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National Electricity Amendment (Network Service Provider Expenditure Objectives) Rule 2013 – Consultation Paper

Jemena Electricity Networks (**Jemena**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**) Consultation Paper on the rule change request submitted by the Standing Council on Energy and Resources (**SCER**). The rule change relates to the operating expenditure and capital expenditure objectives in chapter 6 of the National Electricity Rules (**NER**).

Jemena supports the proposed rule change by SCER.

SCER has proposed to insert new clauses in the NER to qualify the existing forecast capital and operating expenditure objectives. These objectives are for assessing the regulatory proposals and their compliance with jurisdictional reliability standards. Jemena supports the new clauses as they would provide regulatory certainty and remove any potential conflict with the NER in jurisdictions where there are jurisdictional reliability standards or targets.

In Victoria, there are no specific jurisdictional reliability requirements or obligations other than the obligation in Electricity Distribution Code, which does not specify any reliability standards or targets. Instead, the Service Target Performance Incentive Scheme (**STPIS**) regime applies. It provides Distribution Network Service Providers (**DNSPs**) with incentives to pursue opportunities that deliver efficient changes in the level of reliability. The performance benchmarks or targets within the STPIS are based on an average of actual recent performance. Under the STPIS, any such changes in reliability performance will be reflected in future targets. In this way, the STPIS automatically adjusts performance targets through time, to reflect the actual performance of DNSPs who face strong incentives to deliver an efficient level of reliability.

Jemena does not support removal of the existing expenditure objectives 3 and 4.

The NER requires Network Service Providers (**NSPs**) to include in their regulatory proposals the forecast expenditure that they consider is required to:

- meet or manage the expected demand over the regulatory control period (objective 1);
- comply with all applicable regulatory obligations or requirements (objective 2);

- maintain the quality, reliability and security of supply of the regulated services (objective 3); and
- maintain the reliability, safety and security of the distribution or transmission system through the supply of the regulated services (objective 4)

The AEMC puts up an alternative solution to the interpretation issue raised by SCER of the term “maintain” in the NER clauses 6.5.6(a)(3), 6.5.6(a)(4), 6.5.7(a)(3) and 6.5.7(a)(4). The AEMC proposes the removal of objectives 3 and 4 instead of inserting the new clauses proposed by SCER. Without objectives 3 and 4, it is unclear how the issues of reliability and security would be addressed in jurisdictions where no regulatory obligations or requirements exist specific to those matters. For example, there is no jurisdictional electricity legislation in Victoria relating to reliability standards of a distribution system. As a result, without a requirement to maintain reliability of supply, it would be open to either the DNSP to propose (or the regulator to set) expenditure forecasts that allow reliability targets to be lowered.

We believe SCER’s proposal of inserting new clauses is a far better approach compared to removal of objectives 3 and 4. The additional clauses ensure that, where there are specific requirements on reliability of service in the relevant jurisdiction, these take precedence over maintaining current reliability levels. However, where no specific requirements apply, current levels would be required to be maintained.

Jemena supports extending SCER’s proposed rule change to include security but not quality of supply or safety.

Jemena agrees with the AEMC’s understanding that security of supply is in some ways related to reliability of supply. Given the primary focus of the rule change is to clarify the level of reliability that will be used to determine the expenditure allowance, we believe there is merit in extending the rule change to include security.

In our opinion, lowering standards on quality of supply or safety in Victoria would be controversial and therefore unlikely. Jemena believes customers expect DNSPs to maintain the quality of supply to the current standards, because lowering the standards would adversely impact on the performance of customer appliances and equipment and may even cause damage to them. We believe there is no merit in extending SCER’s proposed rule change to include quality of supply or safety.

Please find Jemena’s response to questions in the consultation paper in Annexure 1.

If you wish to discuss the submission please contact me on (03) 8544 9053 or at robert.mcmillan@jemena.com.au

Yours sincerely

Robert McMillan
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Annexure 1

Jemena Electricity Networks (Vic) response to National Electricity Amendment (Network Service Provider Expenditure Objectives) Rule 2013

Jemena's answers to the questions raised in the Consultation Paper are set out below:

Question 1: Is the assessment framework presented in this consultation paper appropriate for assessing this rule change request?

Jemena is generally supportive of the assessment framework presented in the AEMC's consultation paper. The rule change request must be assessed primarily on the basis that it promotes the National Electricity Objective (**NEO**) and the Revenue and Pricing Principles (**RPP**).

Jemena considers it appropriate to assess the rule change request against other economic factors including allocative, dynamic and productive efficiency – as referred to in the AEMC's consultation paper. A framework that assesses consumers' willingness to pay for an associated level of reliability within discrete jurisdictional boundaries is one that best promotes allocative efficiency. A reliability framework of this nature is already in place in Victoria.

The assessment framework must also assess how the rule change will balance the cost of adopting various reliability standards between the short and longer-term requirements of consumers and networks. This arrangement best promotes dynamic efficiency and, importantly, will also promote the longer-term benefits of consumers.

Question 2: Is there uncertainty and conflict in the NER associated with the level of reliability to be used to determine the expenditure allowance? Is there any reason a standard other than the jurisdictional reliability standard should apply?

The rule proponent considers that a strict interpretation of the term "maintain" in the NER clauses 6.5.6(a)(3), 6.5.6(a)(4), 6.5.7(a)(3) and 6.5.7(a)(4) can potentially allow a DNSP to include expenditure in their regulatory proposals they consider necessary to maintain reliability at historical levels.

Such an interpretation may lead to a potential conflict between the NER and jurisdictional requirements, especially where a jurisdiction considers there may be net benefits and potential cost savings from lowering reliability standards. This potential conflict may lead to uncertainty as to what expenditure a DNSP should put forward in its regulatory proposal and what the AER should assess the proposal against. Given this uncertainty, Jemena considers there is merit in clarifying the forecast operating and capital expenditure objectives in clauses 6.5.6(a) and 6.5.7(a).

Under the Australian Energy Market Agreement, the States and Territories have the responsibility for setting the reliability standards in their respective jurisdictions. The framework provided for jurisdictional reliability standards to prevail unless the jurisdiction has elected not to specify standards and has left it to the regulator to decide on what is a reasonable reliability standard having regard to what customers want and are willing to pay.

In Victoria, there are no specific jurisdictional reliability requirements or obligations other than the obligation[1] in Electricity Distribution Code[2], which does not specify any reliability standards or targets. Instead, the STPIS regime applies. The STPIS provides DNSPs with incentives to pursue opportunities that deliver efficient changes in the level of reliability[3]. The performance benchmarks or targets within the STPIS are based on an average of actual recent performance. Under the STPIS, any such changes in reliability performance will be reflected in future targets. In this way, the STPIS automatically adjusts performance targets through time, to reflect the actual performance of DNSPs who face strong incentives to deliver an efficient level of reliability.

Jemena believes a standard other than the jurisdictional reliability standard could apply provided the jurisdiction elects to transfer responsibility to the AER for setting distribution reliability standards.

Given the penalty and reward nature of the STPIS, it is important to ensure that any change to the NER does not undermine the principle that, in the absence of an explicit state requirement to reduce reliability, a business should be funded to at least maintain its historical performance under the STPIS. Without this principle, a business could end up in the unfortunate position of not being provided sufficient revenues to fund historical performance and having to chose between making unfunded investments or incurring penalties under the STPIS. Neither outcome would be consistent with providing the business a reasonable opportunity to recover its efficient costs.

Question 3: Do stakeholders agree with the interpretation of reliability, security, safety and quality in a network context set out in section 2.3 of this paper?

In section 2.3, AEMC provides its interpretation and understanding of reliability, security and quality of supply and network safety in the context of operating and planning of an electricity network. Jemena largely agrees with the AEMC's interpretations.

In section 2.3.1, we believe that in additional to the two dot points on causes of supply interruptions to customers in the context of reliability, there is an additional cause – that is, when the supply path to a customer is interrupted due to network faults caused by the failure of network components or by external factors such as lightning strikes.

In section 2.3.2 on security of supply, the consultation paper refers to:

"That is, relaxing the standards for power system security would increase the utilisation of the network assets ***and hence the reliability of supply to consumers****, but this would be at the expense of an increased risk of prolonged interruptions to consumers or even equipment damage following a contingency event." [Emphasis added]*

Jemena would have thought that an increase in the utilisation of the network assets would have an adverse effect on the reliability of supply to customers.

[1] A ***distributor*** must use best endeavours to meet targets required by the ***Price Determination*** and targets published under clause 5.1 and otherwise meet reasonable ***customer*** expectations of ***reliability of supply***.

[2] Essential Services Commission of Victoria, Victorian Distribution Code, Version 7, May 2012.

[3] Where the VCR is taken to be a reasonable proxy for the marginal value of reliability to consumers.

Apart from the risk of prolonged interruptions and equipment damage, we believe health and safety to the general public could also be jeopardised. For example, an overloaded overhead high voltage distribution line will elongate and could potentially sag into a low voltage line underneath it causing high voltage injection into consumer premises. This concern has been noted in section 2.3.4 on safety.

In section 2.3.3 on quality of supply, Jemena considers there is an additional issue – that is, poor quality of supply can lead to premature appliance breakdown and replacement.

Question 4: Is it clear that consumers may be paying more for an outcome with respect to safety, security and quality? Is there any evidence of this?

Jemena does not believe there is any evidence that customers in Victoria are paying more for an outcome relating to security, quality and safety.

Question 5: To what extent would it be practical to give more weight and clarity in the NER to standards relating to quality, security and safety to determine the expenditure allowance?

The AEMC contemplates the possibility of lowering of security and quality standards and the resultant economic trade-off on the basis of the same arguments for lowering reliability.

It is worth noting that consumer appliances and equipment are designed to operate within a range of supply quality standards such as voltages and frequencies that are defined in international and AS/NZS standards. Any excursion outside these set parameters would severely compromise the performance and life expectancy – and under certain circumstances safety – of consumer appliances and equipment unless equipment design standards are revised to reflect the changes in supply conditions. Changes to these standards require multilateral discussions and decisions as consumer products are generally manufactured for the global market.

In our opinion, lowering standards on quality of supply would be controversial and therefore unlikely. Jemena believes customers expect DNSPs to maintain the quality of supply to the current standards because lowering of the standards would adversely impact on the performance of customer appliances and equipment and may even cause damage to them. While there is a lot of discussion about ‘gold plating’ a network (from a reliability perspective), the same discussion does not extend to about power quality, especially from customers that have sensitive equipment. These customers want power quality improvements. We believe there is no merit in extending SCER’s proposed rule change to encompass quality of supply.

On the matter of safety, we believe the jurisdictional safety regulator is the appropriate body to determine safety standards. Safety standards generally vary between jurisdictions. Some of these safety standards may relate to geographical and weather conditions in a particular jurisdiction. For example, in Victoria, there are numerous network safety standards to mitigate bushfires, which may not be appropriate in other jurisdictions.

The consultation paper notes that a new electricity safety management systems (**ESMS**) standard is currently being developed by Standards Australia and the AEMC contemplates the possibility of a harmonised standard[4] for safety in the future. Jemena believes it is not practical to have a harmonised safety standard in all areas. This ESMS standard would only provide the basis for developing a common management system for safety – not a common set of harmonised safety standards. We believe there is no case to extend SCER's rule proposed change to safety matters.

Jemena agrees with the AEMC's understanding that security of supply is in some ways related to reliability of supply. Given the primary focus of the rule change is to clarify the level of reliability that will be used to determine the expenditure allowance, we believe there is merit in extending the rule change to include security.

Question 6: Are movements in safety standards so difficult to observe that it would not be workable to include safety as part of this rule change? Is there any in principle reason as to why safety should be treated differently to reliability?

Jemena believes lowering safety standards is unlikely. Safety standards are progressively increased to meet community expectations. These standards and the extent to which they vary depend on jurisdictional safety regulators and community expectations. Such movements in safety standards are generally addressed through step changes in expenditures in DNSPs' regulatory proposals.

Jemena believes safety should be treated differently to reliability in the context of the proposed rule change.

Question 7: Is it practical to clarify and give more weight to some but not all of the measures in the expenditure objectives?

Refer to our response to question 5.

Question 8: Does the proposed rule achieve the proposed intent or is there alternative drafting that would better reflect this

Jemena believes the proposed rule[5] achieves the intent of the rule proponent.

Question 9: If the expenditure objectives require clarification, should the approach in proposed rule be used or should expenditure objectives 3 and 4 be removed?

The NER requires NSPs to include in their regulatory proposals the forecast expenditure that they consider is required to:

- meet or manage the expected demand over the regulatory control period (objective 1);
- comply with all applicable regulatory obligations or requirements (objective 2);
- maintain the quality, reliability and security of supply of the regulated services (objective 3); and
- maintain the reliability, safety and security of the distribution or transmission system through the supply of the regulated services (objective 4)

SCER has proposed to insert new clauses in the NER to qualify the existing forecast capital and operating expenditure objectives. These objectives are for assessing the regulatory proposals and their compliance with jurisdictional reliability standards.

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[4] Network service provider rule change request, 7 February 2013, Consultation paper, p14.
[5] Network service provider rule change request by SCER, Schedule 1, September 2012.

In the consultation paper, the AEMC puts up an alternative solution to the potential interpretation issue raised by the proponent. The AEMC suggest that this issue could be addressed by removing objectives 3 and 4. But it notes that if the objectives 3 and 4 are removed "there may be a risk that the AER would take too broad an interpretation and not consider particular aspects of performance such as reliability, quality, security and safety". Jemena considers this risk to be material.

This risk is a major concern to Jemena, given that there is no jurisdictional electricity legislation in Victoria relating to reliability standards[6] of a distribution system. Objectives 3 and 4 explicitly deal with reliability, quality, security and safety, which are key characteristics of electricity distribution and transmission systems. Objective 2 does not explicitly deal with these key characteristics; and objective 1 relates to expected demand.

We believe SCER's proposal of inserting new clauses to improve regulatory certainty and provide clarity as to what should be put forward in its regulatory proposal and what the AER should assess the proposal against is a far better approach compared to removal of objectives 3 and 4.

The consultation paper notes that the AEMC is not considering whether operating expenditure should be allowed for under utilised assets in general. Instead, the AEMC is only interested in the issues as they relates to meeting the level of reliability for the purposes of the NSP expenditure proposals[7].

Jemena considers the approach in SCER's proposed rule should be used. We do not support the removal of objectives 3 and 4. Furthermore, for the avoidance of doubt, Jemena considers the forecast operating expenditure clause 6.5.6(a) should be clarified to include opex of under utilised assets as a result of changes to jurisdictional requirements. Similar clarification is not required for forecast capital expenditure in clause 6.5.7(a).

Question 10: Are there any special considerations that should be given to particular jurisdictions with respect to this rule change request? For example, should the rule be drafted differently for Victoria? If any, what should be the differences?

Jemena has noted in its response to question 9 that it does not support removal of expenditure objectives 3 and 4 due to the different approach to reliability standards in Victoria. The proposed rule change[8] would work for Victoria.

Question 11: Are there any transitional issues and/or consequential changes that would likely need to be considered for this rule change request?

From a Victorian perspective, we consider there are no transitional issues that need consideration for this rule change request.

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[6] The Victorian DNSPs propose their own reliability performance targets in regulatory proposals. The performance benchmarks or targets within the proposed STPIS are based on an average of actual recent performance.

[7] Network service provider rule change request, 7 February 2013, Consultation paper, p16.

[8] Network service provider rule change request by SCER, Schedule 1, September 2012.