regulatory proposals, Essential Energy, Ausgrid and Endeavour Energy have all stated they expect to be able to sustain their operating expenditure savings into the next regulatory period.[1]

It should also be noted that the current regulatory framework provides specific incentives for distribution networks for maintaining and improving network performance, to the extent that customers are willing to pay for such improvements. The service target performance incentive scheme (STPIS) requires distribution networks to put a portion of revenue at risk in order to meet the targeted performance levels. The IPART review of reliability standards should be consistent with this existing incentive scheme.

Customer preferences on reliability

Essential Energy supports the work being done by the AER in calculating the Value of Customer Reliability (VCR). We also support the use of this measure as an input into the review of reliability standards. We note that the work of the AER to determine the VCR will only be completed at the end of this year, which may present difficulties in fully including this work in the IPART review.

Accurate and robust calculations of the value that customers place on reliable electricity supply are an important input to trading off the costs of reliability with its value.

Despite the value of VCR metrics, Essential Energy considers that they should be supplemented with other information regarding customer preferences, where available. This other information can serve as a 'sense check' of quantitative metrics and can help to make sure that imperfect or flawed calculations do not drive perverse outcomes for customers.

Operating environments of distribution networks

Essential Energy considers that an important factor for consideration is the operating environment of each of the distribution businesses in New South Wales. The conditions under which each network operates are different and this has an impact on the cost of reliable supply to customers.

The geographic spread of our network and demographics of the communities we serve sets Essential Energy apart from other electricity distributors. Essential Energy has about one third the number of customers per kilometre of powerline compared to the average customer density across the National Electricity Market.

A distribution network with a low customer density requires more poles and wires to reach customers than other networks with a higher customer density. This significantly impacts the cost to serve our customers. Relatively sparsely populated networks also provide significant challenges for achieving reliability and service quality targets. Network operating environments should therefore be considered as part of this review.

[1] AER, 2018 distribution network service provider benchmarking report, p. 20.

Barriers under the current regulatory framework for lowering network costs

As noted above, Essential Energy supports any improvements that can be made to increase energy affordability. However, IPART should have regard to the current regulatory framework when determining what actions can be taken to reduce network costs and therefore customer bills.

One pertinent example of a current barrier is the inability of distribution networks in New South Wales to charge locational network charges that reflect the cost to serve customers in different locations. Essential Energy has a diverse service territory and a wide range of customers who cost us very different amounts to reliably supply them with energy. Under "postage stamp" pricing, our customers in Tamworth pay the same network charges as those in Tibooburra.

Essential Energy notes that solutions such as transitioning high cost-to-serve customers to off-grid supply through stand-alone power systems has the potential to lower network costs. However, given the need for regulatory change in this area and current technology costs these savings are likely to accrue over the longer term, beyond the time horizon of this review.

Finally, Essential Energy notes that the timeframe for the review is quite long, with a draft report not expected until March 2020. To ensure IPART can can have regard to the final decisions of the AER's review of VCR and the AEMC's review of SAPS it would be advisable that the IPART review commence towards the end of 2019. This timing would also assist engagement with other stakeholders who would need to understand the final decisions of these reviews. It would also be appreciated if IPART could provide more detail on the milestones and timeframes for this review, to the extent possible.

If you have any questions please do not hesitate to contact Natalie Lindsay, Head of Regulatory Affairs on [redacted] or at Natalie.lindsay@essentialenergy.com.au.

Yours sincerely

[redacted]

Chantelle Bramley
General Manager, Strategy, Regulation and Transformation

Appendix A: Draft Terms of Reference for IPART to review electricity distribution reliability standards

I, Gladys Berejiklian, Premier of New South Wales, under section 12 A of the *Independent Pricing and Regulatory Tribunal Act 1992,* refer to the Independent Pricing and Regulatory Tribunal (IPART) for investigation and report the following matter.

IPART is to provide a report to the Premier and Minister for Energy and Utilities recommending:

1. any changes to electricity distribution reliability standards for the NSW distribution network businesses that could deliver bill savings to NSW electricity customers; and
2. any other measures that could be imposed on or implemented by the NSW distribution network businesses within the current regulatory framework that would be likely to reduce network prices and are consistent with National Electricity Objective.

In making recommendations as to electricity distribution reliability standards, IPART is to apply an economic assessment to evaluate how efficient network capital and operating costs would vary with different levels of reliability, and then compare the level of expected capital and operating expenditure against the value that customers place on reliability.

In undertaking the review, IPART is to have regard to:

1. the objective of the New South Wales Government to improve electricity affordability, while maintaining a safe, reliable and secure electricity network;
2. the potential impact on customer bills, assuming current regulatory arrangements, from:
    a. any change in the distribution network reliability standards;
    b. any other measures that would reduce network prices and are in the long term interests of consumers;
    c. network improvement plans already in place in the distribution networks.
3. the importance customers place on having a safe, reliable and secure electricity network including any feedback or evidence on customer preferences;
4. published values of customer reliability (VCRs), including the AER's estimates to be published by 31 December 2019;
5. The operating environment of distribution networks;
6. the NSW distribution network businesses' safety and security obligations;
7. a stable regulatory environment;
8. current regulatory barriers to lowering network costs, for example, postage stamp pricing;
9. The AER's regulatory determinations for the 2019-24 regulatory period;
10. the relevant recommendations of the 2018 State Infrastructure Strategy and the Australian Competition and Consumer Commission's Retail Electricity Price Inquiry.

IPART is to undertake public consultation for the purposes of its investigation.

IPART is to release a draft report for consultation by the end of March 2020 and release a final report by end June 2020