

12 July 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 - NSW WORK STREAM (EPR0027)

Thank you for the opportunity to comment on the draft report on the AEMC's Review of Distribution Reliability Outcomes and Standards. Endeavour Energy has the following comments to make in response to the report.

Question 1 Approach to cost-benefit assessment

- a) *What discount rate should be used in converting capital expenditure and the value of expected energy not served to net present value?*

Endeavour Energy notes that the weighted average cost of capital (WACC) determined by the AER for the current regulatory control period has been used by the AEMC to determine the net present values of capital expenditure and expected energy not served. This is appropriate however it needs to be recognised that the AER will determine a new value for the WACC that will apply for the 2014-2019 regulatory control period as part of their upcoming regulatory determination process. Prevailing financial conditions mean that this new WACC is likely to be significantly less than the value currently in use and this may substantially alter the absolute net benefit forecast to be obtained from any change to the licence conditions.

- b) *Should any other sensitivities be undertaken to test the bounds of our cost-benefit assessment?*

There are a number of parameters whose values are not known with certainty that impact on the cost benefit analysis, around which sensitivity analysis may be performed. It is however Endeavour Energy's view that further analysis is unlikely to change the conclusions of the AEMC's report in any meaningful way; ie that reductions in mandated reliability standards will save capital expenditure by DNSPs but will have only small impacts on customer prices. We do not therefore believe that any other sensitivity analysis should be undertaken.

Question 2 Customer survey results

Are there any implications from the NSW VCR survey methodology we have used that we should take into account in considering the survey results?

It is noted that the survey was intended to gather information to enable estimates to be made of the direct and indirect costs of unserved electricity due to a supply interruption. However the estimate for residential customers is based solely on the monetary costs of mitigating the impacts of an outage and do not appear to include any estimate of the loss of convenience or other non-monetary benefit, which is required to estimate the total cost. The VCR values are therefore likely to be underestimated.

Similarly, because the questions aimed at eliciting information on customers' willingness to pay / willingness to accept shorter / longer outages did not seek information for amounts in excess of 2% of a customer's annual electricity bill, and because significant numbers of people surveyed indicated that they would be willing to pay for / accept changed reliability outcomes, it is likely that the Willingness to Pay and Willingness to Accept values are also understated.

Endeavour Energy considers that these important limitations on the survey results that should be highlighted and considered in more detail in the AEMC's report.

Question 3 Options for changes to the proposed scenarios

a) Should any further changes to the AEMC's proposed scenarios be considered? If so, what changes should be considered?

Endeavour Energy does not support consideration of any further changes to the proposed scenarios. The benefit that is likely to be obtained from modelling and analysing further scenarios is unlikely to justify the cost and further time delay involved in further analysis.

b) Are there any additional impacts associated with the AEMC's proposed scenarios which should be taken into account? For example, this could include impacts which may have been difficult to model by the DNSP's?

Endeavour Energy notes that all discussion of reliability impacts in the report relates to the average impact across the network. Endeavour Energy has a concern that the scenarios considered are more likely to result in either a substantial worsening of reliability for those customers connected to the worst performing parts of the network, or an increased likelihood of a major consequence event such as the loss of a Western Sydney substation for an extended period at a time of peak load. Endeavour Energy is required to manage the customer impact of these scenarios and the increased likelihood of these is of serious concern to us.

It is noted that the implications of any licence condition changes for STPIS targets are discussed, with the expectation being that the AER could amend either the STPIS targets or the scheme itself if considered necessary, to compensate for any expected change in reliability performance. While it is accepted that consideration of the workings of the STPIS scheme will form part of Endeavour Energy's regulatory determination process with the AER, the determination of appropriate targets to be achieved under new licence conditions poses significant revenue risk to Endeavour Energy

because of the modelling limitations highlighted in the report. We believe that the AEMC should include a stronger statement within Section 6.3.3 highlighting the likely margin for error in the reliability forecasts and the risks associated with using these forecasts as a basis for incentive payments or penalties.

- c) *Should the definition of a "major event day" in the NSW licence conditions be aligned to the definitions used in the AER's reporting framework?*

Endeavour Energy supports the alignment of the definition for "major event day" with the definition used in the AER's reporting framework in order to make the reliability reporting process more efficient and to avoid the current confusion associated with having different values for the reliability indices in the public domain.

Question 4 Implementation considerations

Are there any other implementation considerations that should be taken into account in relation to the AEMC's scenarios for distribution reliability in NSW?

It is noted that the final report only contains options for consideration by the NSW Government. No indicative timeframe is provided for implementation of a preferred option. The AEMC and the NSW Government need to be aware that, because of the long lead times involved in procuring some items of equipment for network augmentation, Endeavour Energy has made commitments of capital expenditure at least twelve months in the future. Delays in deciding on the final form of revised licence conditions will result in further expenditure being committed which may not be required under revised licence conditions.

General considerations

The following general issues arising from the review are noted for the AEMC's consideration:

- Endeavour Energy considers that a future move to an "outputs-based" approach to setting reliability standards has some attraction as it has the potential to lead to improved customer outcomes. However, we support the view of the AEMC that:

"...it would be a very significant change for the NSW licence conditions to move away from an approach that incorporates design planning criteria. Further analysis would be required before determining whether such a change was appropriate. Such a change would also require the NSW DNSPs to make significant changes to how they plan and operate their networks and it is unlikely that it could be implemented before the start of the next regulatory control period."

Given the significant analysis that would be required to appropriately define an outputs-based reliability regime, it is appropriate to maintain the existing expression and structure of distribution reliability obligations in the NSW licence conditions for the preparation of the submissions for the 2014-19 regulatory period.

It is acknowledged that in a parallel process to the NSW Review, the AEMC has recently commenced a national review of reliability outcomes and standards. The national review will assess the merits of establishing a national framework for distribution reliability outcomes and include consideration of reliability frameworks more broadly (e.g. 'input' versus 'output' based approaches to reliability outcomes). There appears to be little value in substantially amending aspects of the NSW licence conditions before the outcomes of the AEMC's national review are determined (particularly if a fundamental new approach to achieving NSW reliability outcomes is recommended), particularly in light of the need to finalise investment programs over the next few months that underpin regulatory proposals as part of the AER 2014-19 Determination process.

Should the AEMC's national review recommend changes to the current expression and structure of the NSW reliability standards, there are regulatory mechanisms available (including cost pass through provisions) that could allow any amended standards from this national review, as approved by the NSW Government, to be reflected in the AER 2014-19 Determinations (and therefore customer prices) in a timely manner.

- Endeavour Energy notes that the largest annual cost savings for a residential customer forecast to be achieved under any of the scenarios is \$18 in fifteen years time, which is in the order of 1% of a typical annual bill. The associated reduction in reliability of 15 minutes is between 15% and 20% of the reliability levels currently being achieved by Endeavour Energy and Ausgrid, which could be considered to be disproportionate to the savings achieved.
- Endeavour Energy is also concerned that some of the information presented in the report with respect to current and forecast baseline reliability performance may be taken out of context and used to justify inappropriate adjustments to our capex and opex forecasts during the forthcoming regulatory determination process. This concern manifests itself in two key areas:
 1. The report uses the term "outperforming" in reference to reliability results achieved by Endeavour Energy in comparison to the average feeder standards contained in the existing licence conditions.

Reliability performance is a function of a number of factors including network design and configuration; environmental influences; asset management practices as well as the level of capital expenditure on the network. Endeavour Energy's performance is as much due to a focus on improving asset management practices to improve cost and service outcomes as it is on our level of capital expenditure.

Furthermore, the level of capital expenditure itself is also driven by factors other than a need to improve network reliability although reliability improvement may be an associated benefit. For example, as the network servicing some of the fastest growing parts of the country, a large proportion of Endeavour Energy's current capex allowance is driven by the need to install new assets to service this growing demand. Although difficult to model, we consider that a significant portion of the improvement in reliability that our network has experienced in recent years is due to the connection of new customers to new and inherently reliable sections of network.

2. The context for the graphs in Section 5 of the report that show the changes in the duration of supply interruptions compared to the baseline for the three distributors is not well explained. These graphs appear to overstate Endeavour Energy's reliability performance although the baseline reliability line is intended to purely show the expected reliability impact of the existing licence conditions according to a theoretical model, which will not bear any relationship to the actual reliability results that will be achieved. The baseline forecast line for Endeavour Energy shown in figures 5.19, 5.29 and 5.39 shows a reliability result of around 50 minutes SAIDI in the first year, which is substantially better than we expect to achieve. The fact that figure 5.39 has a different timescale on it also adds to the potential confusion over how these graphs should be interpreted.

If you have any questions regarding this submission, please do not hesitate to contact our Regulatory Technical Manager, Rick Wallace, on (02) 9853 6648.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Rod Howard', with a long, sweeping flourish extending to the right.

Rod Howard
Interim Chief Operating Officer