



**Australian Energy Market Commission**

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## **CONSULTATION PAPER**

# National Electricity Amendment (Network Service Provider Expenditure Objectives) Rule 2013

7 February 2013

**RULE  
CHANGE**

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Reference: ERC0152

## **Citation**

AEMC 2013, Network Service Provider Expenditure Objectives, Consultation Paper, 7 February 2013, Sydney

## **About the AEMC**

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

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# 1 Introduction

On 8 October 2012, the Standing Council on Energy and Resources (SCER or proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) in relation to the operating expenditure (opex) and capital expenditure (capex) objectives in chapters 6 and 6A of the National Electricity Rules (NER or rules). In particular, the rule change request seeks to clarify the level of reliability to be used for determining the expenditure allowance as part of the regulatory determinations for network service providers (NSPs). It also asks whether similar clarification is required for the safety, quality and security aspects of the expenditure objectives.

This consultation paper has been prepared by the staff of the AEMC to facilitate public consultation on the rule change request and does not necessarily represent the views of the AEMC or any individual Commissioner of the AEMC.

This paper:

- sets out a summary of, and a background to, the rule change request;
- identifies a number of questions and issues to facilitate the consultation on the rule change request; and
- outlines the process for making submissions.

## Submissions

Submissions are to be received by 7 March 2013. Additional details on lodging a submission are outlined in Chapter 6 of this paper.

## Timetable

The draft rule determination (and draft rule if applicable) is required to be published by 16 May 2013.

## 2 Background

This chapter provides background information on the rule change request including the current arrangements in respect of the issues raised and the problem that has been identified by the proponent.

### 2.1 Current arrangements

Under the Australian Energy Market Agreement (AEMA), the States and Territories have the responsibility for setting the reliability standards in their respective jurisdictions.<sup>1</sup>

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;
- comply with all applicable regulatory obligations or requirements;
- maintain the quality, reliability and security of supply of the regulated services; and
- maintain the reliability, safety and security of the distribution or transmission system through the supply of the regulated services.<sup>2</sup>

These are known as the capex and opex objectives (expenditure objectives).

The Australian Energy Regulator (AER) is required to accept a NSP's forecast expenditure where it is satisfied that the expenditure reasonably reflects:

- the efficient costs of achieving the expenditure objectives;
- the costs that a prudent operator in the circumstances of the relevant NSP would require to achieve the expenditure objectives; and
- a realistic expectation of the demand forecast and cost inputs required to achieve the expenditure objectives.<sup>3</sup>

These are known as the capex and opex criteria (expenditure criteria).

If the AER is not satisfied that the proposed forecast expenditure does not meet these criteria, then it must set out an estimate of the expenditure that it considers does reasonably reflect the expenditure criteria.<sup>4</sup>

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<sup>1</sup> Annexure 2 to the Australian Energy Market Agreement, as amended on 2 October 2011, p. 2.

<sup>2</sup> NER clauses 6.5.6(a), 6.5.7(a), 6A.6.6(a) and 6A.6.7(a).

<sup>3</sup> NER clauses 6.5.6(c), 6.5.7(c), 6A.6.6(c) and 6A.6.7(c).

<sup>4</sup> NER clause 6.5.6(d), 6.5.7(d), 6A.6.6(d) and 6A.6.7(d).

## 2.2 Proponent's identification of the problem

The proponent claims that an interpretation of the NER could potentially allow NSPs to include expenditure they consider necessary to maintain the level of reliability they achieved in the previous regulatory period. This could be a problem where:

- the required jurisdictional reliability standards are lowered; or
- a NSP is performing above the jurisdictional reliability standards.

This also means that potential reductions in expenditure from lower jurisdictional reliability standards may not be passed through to end use consumers.

It is noted that the subject of this rule change request was previously raised as an issue by the AER in its network regulation rule change request and by the AEMC in the New South Wales distribution reliability review.<sup>5</sup> As part of the latter review, the AEMC considered that the above issue should be resolved through a separate rule change process and made these recommendations to the New South Wales Government.<sup>6</sup>

In addition to the issue of reliability, the SCER has also asked the AEMC to investigate whether similar issues in the NER also apply to expenditure associated with quality, security and safety of the network.

## 2.3 Reliability, safety, security and quality in a network context

The rule change request relates to the requirement in the NER on NSPs to forecast the capex and opex that they consider would maintain:

- the quality, reliability and security of supply of services; and
- the reliability, safety and security of the transmission/distribution system through the supply of services.

The first point relates to the supply of electricity to consumers as a service. The second refers to the services that are provided or procured by the NSP in order to operate its network as a whole, consistent with consumers' demand for electricity services.

This section provides an interpretation of what AEMC staff consider is meant by reliability, security, quality of supply and safety in the context of operating and planning an electricity network.

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<sup>5</sup> AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services*, Directions paper, 2 March 2012, p. 30; AEMC, *Review of distribution reliability outcomes and standards - New South Wales workstream*, Final report, 31 August 2012, pp. 108, 118.

<sup>6</sup> AEMC, *Review of distribution reliability outcomes and standards - New South Wales workstream*, Final report, 31 August 2012, pp. 108, 118.

### 2.3.1 Reliability

Reliability refers to the continuity of supply to customers. Interruptions to the supply to customers either occur when:

- there is insufficient generation available to a region, including imports from other regions, to meet the load in that region (reliability of the power system); or
- the load exceeds the capacity of the network that is available to supply that load (reliability of supply).

For the purposes of this rule change request, when reliability is referred to, it is with respect to the latter point.

In the context of transmission and distribution networks such interruptions generally occur during periods of high demand coincident with planned or forced outages of one or more transformers or lines. For example, this can occur on a very hot afternoon when air-conditioner use is high and the power carrying capability of the network is reduced. While the reliability of the individual transformers and lines is of some interest, the primary concern is the impact of outages on the supply to consumers.

The reliability standards are specified in state or territory government instruments, such as licence conditions. The transmission and distribution network businesses within the state are required to apply these standards when planning and operating their networks. The form of the reliability standards for planning networks vary between these state and territory governments, as well as between distribution and transmission. For example, in transmission for:

- New South Wales, Queensland and Tasmania: the reliability standards are deterministic in nature, with the level of redundancy within the networks specified;
- Victoria: the reliability standards are based on an economic assessment approach, with the level of expenditure in the networks based on the value that consumers place on a reliable supply; and
- South Australia: the reliability standards are based on a mixture of deterministic and economic assessment approaches.

There are two approaches to measuring the historical reliability of electricity networks. For transmission networks, historical reliability is usually measured in system minutes of unsupplied energy to consumers, ie the total amount of energy to consumers that is interrupted divided by the total demand.<sup>7</sup> For distribution networks, historical reliability is usually measured using the System Average Interruption Duration Index (SAIDI), System Average Interruption Frequency Index (SAIFI) and Customer Average

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<sup>7</sup> The AER's 2012 State of the Energy Market discusses transmission network reliability on page 73. This report is available at [www.aer.gov.au](http://www.aer.gov.au).

Interruption Duration Index (CAIDI) statistics that measure the number and duration of consumer interruptions.<sup>8</sup>

As noted in the SCER rule change request, Victorian distribution network service providers (DNSPs) can set their own reliability performance targets as the jurisdictional regulator or Victorian Government does not set minimum targets or standards. Each year, Victorian DNSPs must publish their reliability targets and use their best endeavours to comply with these targets.<sup>9</sup> For 2012, these targets were the same as the AER's Service Target Performance Incentive Scheme (STPIS) targets. The STPIS provides for discretionary service standards for which financial incentives and penalties can apply. These are different standards to the mandatory jurisdictional reliability standards and are based on performance against specific measures. These standards are set by the AER.

Network reliability is discussed further in Appendix D of the AEMC Reliability Panel draft report on its 2012 Annual Market Performance Review.<sup>10</sup>

### 2.3.2 Security of supply

Security of the power system and security of supply relate to the way the power system is operated. That is, the power system is required to be able to continue to operate in a satisfactory state following the most severe single credible contingency event possible in the power system.<sup>11</sup> Security of the power system is achieved by limiting flows of electrical power in the network so that it would continue to operate in a “satisfactory state” following a “single credible contingency” event, where:

- a satisfactory state means that all equipment in the power system is operating within its capability, and the voltage and frequency is within the allowable standards; and<sup>12</sup>
- a single credible contingency is a contingency in the power system, such as the loss of a transformer or line, which is reasonably likely to happen.<sup>13</sup>

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<sup>8</sup> The SAIDI, SAIFI and CAIDI statistics measure the impact of interruptions to consumers of greater than one minute. The AER's 2012 State of the Energy Market discusses distribution network reliability on page 76.

<sup>9</sup> Essential Services Commission, Victorian Electricity Distribution Code, Version 7, May 2012, clause 5.2.

<sup>10</sup> The AEMC Reliability Panel draft report on its 2012 Annual Market Performance Review is available at <http://www.aemc.gov.au/market-reviews/open/annual-market-performance-review-2012.html>.

<sup>11</sup> Clause 4.2.4 of the NER defines a secure operating state for the purposes of power system operations.

<sup>12</sup> Clause 4.2.2 of the NER defines a satisfactory state for the purposes of power system operations.

<sup>13</sup> Clause 4.2.3 of the NER defines a credible contingency event for the purposes of power system operations. Note that clauses 4.2.3A and 4.2.3B expand this definition as it applies under unusual conditions such as severe weather and bush fires.

The Australian Energy Market Operator (AEMO) is responsible for maintaining the security of the power system as a whole and the distribution businesses are responsible for security within their networks.

The standards that apply to security relate to the definitions of a satisfactory operating state and credible contingency. That is, relaxing the security standards would be achieved by either:

- relaxing the definition of a satisfactory operating state, including by allowing a broader range of voltages and frequencies to exist in the power system, or by being less risk adverse (less conservative) when determining the ratings of transformers and lines; or
- reducing the range of credible contingencies considered to exclude some more severe and low probability events.

Setting the definitions of a satisfactory operating state and credible contingency is an economic trade-off between:

- the capability of the network to transfer electrical power; and
- the risk that the system would enter an unsatisfactory state.

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.

### **2.3.3 Quality of supply**

In Australia the electricity supply is specified as a 50 Hz sinusoidal waveform at the nominal voltage, which is 230 V for small businesses and domestic residences.

However, the actual voltage at a consumer's premises is unlikely to be a perfect 50 Hz sinusoidal waveform of precisely 230 V. Variations to frequency and voltage magnitude, and imperfections to the sinusoidal voltage waveform, are normal and collectively referred to as "power quality" or "quality of supply".

In general these variations and imperfections in the voltage waveform are not too large and are not a problem for consumers. However, if the quality of supply is allowed to deteriorate then it can cause some consumers' appliances and network equipment to malfunction or overheat. The relevant standards for different aspects of quality of supply include the:

- AEMC Reliability Panel frequency operating standards,<sup>14</sup>

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<sup>14</sup> The mainland and Tasmanian frequency operating standards are available on the AEMC website at <http://www.aemc.gov.au/panels-and-committees/reliability-panel/guidelines-and-standards.html>.

- AS/NZS 60038, which specifies the allowable range of the steady state voltage magnitude; and
- AS/NZS 61000, which specifies the allowable voltage fluctuation and harmonic voltage distortion.

Quality of supply problems generally originate from some types of equipment operated by network users and such problems can be propagated to other network users via the NSP's network. NSPs have obligations to provide consumers with an electricity supply that is of sufficiently high quality. NSPs manage this through the connection agreements by requiring that network users' loads and generators meet the appropriate technical standards. When a consumer's load is likely to cause a quality of supply problem the connection agreement should require mitigation, either in the network user's premises or in the NSP's network, depending on the nature of the problem.

### 2.3.4 Safety

While safety of the National Electricity Market (NEM) and safety of equipment, power system personnel and the public is an important consideration under the National Electricity Law (NEL) in general terms, there is no national safety regulator for electricity.<sup>15</sup> Jurisdictions have specific provisions that explicitly refer to safety duties of transmission and distribution systems.<sup>16</sup>

The safety considerations in the NEM are closely linked to the security of the power system and operating assets and equipment within their technical limits. For example, if a transmission line was overloaded, the lines could sag below minimum acceptable clearances to ground. This would present a danger to people or vehicles near the transmission line. Therefore, such aspects of safety can be managed by ensuring that the power system is operated within ratings and technical limits. Under this limited scope, maintaining security of the power system could be considered as maintaining a 'safe' power system to meet the requirements for safety in a general sense.<sup>17</sup> It is noted that this is a narrow definition of safety.<sup>18</sup>

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<sup>15</sup> In January 2012, the Commonwealth and State and Territory governments entered an Intergovernmental Agreement on Energy Supply Industry Safety. Under this agreement, the governments committed to work with the energy sector to improve the consistency of state based regulations – such as occupational health and safety requirements – that apply to the energy sector. To progress this initiative, the Energy Supply Industry Safety Committee (ESISC) has been formed to guide the harmonisation of energy technical and safety regulations. The ESISC is a non-statutory policy and regulatory advisory body that reports to the SCER. The ESISC developed the new Electricity Network Safety Management Systems Australian Standard which was to be expected to be published in January 2013.

<sup>16</sup> See NEL section 2D(a).

<sup>17</sup> Although it is noted that some system security considerations do not relate to safety, for the purpose of our considerations, where the power system has been maintained in a secure state, it is considered that it is also 'safe'.

<sup>18</sup> Safety in the context of the NER is discussed in Chapter 7 of the AEMC Reliability Panel draft report on its 2012 Annual Market Performance Review.

A broader definition of safety could include issues that are not directly related to the operation of transmission or distribution network, ie public safety issues, and may include many such things as:

- substation fencing;
- environment issues such as the management of transformer oil leaks and audible noise abatement; and
- occupational health and safety (OHS) issues.

## 2.4 Other work being undertaken on reliability issues

It is important to note that this rule change request does not consider whether existing levels of jurisdictional reliability standards are appropriate or whether the setting of standards should be done at a jurisdictional or national level. In this regard, the AEMC has been requested by SCER to undertake a review to develop a national framework for setting distribution and transmission reliability standards.<sup>19</sup> The Council of Australian Governments (COAG) has recommended amendments to the AEMA to make explicit the opportunity for jurisdictions to transfer responsibility of applying the framework to the AER.<sup>20</sup> In parallel, the Productivity Commission is also looking at reliability as part of its electricity network regulatory frameworks review.<sup>21</sup>

It is noted that the AER is currently developing guidelines in response to the network regulation rule determination made by the AEMC in November 2012.<sup>22</sup> These guidelines will be in place by November 2013. The first time the AER applies the new rules in a revenue reset will follow this date. This would also be the first time the AER could apply any rule changes made as a result of this rule change request.

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<sup>19</sup> SCER, Meeting Communiqué, 14 December 2012, Hobart..

<sup>20</sup> SCER, Meeting Communiqué, 14 December 2012, Hobart..

<sup>21</sup> Productivity Commission, *Electricity Network Regulatory Frameworks*, Draft report, 18 October 2012.

<sup>22</sup> AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services*, Directions paper, 2 March 2012, p. 30.

### 3 Details of the rule change request

#### Proposed solution to the problem

The rule change request proposes to amend the opex and capex objectives in the NER.<sup>23</sup> The amendments would have the effect of only allowing NSPs to include in their regulatory proposals sufficient expenditure to comply with applicable regulatory obligations or requirements relating to reliability.<sup>24</sup>

The proponent's rule change request includes a proposed rule.<sup>25</sup> The proposed rule inserts new clauses to qualify the existing capex and opex objectives where an NSP is required to comply with a regulatory obligation or requirement relating to reliability for providing services. In such circumstances, the amount a NSP includes in its regulatory proposal must be no more than an amount it considered is required to comply with that regulatory obligation or requirement. With the exception of the additional qualifying clause, the existing provisions would remain unchanged.

The proponent seeks for the rule to commence operation no later than the anticipated date that the New South Wales DNSPs are to submit their next regulatory proposals.<sup>26</sup> Under Chapter 6 of the NER, as amended by the Economic Regulation of Network Service Providers rule change request which commenced operation on 29 November 2012, the New South Wales DNSPs are required to submit their next regulatory proposals by 31 May 2014.<sup>27</sup> If a rule were to be made, it would apply to all future regulatory determinations, with the exception of SP AusNet's (transmission) next regulatory determination.<sup>28</sup>

#### Rationale for the solution

In its rule change request, the proponent provides its rationale for the proposed rule. It states that the proposed rule would:

- improve regulatory certainty by removing a potential conflict between the NER requirement for NSPs to include sufficient expenditure to maintain reliability levels, and jurisdictional obligations for NSPs to comply with the potentially lower jurisdictional reliability standards or targets;

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23 SCER, Rule change request, Attachment A, Section 2.

24 The relevant NER clauses that would be affected include 6.5.6(a)(3), 6.5.6(a)(4), 6.5.7(a)(3), 6.5.7(a)(4), 6A.6.6(a)(3), 6A.6.6(a)(4), 6A.6.7(a)(3) and 6A.6.7(a)(4).

25 SCER, Rule change request, Attachment B.

26 SCER, Rule change request, Attachment A, Section 9.

27 Clause 11.55.2 of the NER in effect requires New South Wales DNSPs to submit their transitional regulatory proposals by 30 September 2013 for the transitional regulatory period of 12 months commencing on 1 July 2014. After that transitional regulatory period, under clause 6.8.2(a) of the NER, New South Wales DNSPs are required to submit their regulatory proposal by 31 May 2014.

28 SP AusNet is due to submit its regulatory proposal by 28 February 2013.

- allow for savings in expenditure associated with potentially reduced reliability standards under jurisdictional obligations with lower reliability standards to be passed on to consumers; and
- improve efficient investment as a result of expenditure reflecting jurisdictional reliability standards.<sup>29</sup>

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<sup>29</sup> SCER, Rule change request, Attachment A, Section 5.

## 4 Assessment framework

The Commission's assessment of this rule change request must consider whether the proposed rule promotes the National Electricity Objective (NEO) as set out under section 7 of the NEL. The NEO under section 7 of the NEL states:

“The objective of the Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to-

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

The Commission's assessment of the rule change request must also include other considerations such as taking into account the revenue and pricing principles and any relevant SCER statement of policy principles.<sup>30</sup>

The AEMA gives responsibility for the States and Territories to set the reliability standards in their respective jurisdiction.<sup>31</sup> This gives the State and Territory governments the ability to determine the level of reliability standards that consumers want given the costs of providing different reliability standards. On this basis, the premise of the rule change request is that jurisdictional reliability standards are an appropriate reflection of what state and territory governments consider consumers in that jurisdiction want given the costs of providing different reliability standards.<sup>32</sup> What consumers want and are willing to pay for will assist in showing what is efficient. A similar argument can be made for quality, security and safety of supply.

With this in mind, in assessing the rule change request against the NEO and the revenue and pricing principles, AEMC staff consider that the following issues could be taken into account:

- the ability of the proposed rule to allow for expenditure that better reflects efficient costs in the long term. For example, if the NSP is only allowed expenditure to meet reliability standards and these standards are a reflection of what level of reliability consumers should pay for, then the expenditure allowance for reliability is more likely to represent efficient costs. This promotes allocative efficiency because it allows the value that consumers place on the NSP undertaking certain expenditure to be better reflected in the allowance. It also promotes productive and dynamic efficiency because it relates to cost and

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<sup>30</sup> The revenue and pricing principles are set out under section 7A of the NEL. Under section 33 of the NEL, the AEMC must have regard to any relevant Ministerial Council on Energy (now known as the SCER) statement of policy principles in making a rule. As of the publication of this Consultation Paper, there is no relevant SCER statement of policy principles.

<sup>31</sup> Annexure 2 to the Australian Energy Market Agreement, as amended on 2 October 2011, p. 2.

<sup>32</sup> It is noted that the Victorian Government has allowed Victorian DNSPs to set their own reliability standards, with the jurisdictional regulator responsible for enforcing these obligations.

investment over the longer term. Having expenditure that better matches consumers desired reliability standards also acts to further the long term interests of consumers;

- the ability of the proposed rule to provide clarity, which would lead to regulatory certainty, for the NSP in proposing expenditure and the AER in assessing the expenditure against an appropriate level of reliability requirements. If jurisdictional standards are lowered then it is clearer that the expenditure allowance is only to be set at the level to meet the reduced standard. This additional certainty could promote productive and dynamic efficiency; and
- the ability of the proposed rule to allow for administrative efficiency where there may be administrative implications of having a different benchmark in the NER for the different measures of performance, ie having to maintain levels of performance for some measures and not others. In practice, this means that the NSP and the AER could use the same approach for assessing the different measures especially when there is overlap between these measures. This promotes productive efficiency because it allows the NSP and AER to streamline their approach when developing the appropriate expenditure allowance, and generally minuses the costs of the regulatory process.

This assessment framework will not consider whether the existing levels of jurisdictional reliability standards are appropriate. This is a matter that is outside the scope of this rule making process.

**Question 1**

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

## 5 Issues for consultation

We have identified a number of issues for consultation that appear to be relevant to this rule change request. These issues outlined below are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request or this paper including the proposed framework.

### 5.1 The nature of the problem

The proponent has claimed that an interpretation of the NER could be made which may potentially allow NSPs to include expenditure they consider necessary to maintain the level of reliability they achieved in the previous regulatory period. This could be a problem where: the required jurisdictional reliability standards are lowered; or a NSP is performing above the jurisdictional reliability standards. For instance, the jurisdiction may consider that there may be significant net benefits in lower reliability outcomes and that there would be potential costs savings for customers from lower levels of distribution investment to meet reliability requirements which would outweigh the potential costs to customers from a lower level of reliability performance.<sup>33</sup> This may lead to a potential conflict between the NER and jurisdictional obligations and requirements. This conflict may create uncertainty as to what expenditure the NSP should put in its regulatory proposal and what the AER should assess the proposal against.

The AEMC discussed this issue as part of its directions paper on the Economic Regulation of Network Service Providers rule change request.<sup>34</sup> At that time, submissions from stakeholders indicated support to resolve this issue. Submissions from the Energy Networks Association and the AER on the directions paper supported changes to the NER to clarify the intent of the objectives, so that expenditure forecasts target compliance with mandated service and reliability standards rather than maintaining historic levels of reliability.<sup>35</sup> Jemena also supported clarifying the intent of the objectives, but noted that prudently incurred capital expenditure that is required to meet jurisdictional standards should not be stranded if those standards are later relaxed.<sup>36</sup>

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<sup>33</sup> AEMC, *Review of distribution reliability outcomes and standards - New South Wales workstream*, Final report, 31 August 2012, pp. v-vii.

<sup>34</sup> AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services*, Directions paper, 2 March 2012, p. 30.

<sup>35</sup> Energy Networks Association, Submission to AEMC directions paper: Economic regulation of transmission and distribution Network Service Providers rule change proposal, April 2012, p. 24; AER, Submission to AEMC directions paper: Economic regulation of transmission and distribution Network Service Providers rule change proposal, April 2012, p. 17.

<sup>36</sup> Jemena, Submission to AEMC directions paper: Economic regulation of transmission and distribution Network Service Providers rule change proposal, April 2012, p. 14.

In the New South Wales reliability standards review, the AEMC considered that the above issue should be resolved through a separate rule change process and made these recommendations to the New South Wales Government.<sup>37</sup>

To the extent that there is a likelihood that uncertainty and conflict between the NER and jurisdictional obligations and requirements arises, it would seem appropriate to consider whether the NER needs to be amended.

**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?**

## 5.2      **Scope of the rule change**

This rule change request primarily focuses on clarifying the level of reliability that will be used when determining the expenditure allowance. The proponent has also asked whether similar clarification is required in relation to the security, safety and quality components of the capex and opex objectives.

It suggests that in theory the same issue could occur for these measures – that is if security, safety or quality standards are lowered then there could be a potential conflict between the standards and the level of performance required for coming up with a NSPs expenditure allowance. In this way, the current drafting of the NER could lead to issues where consumers may be paying for an outcome on security, safety and quality that is higher than the statutory and other requirements.

If the same problem does occur with these performance measures, the question then becomes whether it is possible to give more weight and clarity to standards relating to these measures in the NER from a practical point of view.

In this regard, it would seem practical to give more weight and clarity to security and quality of supply standards in the NER as these measures appear closely related to reliability, and there appears to be clear definitions, understanding and obligations for them.

In relation to safety, it is recognised that a relevant body has the responsibility to determine the appropriate levels of safety that need to be met and that NSPs will be aware of the standards that they have to meet. In addition, it is understood that a new electricity network safety management systems standard is currently being developed by Standards Australia.<sup>38</sup> A harmonised standard for safety may make more of a case

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<sup>37</sup> AEMC, *Review of distribution reliability outcomes and standards - New South Wales workstream*, Final report, 31 August 2012, pp. 108, 118.

<sup>38</sup> SCER, Meeting Communiqué, 14 December 2012, Hobart.

for clarification around the expenditure objectives in relation to safety similar to the other network performance measures for the purpose of this rule change request. Further, there has to be some consideration of the costs and benefits of expenditure to get a broadly efficient level of expenditure for safety.

However, there is less clarity on the extent to which it is practical for safety requirements to be given more weight and clarity in the NER, given a potentially broader definition and therefore wider range of obligations for this measure as set out under section 2.3.4. As a result, it may be difficult for the AER to be aware of all of the obligations in this area and whether they have changed between regulatory determinations. There is also a question as to whether safety should be included in principle, ie whether it is appropriate that the NER provides for expenditure to only meet standards with respect to safety, which could be less than the expenditure required to maintain the existing levels of safety. This could be interpreted as a lowering of safety standards. For these reasons, it may appear inappropriate to treat safety in the same manner as the other aspects of performance.

An additional issue that needs to be considered is the extent to which some (but not all) of the performance measures in the capex and opex objectives could be clarified. For example, the extent that it is practical to potentially change the expenditure objectives for some (but not all) of the measures may require further thought, given the overlap between the measures.

**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?

**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?

**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?

**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?

<b>Question 7</b>	<b>Is it practical to clarify and give more weight to some but not all of the measures in the expenditure objectives?</b>
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### **5.3 Implementation issues**

Assuming that there is a problem that requires a rule change to be made to the NER, the solution needs to be practical and the structure of the clause needs to reflect the intended solution.

#### **5.3.1 Flexibility in applying rules**

Before applying a solution, it is important that the regulator has the flexibility in applying the NER to account for different circumstances that may arise. In terms of this rule change request, the proponent seeks to address a risk of NSPs seeking expenditure to build for investment to exceed their jurisdictional obligations or requirements for reliability. The purpose of this section is to raise potential reasons why a solution to this problem needs to be flexible.

For example, when building new network infrastructure or augmenting existing infrastructure, it is often efficient or practical to build for additional capacity at that time as opposed to waiting for when it is immediately required. Therefore, network investment can be described as "lumpy" in nature as it is often difficult to expand the network in small increments. In this way, it may be more efficient to allow expenditure to achieve reliability levels which are higher than the jurisdictional standard in the short term. For example, it may be more efficient to lay two lines in an area to account for longer term demand; however, this will provide a short term level of reliability that is higher than is required.

Another example is where an existing asset becomes redundant as it is no longer required in the short term with changes to a jurisdictional reliability obligation. Opex is normally provided to maintain the upkeep of that asset. A problem may arise when this asset is required to meet future consumer demand. If this asset is not kept in an operational condition so that it can be immediately used when required, then this may not be an efficient outcome. In this scenario, it should be noted that we are not considering whether opex should be allowed for under-utilised assets in general. Instead, we are only interested in the issues as it relates to meeting the level of reliability for the purposes of the NSP expenditure proposals.

For the avoidance of doubt, if the jurisdictional reliability standard is lowered and as a result capex previously undertaken is no longer required, then the NSP would still be able to recover the cost of that capex under the NER.

The two examples above demonstrate that the AER needs sufficient discretion to accommodate various situations and circumstances. In addition, the solution needs to remain relevant and effective over time. It should not be limited to meeting

jurisdictional standards in the short term, but should require the AER to take a broader and longer term view. In the absence of such aspirations, it would likely not allow for expenditure that better reflects efficient costs that consumers are willing to pay for in the long term. Similarly, the solution would need to be flexible enough to allow NSPs to recover efficient costs and the AER to have clarity to enable it to assess these costs.

### 5.3.2 Structure of clause

As noted in section 2.1, 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).<sup>39</sup>

In considering the appropriateness of these existing provisions and whether they should be changed for clarity, any changes need to result in regulatory certainty. The NSP would need to understand the level of reliability that should be used to determine its expenditure allowances. This, in turn, would allow the AER to assess the proposed expenditure against appropriate expenditure criteria and objectives.

Without changing objectives 1 to 4, the proponent proposes to insert new clauses to qualify these objectives where an NSP is required to comply with a regulatory obligation or requirement relating to reliability for providing services. In such circumstances, the amount a NSP includes in its regulatory proposal must be no more than an amount it considered is required to comply with that regulatory obligation or requirement. The proponent's proposed rule may have some merit if the existing objectives 1 and 2 are inadequately clear.

An alternative solution to the problem raised by the proponent could be to actually remove objectives 3 and 4. If the existing objectives 1 and 2 are sufficiently clear,<sup>40</sup> and objectives 3 and 4 do not add any value to objectives 1 and 2, this solution may be appropriate.<sup>41</sup> In these circumstances, the proponent's proposed rule would not be necessary. However, if the clauses are removed, there may be a risk that the AER would take a too broad of an interpretation and not consider particular aspects of performance such as reliability, quality, security and safety. If the existing objectives 1

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<sup>39</sup> NER clauses 6.5.6(a), 6.5.7(a), 6A.6.6(a) and 6A.6.7(a).

<sup>40</sup> NER clauses 6.5.6(a)(2), 6.5.7(a)(2), 6A.6.6(a)(2), 6A.6.7(a)(2).

<sup>41</sup> NER clauses 6.5.6(a)(3)-(4), 6.5.7(a)(3)-(4), 6A.6.6(a)(3)-(4), 6A.6.7(a)(3)-(4).

and 2 are inadequately clear, then further changes need to be considered, such as that proposed by the proponent.

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

**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?

### 5.3.3 Jurisdictional considerations

As noted in section 2.3.1, the Victorian jurisdiction has taken a different approach for reliability standards compared to other jurisdictions where Victorian DNSPs set their reliability standards, as opposed to the jurisdictional regulator. Another difference is the nature of jurisdictional reliability standards for planning where, for example, Victoria is based on an economic assessment approach while some other jurisdictions are based on a deterministic approach. On this basis, Victoria may require a different approach in the drafting of the rule compared to the other jurisdictions. For instance, if objectives 3 and 4 are removed then objectives 1 and 2 may need to be broadened. We welcome views on whether Victoria should be treated differently and, if so, how it should be treated. However, where possible, national consistency in application of the NER is our default position.

**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?

### 5.4 Savings and transitional requirements

Any rule change would not have an impact on NSPs until their next regulatory determination. The proponent has proposed that the propose rule commences operation before New South Wales DNSPs must submit their next regulatory proposal.

It is noted that the Transend, TransGrid, and the Australian Capital Territory and New South Wales DNSPs would likely be the first of the NSPs in the NEM that would be subject to any new rule. These NSPs are due to submit transitional regulatory proposals to the AER by 31 January 2014 and full proposals during May 2014. Except for SP AusNet (transmission) these NSPs are the next NSPs to have their regulatory determinations made by the AER. SP AusNet is due to submit its regulatory proposal

by 28 February 2013. It is not possible to have the rule change in place in time for this regulatory determination.

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

## **6 Lodging a submission**

The Commission has published a notice under section 95 of the NEL for the rule change request inviting written submissions. Submissions are to be lodged online or by mail by 7 March 2013 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on rule change requests.<sup>42</sup> The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Neil Howes on (02) 8296 7800.

### **6.1 Lodging a submission electronically**

Electronic submissions must be lodged online via the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), using the "lodge a submission" function and selecting the project reference code ERC0152. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

### **6.2 Lodging a submission by mail**

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0152.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

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<sup>42</sup> This guideline is available on the Commission's website.

## Abbreviations

AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CAIDI	Customer Average Interruption Duration Index
capex	capital expenditure
COAG	Council of Australian Governments
Commission	See AEMC
DNSP	distribution network service provider
ESISC	Energy Supply Industry Safety Committee
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
OHS	occupational health and safety
opex	operating expenditure
proponent	See SCER
rules	See NER
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
SCER	Standing Council on Energy and Resources
STPIS	Service Target Performance Incentive Scheme