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Mr John Pierce
Chairman
Australian Energy Market Commission
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Dear Mr Pierce,

REVIEW OF DISTRIBUTION RELIABILITY OUTCOMES AND STANDARDS IN NSW

IPART welcomes the opportunity to comment on the AEMC's review of distribution reliability outcomes and standards in NSW (draft report).

We are the economic regulator of electricity and gas retail prices for small customers in NSW that have not entered into a market contract with a licenced retailer. Throughout our price review processes, customers and their representatives have highlighted to us that they have serious concerns about increasing electricity prices and its effects on customers, particularly low income households. Given public concerns about rising electricity prices, it is particularly important to establish whether the community considers that the reduced risk of failure as a result of higher reliability standards introduced in NSW in 2005 (and amended in 2007) represents 'value for money'.

The reliability standards set out in the network operators' licence conditions reflect judgements made by the NSW Government (on the community's behalf) of the level of service (and the associated cost) valued by the community.

In this context we support an open and transparent review of the trade-off between the community's expectations and the benefits they attach to the reliability of electricity supply, and the costs associated with this supply. This will assist the NSW Government in making an informed decision on the appropriate level and structure of reliability standards over the next regulatory period and beyond. Given the long lived nature of network assets we consider it important that any changes to reliability standards are implemented in a timely manner and should be done in time for the next NSW distribution determination. This will help to avoid any unnecessary investment and reduce the associated impacts for customer bills.

We have focused our comments on the key issues around the setting of reliability standards. We recommend that:

- ▼ reliability standards in NSW should be expressed on an outcomes basis,
- ▼ lowering the reliability standards in NSW provides net benefits to society as evidenced by the work undertaken by the AEMC. Further, current electricity customers are paying higher electricity prices as a direct consequence of NSW distribution businesses outperforming against the existing reliability standards,
- ▼ setting reliability standards too high may discourage competition and future innovation in services on the customers' side of the meter. It may lead to investment in the distribution network that is ultimately not valued by many customers.

Reliability standards in NSW should be changed and expressed on an outcomes basis. The design planning criteria in NSW specify how the distribution businesses must plan their networks in addition to specifying the reliability standards (a 'deterministic' approach). In contrast, other jurisdictions set their standards by reference to performance of the network, including the duration and number of outages (an 'outcomes based' or 'probabilistic' approach). The AEMC commissioned report by The Brattle Group found that the design planning criteria in other jurisdictions do not appear to be driving network investment in the same way as NSW, as the criteria used in other jurisdictions are less stringent. We are concerned that the deterministic approach applied in NSW does not necessarily allow the specified performance of the distribution network at least cost.

We note that changing to an outcomes based approach will require a review of the NSW distribution businesses' capital plans. While the AEMC has suggested that a change in standards be delayed, we suggest that adopting an outcomes basis for setting reliability standards now will allow the newly merged NSW distribution business to incorporate the revised standards in establishing its asset management plan.

The AEMC draft report provides evidence that the current distribution reliability standards in NSW may be too high. The AEMC's cost-benefit analysis examined 3 different scenarios with lower reliability than the current standards, and all resulted in net benefits for society. Having reliability standards that are too high means that unnecessary capital investments are undertaken to meet these standards. This imposes costs on electricity users through higher electricity prices and bills. While the analysis shows that lower reliability standards provide net benefits to consumers, it will be important for all electricity users to understand the risks and consequences associated with lower standards.

Where particular electricity customers place a high value on reliable electricity supply they have opportunities to take their own measures to improve reliability, for example through uninterruptable power supply equipment. This is preferable to all electricity consumers paying higher prices for reliability that they may not value.

In addition to existing reliability standards being too high, the draft report also indicates that the NSW distribution businesses are currently outperforming against these standards. Importantly, the AEMC notes that compliance with the current standards may have been achieved with a lower amount of capital expenditure. As all capital expenditure incurred by network businesses contributes to higher electricity prices regardless of whether the expenditure is efficient or prudent, and valued by the community, current electricity customers are paying higher electricity prices and bills than necessary.

Finally, we suggest that the names for the scenarios in the cost-benefit analysis (e.g. "large" and "extreme" reduction in reliability) be revised to be more objective. It would also be useful to understand how the scenarios compare with the levels of reliability provided by the distribution businesses in NSW prior to the changes in standards in 2005.

If you have queries regarding this submission, please contact Anna Brakey on 02 9290 8438 or Alexis van der Weyden on 02 9290 8460.

Yours sincerely



Peter J. Boxall AO
Chairman