



Response to the Energy White Paper – Issues Paper

7 February 2014

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INTRODUCTION

Energy Networks Association

The Energy Networks Association (ENA) is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia. ENA members own assets valued at over \$100 billion in energy network infrastructure.

This submission by the ENA is in response to the Australian Government's *Energy White Paper – Issues Paper*.

National energy market reform agenda

The *Energy White Paper – Issues Paper* begins a process of identifying the potential for national reforms to address cost of living pressures, improve business confidence, growth in energy exports and encouraging investment.

ENA considers that the *Energy White Paper* is an opportunity to revitalise the national energy market reform agenda, and to reduce the regulatory burden in the interests of energy consumers.

This agenda is informed by the extensive reform processes that have been completed in recent years, and the products of those reviews that are now being implemented through the Standing Council of Energy and Resources (SCER).

In addition to specific policy measures, in this submission the ENA has proposed the enhancement of SCER's role in managing energy market reform, the establishment of a truly national economic regulator for electricity and gas networks and consideration of the regulatory burden as a standing item on the SCER agenda.

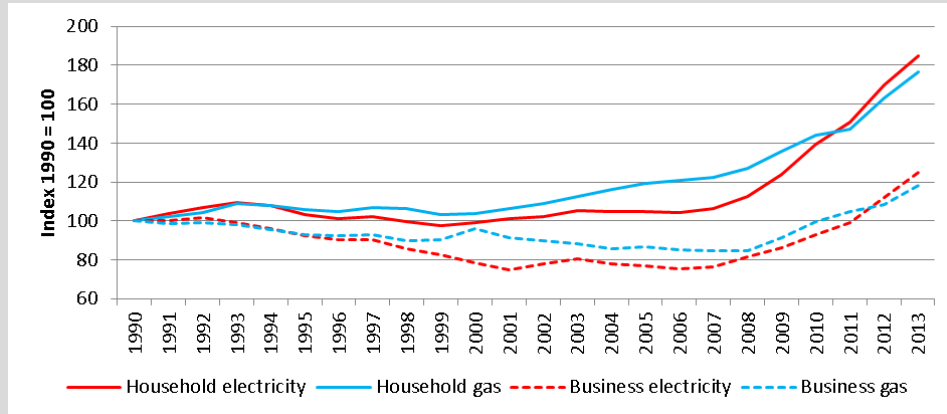
Network sector outlook

The specific policy recommendations in ENA's submission are informed by the outlook for future network charges and fundamental changes underway in Australia's electricity and gas network sector.

Moderate outlook for network prices

After a long period of stable retail electricity and gas prices, significant increases have occurred in most jurisdictions since 2008 with the significant factor being increased network costs. These increases were a direct result of the rise in the cost of capital following the Global Financial Crisis, the need to replace ageing network infrastructure for both gas distribution and electricity networks and, in some jurisdictions, government increased in reliability standards prescribed by governments.

Electricity and gas retail price index (real), Australia

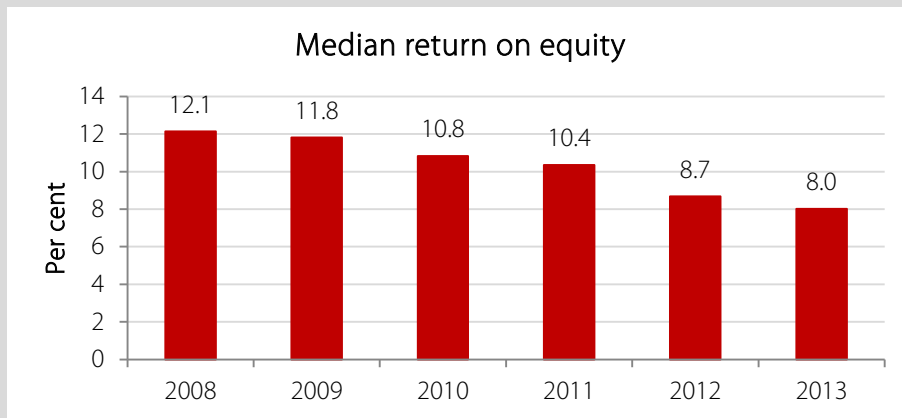


Source: ABS, Consumer Price Index and Producer Price index

While network costs increased substantially in most jurisdictions during this period, the trend has not been uniform. Victorians have seen a real decrease of 3% over 10 years in standard distribution network charges excluding the introduction of advanced meters.

It is also noted that while input costs to network services have increased over the period and network services have become exposed to greater technology and demand risk, the regulated return on equity allowances provided for investors have fallen over the period.

Median return on equity



Source: AER regulatory determinations

In contrast to the trend over the last 5 years, the outlook is for moderate growth in electricity network and gas distribution network prices in the near to medium term.

This is based on stable or falling revenue growth for electricity networks and gas distribution networks for the remainder of the regulatory period, reflecting the lower cost of capital since the initial phase of the

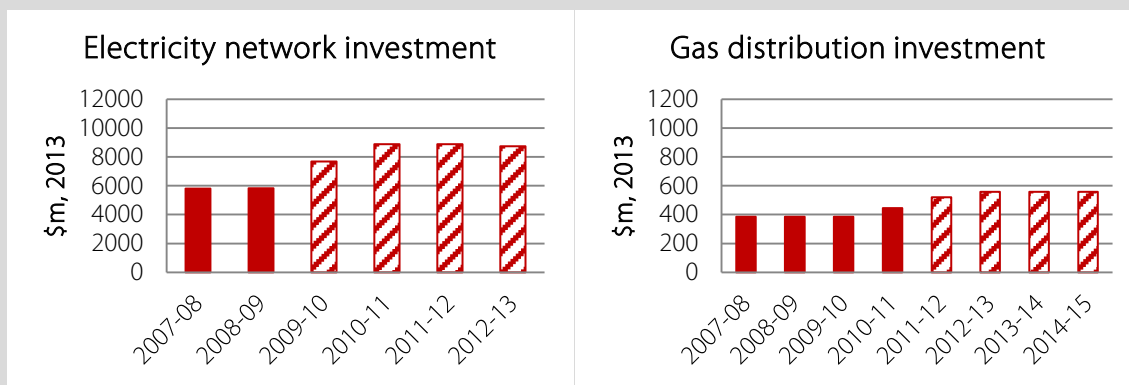
Global Financial Crisis and reduced need for capital investment to replace ageing assets or meet peak demand.¹

This moderate growth outlook for in network prices has been confirmed by the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER).

For retail residential electricity prices the AEMC² has projected that overall the national average annual increase will be lower than the expected level of inflation at 1.2% a year from 2012/13 to 2015/16. Similarly the latest investment and pricing proposals for the NSW electricity distribution businesses Ausgrid, Endeavour Energy and Essential Energy project a fall in household electricity prices for a second year in a row.³

According to the Australian Energy Regulator (AER) the outlook is for gas retail charges for residential customers to continue to rise at the same rate as recent years, which is between 5-6 per cent per year, except for customers of Envestra in Victoria, Multinet (where price increases will be small) and SP Ausnet where prices will fall.⁴

Network Investment



Source: AER, State of the Energy Market 2013.

Actual investment data (solid fill) are used where available, the AER's forecast allowances (dashed fill) are used for the remaining years.

¹ The network sector component of total retail prices ranges from [32-57 per cent] for electricity and according to the AER is between 40 to 60 per cent for gas. The transmission network component is 4 to 14 per cent of total retail electricity prices and is 3 to 8 per cent of total retail gas prices (AER).

² AEMC, 2013 Residential Price Trends Report

³ NSW Treasurer, Mike Baird, *Electricity Bill Relief for NSW Households*, 2 February 2014, accessed online at http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0016/123181/02-02-14_Electricity_bill_relief_for_NSW_households.pdf

⁴ AER, State of the Energy Market 2013, p. 116-17

The changing nature of the electricity grid

The electricity grid is experiencing seismic shifts in the energy generation mix, technology, energy use and in consumer preferences.

As new technology and a wider range of renewable and alternative energy supply choices become available to consumers, the grid will continue to play a vital enabling role. The CSIRO in its Future Grid Forum report has found that even where customers have their own onsite generation and make use of battery or electric vehicle storage, they will still rely on the grid for back-up supply and other services.⁵

The electricity grid has already developed to be more than just poles and wires. The sustained high temperatures experienced this summer across Australia highlighted key trends playing a role in the capacity of the grid to manage peak events.

- ▶ Innovative network tariff structures allowed customers to work with network businesses to reduce demand and to save money.
- ▶ Advanced meters informed network operators about pressure points, and enabled faster responses.
- ▶ Distributed generation supported the capacity of the electricity grid, as did the domestic gas network in augmenting supply.
- ▶ Network infrastructure met its obligation to meet to the extreme peaks.

Regardless of the evolving energy system, the core business of energy networks, to deliver safe and reliable energy, does not change. The shifts within the energy network sector are complemented by the existing expertise in managing the grid. The recent peak event also witnessed the contribution of a large number of networks operational staff who were the quiet heroes who worked in extreme heat to minimise customer impacts. The recent event demonstrates that energy network businesses are actively integrating new technology and business models into their operations, while drawing on their existing expertise and capabilities to deliver an increasingly resilient grid for customers.

Developments in gas markets

Australia is currently experiencing unprecedented development in liquefied natural gas (LNG) projects. While this is of significant value to the national economy, there is considerable uncertainty about the outlook for supply and demand in the domestic gas market.

As the cost of wholesale gas supply increases, there is the potential to significantly affect residential customers through higher retail gas prices, and through driving up the cost of electricity sourced from gas-fired power generation.

⁵ The Future Grid Forum, *Change and choice*, December 2013, Figure 16, p. 34

The ENA is also concerned that higher gas wholesale prices may drive customers to switch to appliances that are less energy-efficient and emit higher levels of greenhouse gas emissions.

Reduction in the use of gas also has the potential to drive gas prices higher because infrastructure costs would have to be recouped over a smaller customer base. Current government incentives schemes such as the Small-scale Renewable Energy Scheme (SRES) distort markets by further driving the residential customer base away from least cost emissions gas technologies. The Million Solar Roofs, if not implemented in a fuel neutral manner to achieve emission abatement objectives, has the potential to increase these market distortions, disadvantaging gas as a competitive supply source, without benefit to consumers.

The ENA is concerned about the impact of wholesale gas price volatility on domestic gas markets and considers this is an issue which must be addressed meaningfully in the Australian Government's *Eastern Australian Gas Supply Strategy to 2020* and the *Energy White Paper*. Such consideration should include evaluating the role of a National Interest Test on future large-scale export gas developments, as has been adopted in other international jurisdictions. While the ENA does not support direct government intervention in markets unless this can be justified from a public policy perspective, the government should remain open to intervening in the gas market in the event that the evolution to an export based gas industry creates transitional issues in Australia that undermine the long term productive capacity of the domestic gas sector. If intervention is required, it should be technologically neutral.

In this submission, the ENA suggests that that securing and increasing the supply of gas to the domestic market through reducing duplication in the approvals process and increasing gas market transparency in upstream operations would have a positive effect on Australia's competitiveness. Increasing the competitiveness of gas markets will assist to minimise potential increases in domestic gas prices.

The ENA does not support government incentive programs that do not provide a technologically neutral solution to emissions reduction, such as the SRES. The ENA notes that the proposed Million Solar Roofs program must be carefully designed to avoid exacerbating current hot water appliance market distortions, without benefit to consumers.

STRATEGIC PRIORITIES FOR AUSTRALIAN ENERGY NETWORKS

Five steps to achieve better outcomes for energy network customers

The development of the *Energy White Paper* is an important opportunity to deliver a new framework for national energy policy that addresses in an integrated way the seismic shifts in energy generation mix, technology, energy use and consumer preferences that are impacting Australia's electricity grid and gas distribution networks.

The ENA calls on the Federal Government to take the following five steps in the *Energy White Paper* to deliver safe, reliable and affordable energy network services for customers:

1. **Deliver the current national network regulatory reform program** to improve incentives and engage consumers, without policy reviews which add uncertainty to the cost of financing future network industry investment.
2. **Enhance SCER's role in managing energy market reform**, through increasing the frequency of SCER meetings, enhancing peak industry and consumer engagement, publishing a regular reform road map.
3. **Achieve a truly national economic regulator for electricity and gas networks and reduce the regulatory burden**, while maintaining the integrity of Australia's independent energy regulation and rule making process.
4. **Implement three key electricity market reform priorities:**
 - a. an **integrated roadmap for tariff reform** to support the fair and efficient transition to cost-reflective retail pricing;
 - b. the **acceleration of proposed demand side participation measures in a logical, prioritised sequence**; and
 - c. the proper **resourcing of national measures of the value of customer reliability** (for use in all jurisdictions).
5. **Support market development and a level playing field for gas**, through removal of unnecessary barriers to new gas supply, developing measures to promote greater transparency in the gas market and to ensure that energy schemes designed to reduce emissions are fuel neutral.

Recommendations

Recommendation 1

Deliver the current national network regulatory reform program to improve incentives and engage consumers, without policy reviews which add uncertainty to the cost of financing future network industry investment.

Any new potential network policy reforms proposed for consideration in the Energy White Paper should be rigorously tested against the objectives of the *Australian Energy Market Agreement*.

Recommendation 2

Enhance SCER's role in managing energy market reform, through increasing the frequency of SCER meetings, enhancing peak industry and consumer engagement, publishing a regular reform road map.

Recommendation 3

Achieve a truly national economic regulator for electricity and gas networks and reduce the regulatory burden, while maintaining the integrity of Australia's independent energyregulation and rule making process.

Recommendation 4

SCER should develop an integrated road map for tariff reform to support the fair and efficient transition to cost-reflective retail pricing, including: a balanced approach to the regulation of advanced metering; a consumer education initiative; a national implementation framework for flexible pricing based on trigger events and consumption thresholds; the refocussing customer hardship programs; and the deregulation of retail prices .

Recommendation 5

Demand side participation measures should be accelerated in a logical, prioritised sequence.

Recommendation 6

SCER should properly resource the development of national measures of the Value of Customer Reliability (for use in all jurisdictions).

Recommendation 7

While direct government intervention in markets should not occur unless it can be justified from a public policy perspective, the *Energy White Paper* should evaluate the role of a National Interest Test on future large-scale export gas developments, as has been adopted in other international jurisdictions.

Recommendation 8

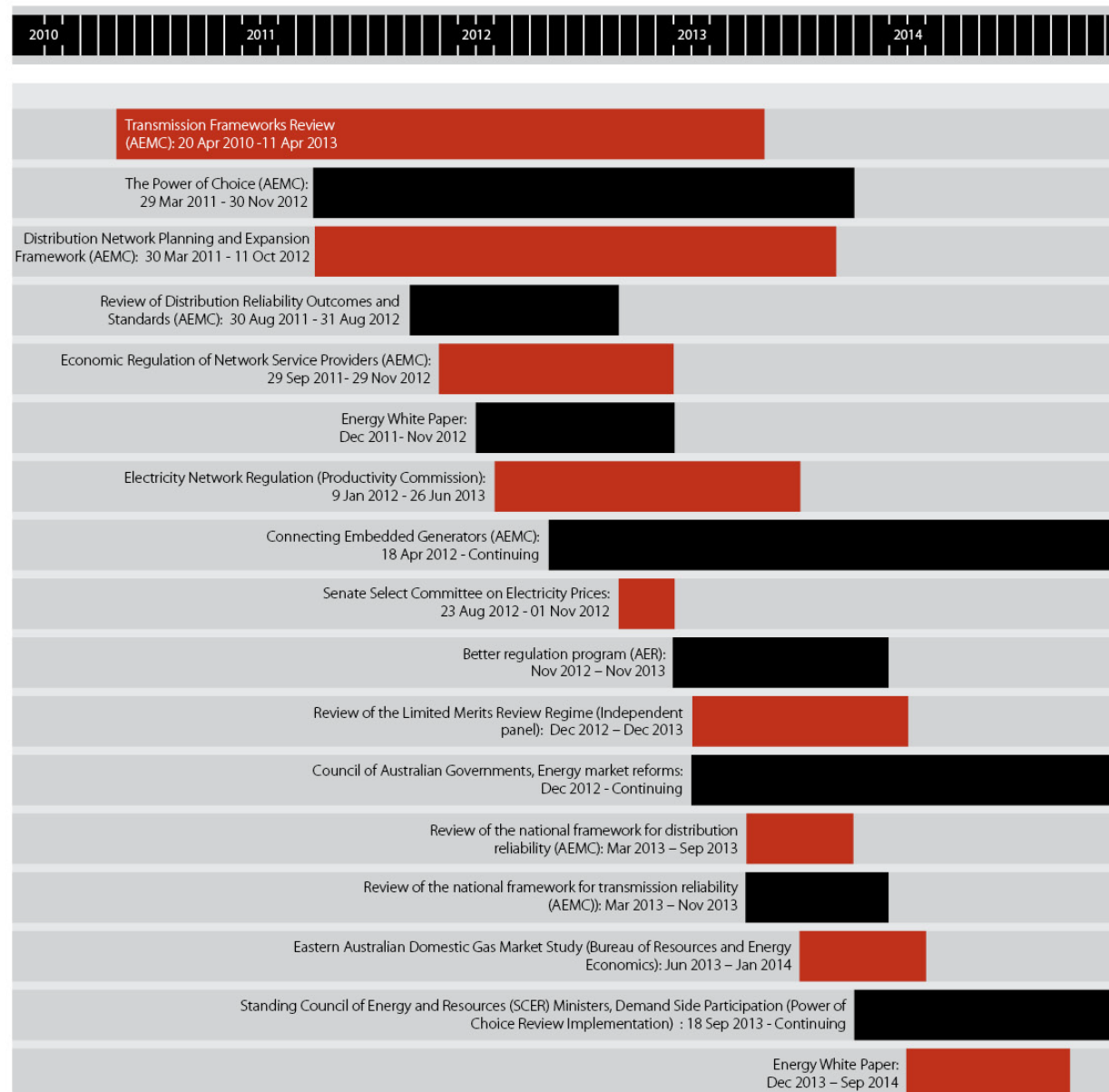
Support market development and a level playing field for gas, through removal of unnecessary barriers to new gas supply, developing measures to promote greater transparency in the gas market and to ensure that energy schemes designed to reduce emissions are fuel neutral.

1 Deliver the current network regulatory reform program

The energy network sector is emerging from a phase of review into implementation

The economic regulatory framework for electricity and gas networks has undergone extensive review and change over last three years, partially in response to public and policy concerns around higher retail electricity and gas prices.

REGULATORY REVIEWS OVER 2010-2014



The product of these reviews is now in the process of implementation. For example, the AER has recently finalised a range of new regulatory guidelines that will be applied for the first time through 2014 to upcoming decisions affecting NSW, ACT and Tasmanian energy networks. This will see significant changes in the way businesses expenditure allowances are assessed and set, new powers to exclude recovery of expenditure over a determined regulatory allowance deemed to be inefficient, and new mechanisms to set the cost of capital for over \$100 billion of existing network assets.

Further examples of national reforms being progressed through SCER include the operationalising of a new Consumer Challenge Panel to enhance the role of consumers through network review processes, and the planned commencement of a national energy consumer advocacy body.

The Government seeks comment on issues relating to the regulation of energy infrastructure.

The *Energy White Paper* should recognise this significant period of review and change, which has altered a range of regulatory settings affecting network businesses with the goal of promoting the long term interests of consumers. Regulatory frameworks for long-life infrastructure require stability and tThe *Energy White Paper* should not consider a further review of network regulatory policy. The current comprehensive reform program needs to be given an adequate opportunity to be implemented and tested.

The Productivity Commission recently warned about the dangers of energy sector reform becoming bogged down in a series of reviews. In rejecting a need for further reviews in the near to medium term the *Energy White Paper* could usefully reinforce the strength of the regulatory and market governance frameworks already in place in the network sector and the value to consumers of a stable and predictable regulatory environment.

Strong institutional frameworks

It is a positive reflection on the existing regulatory frameworks that these reviews and reforms were able to be facilitated by the broad regulatory and market governance arrangements of the sector. These arrangements include the National Electricity Law (NEL), the National Gas Law (NGL) and the existence of a robust independent rule making and market development body, the AEMC.

The AEMC, with its clear and independent rule change processes, guided by the costs and benefits of individual rule proposals against the long term interests of consumers, represents a key underpinning of investors' long-term confidence in Australia's energy sector. Access to merits based review and legislated broad revenue and pricing principles contained in the NEL and NGL are further critical positive features of the regulation of energy infrastructure. The broad-based provisions of these laws, the open rule change process and the expert advisory and review function of the AEMC also provide sufficient flexibility to ensure regulation adapts as required to reflect emerging developments and technology changes. Collectively, these features are a source of fundamental strength and comparative advantage internationally for Australian regulatory arrangements.

Value to consumers of a stable and predictable regulatory environment

Amongst its key objectives the *Australian Energy Market Agreement* clearly recognises the importance of fostering a broadly stable regulatory environment to provide the certainty required to efficiently finance long-lived network infrastructure. Providing this certainty allows network firms to reliably access capital that underpins network investments in renewal, expansion and growth at risk premiums lower than would otherwise be the case.

Currently networks are expected to finance around \$43 billion additional investment over the next five years.⁶ As an illustrative example of the significance of this issue, an increase of the total risk premium applying to current networks investment of just 10 basis points would result in the requirement for an increase in electricity network revenues of approximately \$1.5 billion per annum (or more than \$170 per household), to continue to ensure investment capital was able to be accessed.

International investors and institutions routinely place great weight on factors of regulatory stability and predictability in investment assessments that affect the availability and terms of capital for Australian networks. The potential for further reviews, increases the regulatory risk that is factored into the real cost of capital, and could result in higher network prices for consumers than would otherwise occur.

A stable and predictable regulatory environment would also support any future government policy decisions to increase the role of private sector capital through changes to ownership arrangements of currently publicly owned network infrastructure. Issues of ownership are a matter for current equity holders of network businesses. Previous Australian and international privatisation programs, however, have relied on, credible long-term regulatory regimes with mechanisms to limit undue regulatory risk as an essential pre-condition.

Recommendation 1

Deliver the current national network regulatory reform program to improve incentives and engage consumers, without policy reviews which add uncertainty to the cost of financing future network industry investment.

Any new potential network policy reforms proposed for consideration in the Energy White Paper should be rigorously tested against the objectives of the *Australian Energy Market Agreement*.

⁶ AEMC, *Power of Choice Review*, Final Report, 30 November 2012, p. vi

2 Enhance SCER's role in managing energy market reform

Energy market reform process

SCER has a critical role at the apex of strategic energy market reform and decision-making. SCER can be an effective mechanism for seeking and progressing national outcomes given the split responsibilities between Commonwealth, State and Territory governments on energy network issues.

A key benefit of SCER is that it provides a national focus and 'clearing house' for reforms which often feature diverse points of decision and implementation across Australian jurisdictions.

However energy reform remains unfinished business - some difficult parts of the energy reform agenda have stalled nationally, with various levels of adoption and implementation at a jurisdictional level. The implementation of some recent SCER decisions are experiencing sequencing and co-ordination issues, which risks undermining the legitimate and sincere intent of these processes, and delays in the benefits to consumers.

The Productivity Commission has recommended that SCER *"reform its process and decision making so that critical policy reviews... and their implementation occur in a timely manner."*⁷

ENA congratulates the Australian Government on its formal commitment to enhance opportunities for stakeholder engagement in Ministerial decision-making processes, and the positive recent steps towards this at the December 2013 meeting of SCER. ENA is working with other energy stakeholders to progress potential models for this to occur.

Given the range of high priority energy market reforms currently within the scope of SCER's responsibilities ENA suggests that SCER consider the following three measures, to ensure that SCER's policy making and implementation processes are more efficient and accountable for progress to stakeholders.

1. **Increase the frequency of SCER meetings** – to ensure that the requirement for Ministerial approval for reform initiatives does not unintentionally become a 'choke point', and enable Ministers to collegially examine and discuss the performance of the overall energy market on a more regular basis. Recent practice has seen as few as two SCER meetings a year.
2. **Enhance peak industry and consumer engagement** The transparency of SCER's forthcoming agenda and proposed decision making should be improved. To ensure that Ministers are able to benefit from direct advice and perspectives from key stakeholders ahead of decisions made in the meetings, opportunities should be provided for focused submissions. This type of engagement can assist in better decision-making around the optimum sequencing and implementation of related reform measures. As noted above, we congratulate the Commonwealth Government on initial progress in this area.

⁷ Productivity Commission, Inquiry Report, Volume 2, *Electricity Networks Regulatory Frameworks*, p. 808

3. **A regular reform 'road map'** - SCER should establish a schedule for regularly issued public progress reports mapping out implementation of past decisions, key interdependencies between related reforms and signaling forthcoming areas for SCER decision-making. This would assist stakeholders in planning their engagement and related policy work, ensure transparency over likely future reform directions. This would be a natural complement to existing and valuable informational bulletins on specific issues and SCER communiques.

Review of energy market bodies in 2014

Reviews of the energy market bodies – the AEMC, the AER and AEMO – have been scheduled for 2014. The role and performance of each of these bodies is critical to a successful energy market future. ENA welcomes the strong support from state and territory ministers for structural separation of the AER from the Australian Competition and Consumer Commission (ACCC).

Recommendation 2

Enhance SCER's role in managing energy market reform, through increasing the frequency of SCER meetings, enhancing peak industry and consumer engagement, and publishing a regular reform road map.

3 Achieve a truly national economic regulator for networks and reduce the regulatory burden

It is an achievement of past national reform initiatives led by the Australian Government that consistent national rules applying to the monopoly regulation of electricity networks across Australia exist. The notable remaining exception to this consistency is the existence of bespoke energy regulatory regimes in Western Australia and Northern Territory. Recently, the Northern Territory announced its intention to adopt national frameworks as part of its reform processes.

The absence of interconnection with the NEM provides no plausible basis for differences to occur between how monopoly network assets are regulated, in terms of the process of determining appropriate network revenue and pricing levels between these two jurisdictions and the rest of Australia

Three different sets of economic regulatory rules and regulatory bodies for setting network revenues and prices (and appropriate returns on capital) represent a source of unnecessary divergence, uncertainty and an unnecessary regulatory burden. To the extent these regimes differ, they represent an avoidable source of investment distortion between individual jurisdictions. This has recently manifested in the decisions of the WA Economic Regulatory Authority to issue a Rate of Return Guideline that materially differs from that to be applied by the AER to networks across Australia's eastern seaboard. These outcomes are inconsistent with the foundation objectives for energy market reform set out in the Australian Energy Market Agreement and should be addressed as a matter of priority.

Reducing the regulatory burden

ENA recognises the importance of deregulation and reduction in red tape to potentially create stronger economic growth, greater investment, more innovation and higher productivity in the Australian economy.

The Government seeks comment on further ways that regulatory burdens could be reduced while maintaining appropriate levels of disclosure and transparency in energy markets.

ENA supports the Australian Government's strong commitment to deregulation and reducing the regulatory burden on business. Generally the rule change process has provided an effective mechanism to address the regulatory burden of network economic regulation on an ongoing basis. There are, however, a range of areas where there is potential to reduce or avoid undue regulatory burdens on network businesses.

ENA suggests that SCER consider consulting regularly with peak industry associations and business on the potential for deregulation and reduction in red tape as a standing item on the SCER agenda.

Areas where there are potential for a reduction in the regulatory burden include the following:

1. Remove the expensive burden of access pricing regulation over smaller gas networks where it is unnecessary (for example in small regional networks with competing incumbent fuel sources, or small urban networks with low average usage and significant inter-fuel competition from electricity) .
2. Review the opportunities for more efficient government planning, approval and permit processes at state and local government level to reduce the cost of development of both new sources of gas supply and gas networks.⁸
3. Require that AER proposals to require extensive 'back casting' of data to inform its benchmarking and category analysis activities, be subject to transparent examination of the costs and benefits of providing this information. Information is not costless to collect, forecast or analyse.
4. Develop more light handed regulatory frameworks, as more network services are potentially subject to greater competition and the risk of bypass.
5. Undertake a rigorous assessment process for the implementation of metering contestability in network services, as if not carefully managed there is the risk of erosion of the network -derived benefits to be passed through to consumers.
6. Avoid overly prescriptive regulatory frameworks for governing network connection processes for embedded generation to retain the flexibility and resilience of Australia's electricity distribution system to integrate renewable and alternative energy sources as technology changes.
7. Review the potential for further harmonization or national licensing for energy networks, to replace inconsistent jurisdictional level licensing and associated regulatory arrangements .

Recommendation 3

Achieve a truly national economic regulator for electricity and gas networks and reduce the regulatory burden on network businesses, while maintaining the integrity of Australia's independent energy and rule making process.

⁸ These issues are considered in more detail in this submission in the section on market development and a level playing field for gas.
Victorian Government Gas Market Taskforce, Final Report and Recommendations, 2013,p.30

4 Implement three key electricity market reform priorities

Of the 14 major energy market reforms agreed by COAG three issues require further attention from SCER to achieve better outcomes for consumers. These three issues, raised in the *Energy White Paper - Issues Paper*, are the need to reform network tariff structures, the need for greater demand side participation and the ways in which community expectations can be better understood and reflected in a national framework for network reliability.

The Government seeks comment on priority issues, barriers or gaps within the COAG energy market reform agenda.

An integrated suite of network tariff reforms

In December 2012 SCER agreed to “develop the market settings to provide consumers with the option of cost-reflective retail pricing structures incorporating time varying network tariffs”.⁹ Further, SCER identified that cost reflective retail pricing needed to be accompanied by consumer engagement, education for all consumers and protection for vulnerable consumers.

ENA welcomes SCER’s support for more cost reflective pricing. There is widespread acknowledgement, including in the *Energy White Paper - Issues Paper*, that trends in technology and consumer choices mean that current network tariff structures for residential and small business customers are generally unsustainable. This is because the contribution of these customers to distribution network cost recovery is usually based on the total energy volume consumed, with a small fixed charge component, when distribution network costs are largely fixed.

The Government seeks comment on the need to review existing network tariff structures in the face of rapidly growing deployment of grid-backed-up distributed energy systems, to ensure proper distribution of costs.

A lack of cost-reflectivity can result in inefficient customer investment decisions. There are also substantial and growing “hidden transfers” between different customers, that may only increase as customer choices to take up solar, electric vehicles and battery storage expand. The Productivity Commission *Inquiry in Electricity Networks Regulatory Frameworks* found that a household running a 2 kilowatt reverse cycle air-conditioner in peak times receives a subsidy from other households without airconditioners of \$350 annually.¹⁰ In a similar vein, it has been estimated that in Queensland alone solar households add \$100

⁹ SCER, Putting Consumers First, December 2012, p. 7

¹⁰ Productivity Commission, Inquiry Report, Volume 2, *Electricity Networks Regulatory Frameworks*, p. 352

million annually in network costs to the bills of households without solar, excluding the costs of the feed in tariffs.¹¹

The opportunity to advance greater cost-reflectivity in distribution network pricing may deliver the following benefits to consumers.

- Improved investment efficiency in additional peak capacity, through cost-reflective tariffs lowering consumption at times of distribution network peak demand.
- Greater recovery of distribution network costs on a user pays basis, given the changing mix in on-site solar and battery storage users) and central generation, and the different profiles of energy consumption amongst customers who remain users of the distribution network.
- More resilient distribution network tariff structures in an uncertain demand environment that ensure the sustainable recovery of efficient system costs over time.

ENA supports the progressive implementation of more resilient, cost-reflective tariff structures over time, such as capacity or demand charging, and potentially higher fixed charges. This is best achieved as part of a broader, integrated, suite of cost-reflective pricing reforms to be considered by SCER.

The Government seeks comment on possible approaches and impacts of review of tariff structures including fixed network costs, further time-of-use based electricity tariffs and the use of smart meters.

Currently, only one of the measures necessary to bring about network tariff reform that was recommended in the *Power of Choice Review* is being progressed. This is the changes to the distribution network pricing principles being considered under a rule change by the AEMC.

Rather than this change being considered in isolation ENA proposes that SCER develop an integrated road map for tariff reform to support the fair and efficient transition to cost-reflective retail pricing, including the following five measures.

1. A balanced **regulatory framework for advanced metering** which supports consumers to respond to cost-reflective pricing; that enables the benefits of distribution network derived benefits being passed on to consumers; and removes restrictions on the roll out of advanced meters by networks on an economic basis.
2. A joint initiative between electricity networks, retailers and governments to **inform and educate customers** on the implementation of cost - reflective pricing and choices for customers.
3. A **National implementation framework for flexible pricing** that achieves a phased transition to the introduction of cost-reflective pricing, based on defined consumption thresholds and customer initiated trigger events (such as the connection of solar photovoltaic (PV), battery storage and electric vehicles and connections to new premises).

¹¹ Energy Supply Association of Australia, Discussion Paper, *Airconditioners and solar-why electricity pricing needs to be reformed*

4. The **review and refocussing of customer hardship programs** to support the introduction of sustainable cost-reflective pricing.
5. The implementation of long-standing Council of Australian Governments (COAG) commitments to **deregulate retail prices** in all jurisdictions, where markets are sufficiently competitive. ENA commends for SCER's revised approach to its competition reviews, which will result in annual reporting by the AEMC on the state of competition in retail electricity and gas markets across the NEM.

Recommendation 4

SCER should develop an integrated road map for tariff reform to support the fair and efficient transition to cost-reflective retail pricing, including: a balanced approach to the regulation of advanced metering; a consumer education initiative; a national implementation framework for flexible pricing based on trigger events and consumption thresholds; the refocussing customer hardship programs; and deregulation of retail prices.

4.1 Support greater demand side participation

Demand side participation measures are an important part of the response to the changing nature of the electricity grid as Australia's domestic energy generation mix changes. These measures allow consumers to reduce their energy costs by providing more choices for the efficient consumption of energy.

According to Frontier Economics the estimated economic cost savings of a reduction in peak demand in the National Electricity Market (NEM) is likely to be between \$4.3 billion and \$11.8 billion over the next ten years. This is the equivalent of between 3 per cent and 9 per cent of total forecast expenditure in network and generation infrastructure.¹²

The Government seeks comment on the use of demand-side participation measures to encourage energy productivity and reduce peak energy use.

A range of reforms to enhance demand side participation were initiated by SCER in March 2013 in response to the AEMC's recommendations in the *Power of Choice Review*. These reforms consist of:

- Reform of the distribution network pricing principles (rule change: November 2013-November 2014),
- Increased competition in metering and related services (a rule change),
- Increased customer access to energy and metering data (a rule change),

¹² ENA, *Priorities for Australian Energy Networks*

- Review of open access and common communication standards,
- Reform of the Demand Management and Embedded Generation Incentive Scheme,
- Review of the framework for third parties offering Demand Side Participation (DSP).

ENA's concern is that the implementation of these reforms is proceeding slowly and that each measure may be considered individually and not as a package of inter-related measures.

Delays in implementing decisions that have already been made will delay the benefits that must flow through to the consumer. Unless and until reforms are finalised networks are unable to incorporate these measures in their regulatory proposals as part of the network regulatory determination process.

In particular, ENA considers that the reforms to metering competition and the demand side participation incentive scheme should be progressed as a matter of urgency so that they can be included in the next NSW and Queensland revenue determinations.

In the *Power of Choice Review* it was recognised that the successful implementation of key reforms was dependent upon acceptance and implementation of other related recommendations. Currently, some important reforms are being considered separately and out of sequence. For example:

- the consideration of reform of distribution network pricing principles and the review of open access and common communication standards, both of which are critically dependent upon the policy framework and availability of advanced meters, are proceeding separately and in advance of consideration of competition in metering,
- the ability of networks to fully utilise demand side participation measures is dependent upon finalisation of the review of the Demand Management and Embedded Generation Incentive Scheme and the Metering Contestability rule change (which should enable networks install smart meters as a demand side participation tool where this is the most efficient option), neither of which have commenced,
- it is inappropriate to finalise technical standards in advance of the policy framework for contestable metering. Priority consideration of the metering framework is critical to ensure optimal realisation of metering and related investment values.

These range of reforms are being undertaken by AEMC, AEMO and by a subgroup of the SCER Energy Market Reform Working Group. Leadership and coordination between these groups is critical to successful completion of these reforms as a coherent whole. ENA proposes that the demand side participation measures should be considered in the following sequence.

1. An integrated tariff reform framework (discussed in section 4.1) should be developed to progress phased pricing changes, customer education, metering and hardship reforms to address the most significant issue in energy regulatory policy – the sustainability and fairness of current pricing structures. This should inform evaluation of rule changes on distribution network pricing principles, metering contestability and metering access and communication standards,

2. The rule change for the metering contestability framework and the Demand Management and Embedded Generation Incentive Scheme to be progressed urgently.
3. Access to Data and the Third Parties framework should be considered subsequent to clear direction from the rule change on competition in metering being available.
4. Finalisation of the metering access and communications standards review should follow establishment of the policy frameworks from the rule change on competition on metering and third parties framework..

Responsibility for coordination of the series of reviews underway from the *Power of Choice Review* implementation should be given to AEMC to ensure the coherent integration of the overlapping and mutually dependent elements of these reforms.

Recommendation 5

Demand side participation measures should be accelerated in a logical, prioritised sequence.

Reflecting community expectations in network reliability standards

SCER has agreed to the development of a national framework for network reliability that ensures that network reliability costs are efficiently based and reflect consumers' willingness to pay.

The AEMC has completed reports on a proposed national framework for reliability standards for both distribution and transmission, and SCER has agreed to further work on the national framework for consideration in the first meeting in 2014. Individual jurisdictions will also report to COAG on their recommendation on adopting the national framework following the first SCER meeting in 2014.

Australia's electricity network businesses support a national framework for network reliability, which gives added weight to the views of customers. ENA supports a national framework that ensures that:

- reliability spending is efficient and provides a level of reliability that customers value,
- customers are engaged in the process for determining reliability spending in a meaningful and timely manner,
- there is independent oversight of the way that network reliability standards and targets are set, while a continuing customer relationship with networks is maintained, and
- there is flexibility and incentives for networks to innovate to improve customer outcomes.

ENA supports a number of aspects of the AEMC's proposed reform of the national framework for network reliability. However, whereas the AEMC has proposed a separated process for setting reliability targets for distribution networks, ENA proposes that SCER should adopt an incentives based national framework for network reliability that is integrated with the revenue determination process under the independent AER. Further details of the comparison between the AEMC approach and the ENA approach is in the attached

document *“Delivering the reliability that customers choose”*, also available on the ENA website www.ena.asn.au.

The Government seeks comment on ways community expectations can be better understood and reflected in reliability standards.

Underlying the reform to the national framework for network reliability is the consensus that there should be greater consideration of the value placed on reliability by customers. In December 2013 SCER agreed that AER should assume responsibility for establishing values of customer reliability (VCRs) for use in the setting of reliability requirements for the next round of regulatory determinations commencing in mid-2019.

The benefits to consumers of a national framework for network reliability depend in a fundamental way on national measures of VCRs that are appropriate and sufficiently granular to account for differences in consumers preferences.

Australia’s current measures of VCRs were found by the Productivity Commission to be inadequate.¹³A comprehensive national survey of VCRs has never been undertaken. In Victoria, which is the only jurisdiction which has undertaken periodic surveys, there has been no survey since 2007.

Currently AEMO is undertaking a review to develop VCRs in 2014, which appears to be independent of the uses under a national framework for network reliability and as the basis for incentive payments under the reliability performance mechanism administered by the AER (the Service Performance Target Incentive Scheme).

ENA agrees with the Productivity Commission that there are complex challenges in developing national VCRs and a need for adequate resources as robust VCR measures can be costly to develop. However, the costs of taking a best practice, robust statistical approach to the measurement of VCRs is significantly less than the costs of basing reliability and investment decisions on poor estimates.

Given that VCRs are fundamental to realising the benefits to consumers of a national framework for network reliability the ENA calls on SCER to provide sufficient additional resources to develop appropriate VCRs for use by both transmission and distribution networks from mid-2019.

Recommendation 6

SCER should properly resource national measures of the value of customer reliability (for use in all jurisdictions).

¹³ Productivity Commission, Inquiry Report, Volume 2, *Electricity Networks Regulatory Frameworks*, p. 541

5 Support market development and a level playing field for gas

Removal of unnecessary barriers to new gas supply

The *Energy White Paper – Issues Paper* separates the questions of how to increase new gas resources and areas where approvals could be streamlined. ENA believes these two issues are fundamentally linked. For example the Victorian Government Gas Market Taskforce, Final Report and recommendations notes that

“There are over fifty pieces of Victorian legislation, regulations, policies and administrative arrangements relevant to adopting leading practices for coal seam gas operations. The complexity in regulatory arrangements creates uncertainty in the regulatory environment and adds to the cost for industry. The diversity of the legislation as well as the number of agencies involved creates uncertainty, delays and confusion. Without compromising environmental or safety standards, the Victorian Government should take action to improve certainty, consistency and reduce regulatory costs.”¹⁴

Many of the environmental approvals processes under State and Commonwealth laws apply not just to the extraction of gas but also to the development of production, transmission and distribution facilities. Local government requirements may become significant in gas distribution as well.

Federal, State and Local Government approval processes can impose a significant cost of approvals for new sources of supply. When coupled with political considerations, approvals processes can add to uncertainty, leading to higher costs of finance due to increased risk.. This higher cost of capital must be included in investment project expenditure.

The government seeks ways to increase new gas sources to meet demand and measures to enhance transparency in market conditions

The ENA recognises that the price and availability of gas in Australian domestic markets is directly impacted by international demand and the capacity for large scale gas export development. The ENA supports competitive upstream energy supply markets and also recognises the strategic significance of Australia’s ‘in situ’ gas resource to national economic development.

The ENA is concerned about the impact of wholesale gas price volatility on domestic gas markets and considers this is an issue which must be addressed meaningfully in the Australian Government’s *Eastern Australian Gas Supply Strategy to 2020* and the *Energy White Paper*. Such consideration should include evaluating the role of a National Interest Test on future large-scale export gas developments, as has been adopted in other international jurisdictions. While the ENA does not support direct government intervention in markets unless this can be justified from a public policy perspective, the government

¹⁴Victorian Government Gas Market Taskforce, Final Report and Recommendations, 2013, p.30

should remain open to intervening in the gas market in the event that the evolution to an export based gas industry creates transitional issues in Australia that undermine the long term productive capacity of the domestic gas sector. If intervention is required, it should be technologically neutral.

Recommendation 7

While direct government intervention in markets should not occur unless it can be justified from a public policy perspective, the *Energy White Paper* should evaluate the role of a National Interest Test on future large-scale export gas developments, as has been adopted in other international jurisdictions.

ENA considers that two factors are critical to the development of new sources of gas supply. Firstly capacity by government and project proponents to address community concerns regarding the development of natural gas reserves and secondly removing unnecessary restrictions or duplication in approval processes for exploration, development, production, transmission and distribution without compromising evidence-based environmental regulation.

The Government seeks comments on areas where approvals processes could be further streamlined while maintaining proper environmental safeguards.

The Victorian Government Taskforce suggested several measures that might streamline issues related to approvals of major development projects. These included nominating a senior official within the government as a coordinator of environmental approvals and other industry requirements with access to officers with the right expertise. The Taskforce suggested Commonwealth and State Governments should also work to accredit state environmental assessments and approval processes to remove duplication while maintaining high environmental outcomes.

Measures to increase gas market transparency

The regulation of gas distribution networks under the NGL by the AER already ensures that there is a high degree of transparency concerning gas network tariffs and charges. In addition the operation of eastern gas markets are overseen by AEMO which operates the retail and wholesale gas markets in South-East Australia, and the Victorian Gas Declared Transmission System, including operating the Gas Short Term Trading Market (STTM), a wholesale market system designed to facilitate Short Term Gas trading driven by daily prices.

The ENA believes SCER is the appropriate body to pursue improvements to upstream transparency in the gas market and that the AEMC should be enabled to conduct reviews into upstream issues that would increase upstream market transparency.

The Government is seeking comment on possible measures to promote greater price transparency in gas markets.

The ENA supports the development of an efficient market, able to supply long and short term information and with minimal transaction and compliance costs, consistent rules and oversight across jurisdictions with limited Government intervention, a transparent and rigorous process for rule changes and effective emergency management processes.

ENA suggests that the current SCER market reform program has been focused on downstream reforms and that industry-led initiatives currently underway that will facilitate further transparency need to be given time to work.. Government consultation on upstream reforms would be welcomed.

Barriers to the use of natural gas in national vehicle fleet

The increased use of natural gas within the national vehicle fleet could be a significant opportunity to reduce greenhouse gas emissions and improve liquid transport fuels security. However, the adoption of natural gas within the national vehicle fleet has been slow. CNG is used within some government bus fleets and a small amount of LNG is used within the road freight sector. The use of CNG within the passenger car fleet is almost non-existent, apart from a handful of natural gas conversions of petrol-powered vehicles.

The Government seeks comment on any barriers to increased uptake of LPG in private and commercial vehicles and CNG and LNG in the heavy vehicle fleet.

The underlying causes for the slow uptake of natural gas in Australia relate primarily to the lack of natural gas refueling infrastructure and the limited availability of new natural gas vehicles, particularly natural gas passenger cars.

The barriers to the provision of natural gas refueling infrastructure are complex and are generally cost related. This includes the cost of compliance with regulations at multiple levels of government for the development of the infrastructure. A further barrier is expected in the form of increasing costs of wholesale natural gas in the near future.

However, there is an increasing range of home-based natural gas refueling systems available for the refueling of natural gas vehicles via a residential gas connection – in much the same way that home-based recharging systems are potentially available for electric vehicles.

Under current policy and regulatory settings, it appears that in the near to medium term the Australian market is unlikely to overcome the limited availability of new natural gas vehicles and the barriers to the development of refueling infrastructure. Realisation of the opportunity to reduce greenhouse gas emissions and improve transport fuel security through the increased use of natural gas within the national vehicle fleet could be assisted by the following measures.

- The streamlining of regulation that allows for further incentives for the establishment of home-based and public refueling infrastructure for natural gas vehicles.
- Examination of financial options such as allowing for the accelerated depreciation for taxation purposes for investment in public refueling infrastructure.
- The consideration of gas transport infrastructure and vehicles when undertaking transport planning.
- A discussion around the removal or reduction of gas fuel excise

These specific issues could be further developed in the *Energy White Paper* and brought forward for consideration by SCER.

A level playing field for gas

A number of energy schemes designed to encourage lower emissions energy consumption are not fuel neutral and thus represent a distortion in the market. The ENA believes that this is particularly the case in residential hot water heating appliances, where there are market distortions that discriminate against gas hot water systems.

The Government seeks comment on ways to encourage a lower emissions energy supply that avoids market distortion or causes increased energy prices

Residential water heating represents approximately one quarter of domestic energy use in Australia. It is usually either the largest single source of greenhouse gas emissions in the typical Australian home or the second largest source behind space heating and cooling. There are around 4 million electric water heaters still in use in Australia due to the high upfront costs of changing water heaters and despite many years of government incentives under SRES and other State based schemes. Electric resistance hot water heaters generate three times the greenhouse gas emissions than the more efficient alternative of gas water heaters.

Incentives are provided for solar and heat pump technologies under the SRES to replace electric water heaters but less expensive gas hot water systems are excluded. The costs imposed on consumers by the lack of a level playing field for gas hot water systems will only be compounded if the proposed Million Solar Roofs program includes solar water heaters.

ENA proposes that displacement technologies (i.e. solar water heaters and heat pump water heaters) currently included in SRES should be excluded. Alternatively, if displacement technologies continue to be assisted through the SRES, the subsidy should be provided for all emissions efficient technologies on the basis of their abatement.

The ENA provided a submission on the design of the *Emissions Reduction Fund* (ERF) that called for technological neutrality and support of the installation of gas water heaters as replacements for electric water heaters. An ERF that incorporates these elements is not only consistent with least cost abatement

outcomes for the Australian community, but also avoids the distortion of economic investment signals in technological development and innovation. The ENA believes that, when aggregated, the abatement from the replacement of electric water heaters with gas water heaters will be significant.

Recommendation 8

Support market development and a level playing field for gas, through removal of unnecessary barriers to new gas supply, developing measures to promote greater transparency in the gas market and to ensure that energy schemes designed to reduce emissions are fuel neutral.



OCTOBER 2013

DELIVERING THE RELIABILITY
THAT **CUSTOMERS CHOOSE**

Options to reform network reliability



OPTIONS FOR REFORM OF DISTRIBUTION NETWORK RELIABILITY

Key features	AEMC separate reliability process	Alternative integrated reliability process
Independent regulator approves reliability targets	✓	✓
Investment based on customer value of reliability	✓	✓
Reserve role for jurisdictions to require additional targets (eg. high-impact, low probability events & worst performing feeders)	✓	✓
Distribution networks responsible for customer relationship. Customer engagement is timely and in an integrated, not fragmented, manner.	x	✓
Maximises benefits to customers.	x	✓
Distribution businesses incentivised to improve reliability performance at efficient cost.	x	✓
Best practice, integrated decision making on reliability and cost trade offs.	x	✓

For further information, and ENA's submission to the AEMC Consultation Paper, 9 August 2013, visit the ENA website at www.ena.asn.au

RELIABILITY OUTCOMES THAT DELIVER FOR CUSTOMERS

Australia's electricity network businesses support reform of the regulatory framework for electricity network reliability performance.

Together transmission and distribution networks support a national framework which ensures that:

- » reliability spending occurs efficiently to provide the service that customers value, with customers engaged in a meaningful and timely manner;
- » there is independent oversight of the way reliability targets are set while maintaining a continuing customer relationship with the distribution network businesses;
- » the framework provides the flexibility and incentives for distribution networks to innovate to improve customer outcomes.

Australian governments have previously agreed that reform is needed to ensure that in the future customers can be confident that spending on electricity distribution network reliability reflects their willingness to pay. Energy Ministers have tasked the Australian Energy Market Commission (AEMC) with developing a national reliability framework and methodology. A consultation paper and a final report on electricity distribution network reliability have been published and a final report on transmission reliability is expected to be released in early November 2013.

In December 2013, Energy Ministers were to report to the Standing Council on Energy and Resources (SCER) on their willingness to transfer responsibility for the proposed new national reliability framework to the Australian Energy Regulator (AER).¹ Recently, the AEMC has proposed that SCER proceed through an interim stage prior to consideration and full implementation of the reform of network reliability.²

Networks see value in the work to be undertaken in the interim stage, both in its potential to improve existing arrangements and in contributing to the future reform of network reliability. ENA welcomes the opportunity for industry to contribute to the development of nationally consistent definitions for network reliability.

In addition, in the interim stage the AER would be given responsibility for estimating the value of customer reliability. This is an opportunity for SCER to consider the proper resourcing of the measurement of the value of customer reliability (VCR), given the importance of VCRs in a national reliability framework based on the choices of customers about reliability and cost.

The AER should be sufficiently resourced and able to call on expertise in non-market valuation methods to ensure that VCR measures are robust over time and sufficiently granular to reflect the range of customer experiences.

OPTIONS FOR REFORM OF NETWORK RELIABILITY

The starting point for reform of network reliability is consensus that there should be greater consideration of the value placed on reliability by customers, and that investment should be more efficient. Investment in reliability is efficient when the costs of network reliability investment are less than the benefits, as valued by customers.

The ENA supports some aspects of the AEMC's proposed reform of network reliability. In particular we support the AEMC's proposed framework for transmission networks and for sub-transmission assets within a distribution network.³ Where the AEMC and the ENA differ is on the proposed reform of distribution network reliability.

The AEMC proposes a separated process for setting reliability targets for distribution networks in advance of investment. The AEMC's process is built on multiple agencies undertaking activities which need to be aligned. Customer engagement is also fragmented as customers are consulted a number of times, by multiple agencies, on their reliability and cost trade-offs at different stages of the process. This process is represented in Figure 1 in this document.

The ENA proposes a simpler alternative process which is in line with international best practice and integrates the setting of reliability targets with the revenue determination process under the independent AER. State Government jurisdictions could continue to have a role, if they choose, in setting additional targets beyond those approved by the independent regulator, but cost implications and merits of those targets would be made explicit for customers in integrated regulatory consultation. The simpler alternative process is represented in Figure 2 of this document.

This document has been prepared by the ENA to engage customers, policy makers and other stakeholders on the options for network reliability reform. The ENA supports national reforms which provide for effective customer engagement and the transparent and independent oversight of distribution reliability targets through an integrated regulatory process. The current proposal would not be in the best interest of customers because the reliability performance of electricity distribution networks is too important to customers for targets to be set in isolation from other regulatory consultation on network expenditure.

1 Standing Council on Energy and Resources, "Electricity, Putting Consumers First", December 2012

2 AEMC, Final Report, Review of the national framework for distribution reliability, p. v

3 The ENA, together with Grid Australia, has argued for a differentiated approach to transmission and distribution network reliability. ENA and Grid Australia support the AEMC's approach for transmission networks. See ENA's submission to the AEMC review process at <http://www.ena.asn.au/publications/submissions-and-letters/>.

THE AEMC MODEL : A SEPARATE RELIABILITY PROCESS

To achieve independent oversight of reliability targets which drive investment, the AEMC process creates a separate Target Setter, informed by an Economic Advisor. Every five years, multiple actors such as the AER, the Target Setter, the Economic Advisor and Jurisdictions would all assess similar issues relating to the 'trade off' between reliability performance and cost outcomes as perceived by customers.

An unclear, fragmented process for customer engagement would result in these multiple parties interacting with customers in multiple processes about similar issues. This has the potential to be a more frustrating environment for customers seeking meaningful engagement.

FIGURE 1 THE AEMC MODEL : A SEPARATED RELIABILITY PROCESS



ISSUES

VCR measurement across the NEM is at an early stage of development and potentially could produce volatile outcomes driving real swings in reliability spending.

It is not clear how compliance obligations created by jurisdictions would be made transparent to consumers, along with information on the effect on network pricing.

Australia's annual spending on distribution reliability improvement is expected to be small for the foreseeable future (less than 5% of total capital spending). However, the AEMC process would see the assessment of reliability service and expenditure disconnected from the economic regulation process which governs 95% of network expenditure.

The Target Setter would in effect "lock in" the investment spending required in advance of the regulatory determination process. Under the AEMC approach a new national reliability target setting process would need to be designed in detail, developed and tested for support with all jurisdictions. As the AEMC has recognised in recommending an interim stage for consideration by SCER, it could be some years before a national framework for distribution network reliability could be agreed by jurisdictions and implemented.

2 years before

Regulatory determination process		
Framework & approach	Regulatory proposal	Final determination
<p>AER publishes framework and approach for guidance on the determination of revenue and prices for the next regulatory period.</p>	<p>Distribution networks submit expenditure proposals to the AER including reliability improvement spending already locked in with target setter.</p>	<p>AER makes final determination of allowed revenue including revenue for meeting reliability targets.</p>
<p>Stakeholders consulted on framework and approach, <u>except reliability targets</u>.</p>	<p>Networks consult with customers on all aspects of regulatory proposals <u>except spending on reliability improvement</u></p>	<p>Stakeholders consulted on final determination.</p>

FIVE YEAR REGULATORY CONTROL PERIOD COMMENCES

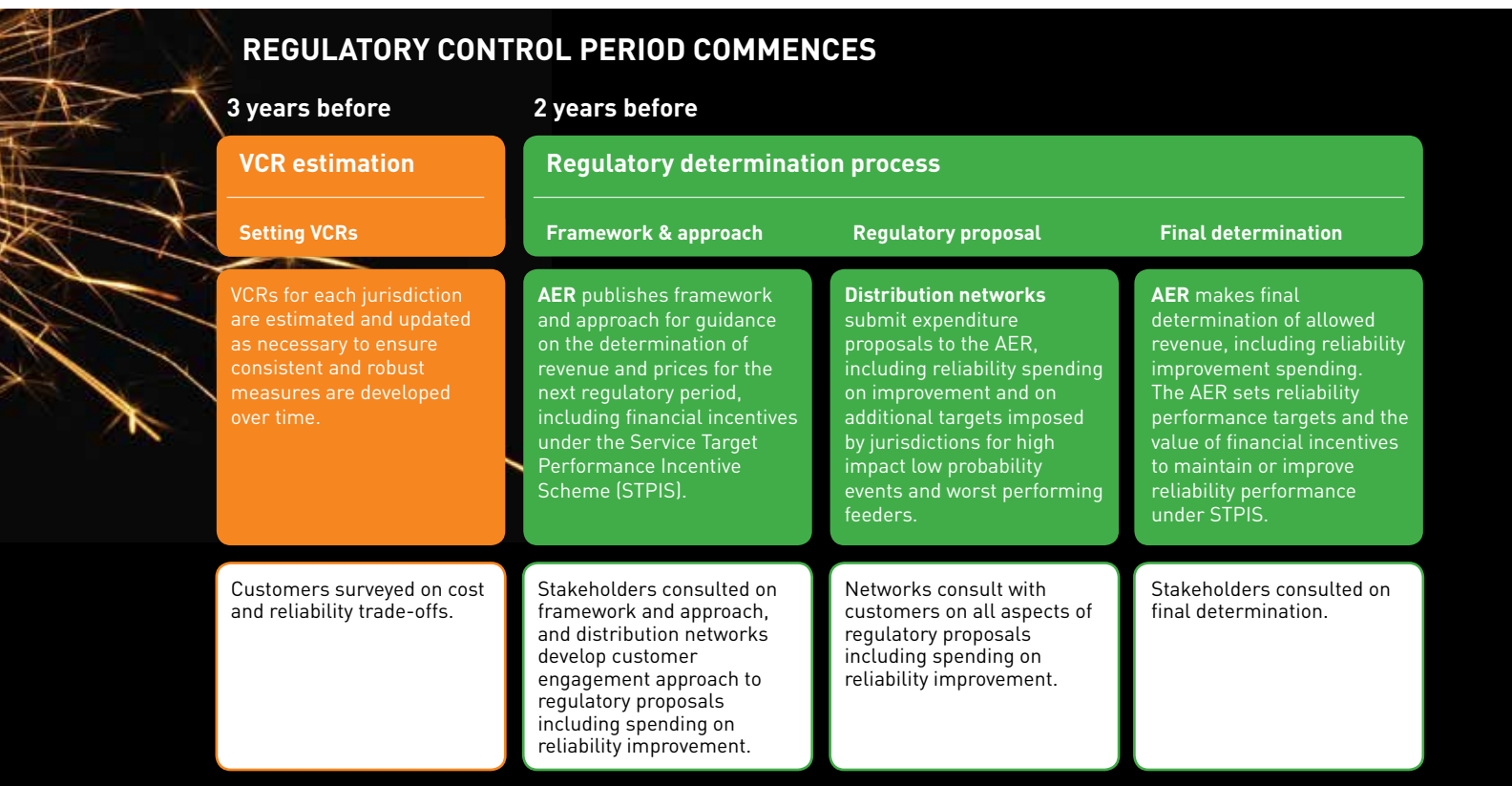
It is unclear how the AER could continue to administer STPIS as an incentive mechanism under the AEMC process.

A SIMPLER ALTERNATIVE : AN INTEGRATED RELIABILITY FRAMEWORK

Under an integrated reliability framework the AER, as the independent regulator, would approve reliability performance targets and assess the efficiency of proposed spending on reliability in an integrated way in the regulatory determination process.

Jurisdictions could set additional targets as compliance obligations, to be taken into account by the AER in the regulatory determination process. This could include targets for areas of high economic importance or service requirements for customers in worst performing feeder areas.

FIGURE 2 INTEGRATED NATIONAL DISTRIBUTION RELIABILITY FRAMEWORK



ISSUES

ENA supports the AER's view that "Given the increased significance of the VCR in the proposed framework, it is also important that the arrangements for determining the VCR are robust. The arrangements should support a cycle of continuous improvement in VCR estimation."

The customer engagement framework for regulatory proposals must include consideration of reliability performance and proposed jurisdiction compliance obligations. Customer engagement (in line with AER draft guideline) will be timely, explain the role of consumers in the engagement process, and be clear and meaningful on the reliability issues.

Regulatory proposals include an integrated and transparent assessment of the cost and reliability trade offs for customers. Customers can consider reliability spending in the context of all cost drivers when providing their feedback on the regulatory proposal.

The contribution of financial incentives to encourage an efficient level of reliability outcomes over time, is a key outcome of the regulatory determination process.

However, under the national reliability framework jurisdictions would be required to make explicit the justification for these additional targets including the economic costs and benefits and the effect on pricing for network customers.

The AER would continue to set financial performance incentives which currently encourage distribution network businesses to improve reliability performance efficiently. Under this approach, distribution networks achieve more efficient reliability outcomes over time as they are rewarded or penalised by the amount that customers value the changes in reliability.

Customers benefit by receiving improved reliability where they are willing to pay for it - or through lower prices if reliability performance falls.

The current financial incentive scheme (the Service Target Performance Incentive Scheme or STPIS) has been in place since 2008, and currently covers the majority of distribution networks (and will apply to the remaining two jurisdictions - NSW and ACT - from 2014). The AER has proposed to undertake a review of the effectiveness of STPIS in the next twelve months. The outcomes of this review could be beneficial to customers through the further development and potential modification of STPIS, as part of a national reliability framework.

FIVE YEAR REGULATORY CONTROL PERIOD COMMENCES

Annual assessment

Reliability performance

Incentive payments

Distribution networks are rewarded financially for meeting reliability targets and financially penalised for a failure to meet targets.

ISSUES

STPIS is designed to encourage distribution networks to improve reliability performance where customers are willing to pay for these improvements.

The AER benchmarks reliability performance annually and approves incentive payments (or penalties) under STPIS that are subsequently reflected in annual network tariff proposals (with a 6 to 12 month lag).



LIMITATIONS OF THE AEMC APPROACH

The benefits and costs of the AEMC's separate reliability framework and the simpler alternative of an integrated reliability framework need to be assessed against the National Electricity Objective.

It is ENA's view that there are four fundamental limitations with the AEMC's approach.

- 1. Customer engagement hasn't been considered holistically.** Multiple consultation by different bodies about the same reliability/cost trade offs does not achieve a better for customers than integrated consultation in a regulatory determination process. In effect under the AEMC approach customers would be consulted on reliability, but not in the context of total network spending and reliability trade-offs. This undermines the electricity distribution networks' direct customer relationship at a time when policy makers argue there needs to be a cultural change to a greater customer focus.
- 2. The model relies on producing new targets for every feeder every five years which is overly prescriptive and costly** given most network businesses report being in 'maintenance mode' for projected reliability spending. Annual spending on reliability improvement (and achieving security standards) in electricity distribution networks is falling and currently is less than 5% of total expenditure.
- 3. The marginal cost of delivering reliability outcomes is likely to be higher under the AEMC approach** as tried and tested network costs are more readily independently validated in the economic assessment process. Under the alternative approach, distribution networks will seek out innovative, less expensive solutions to maintaining or improving reliability performance and recover costs through financial incentive payments.

- 4. The AEMC's separate approach is inconsistent with international best practice.** In line with international best practice, the national framework for electricity distribution network reliability should integrate decision making on price and reliability holistically within the regulatory determination process.

ENA recommends best practice national reliability framework

The ENA proposes that Energy Ministers consider an **incentives** based national framework for reliability that is **integrated** with the revenue determination process under the **independent** AER. This is consistent with international best practice and is more efficient, effective and of greater benefit to consumers than the separate regulatory process proposed by the AEMC.

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