PRODUCTIVITY COMMISSION DRAFT REPORT – FINDINGS AND RECOMMENDATIONS

PC Recommendation	Networks NSW Response
Recommendation 5.4 *Where, within a given regulatory period, a network business spends materially more capital than that allowed for in the Australian Energy Regulator's final ex ante regulatory determination, then its entire capital expenditure should be subject to an ex post prudency test:* *• Only spending that is deemed efficient and prudent, given the information available to the network business at the time, should be included in the Regulatory Asset Base at the end of the period, subject to the condition that:* *– the maximum disallowable expenditure is no more than the difference between the ex ante forecast and realised expenditure* *• If a network businesses is aware that it is going to exceed pre-approved spending levels, it should be able to apply for pre-approval to avoid the ex post assessment.* *The prudency test should not apply to cost pass throughs and contingent projects permitted under chapters 6 and 6A of the National Electricity Rules.*	• This matter has been addressed by the AEMC in its final Rule change package regarding energy networks regulation.
Recommendation 5.5 *The National Electricity Rules should be clarified to indicate that the Australian Energy Regulator is only required to test the reasonableness of the overall expenditure proposal. The Regulator should only be obliged to consider the reasonableness of a specific expenditure item if it could materially affect the judgment of the reasonableness of the total expenditure forecast.*	• We do not support the view that the AER should not need to look at detailed aspects of the proposal and in particular it is not clear how an appeal process could transpire under such circumstances. If the AER accepts the proposal, then they may not necessarily have to assess all detailed components of the proposal. However, if the AER does not accept the proposal, they must give reasons as to why, which would imply that the reasons would include reference to the information DNSPs put forward. This matter has also been addressed through AEMC rule change package.
Recommendation 10.1 *Distribution businesses should implement the roll-out of advanced metering infrastructure — so called smart meters — on a region-by-region basis within their network.* *• Before any roll-out, the Australian Energy Regulator, drawing on the proposal and supporting evidence from the distribution business, should assess the net present value of costs and benefits, and be required to consider demand management options that do not rely on smart meters.* *• When the Australian Energy Regulator determines the optimal start date of the roll-out, the relevant distributor must submit a costing to the Regulator for approval and agree to an appropriate timeline for implementation.*	• Reform of pricing structures is challenging and relies on the roll-out of supporting technology, such as smart meters. We do not consider that the potential costs and benefits to customers have been sufficiently evidenced to warrant the commencement of a mass smart meter rollout at this time - to this extent we support the Commission's stance to not support a mass rollout in the short term. We do, however, support the rollout of smart meters on a regional, case-by case basis when supported by a positive cost-benefit analysis. • In the absence of a Government mandate, wide scale investment in smart metering technology is unlikely to occur due to uncertainty in the policy environment. Until principles such as load control protocols, access to services associated with smart

• *Mandatory time-based network charges to retailers (draft recommendation 11.3) should be implemented once smart meters are installed, appropriate customer consultation and education has taken place, and retail price regulation is removed (draft recommendation 12.3).*	meter functionality and agreement on standard communication platforms, it is unlikely a sufficient business case for a large scale roll out of smart meters could be developed. These matters were discussed at length during the National Smart Meter Programme but they remain unresolved. • Without a "game-changer" in terms of the costs (or benefits) associated with a mass smart meter rollout, the NSW DNSPs do not see the benefits to customers exceeding the corresponding (and potentially significant) electricity price increases in the short to medium term. We note that many of the purported benefits for customers of smart metering have not been satisfactorily evidenced and that the benefits are necessarily experienced across the energy supply chain, rather than as benefits for customers from the provision of standard control distribution services. Therefore, alternative funding arrangements for smart meters beyond what the AER can reasonably set may be required in order to capture the electricity supply chain benefits. • Further consideration also needs to be given to the transition path to providing cost reflective price signals to customers. Providing feedback to customers on their energy use so they are better placed to make informed decisions about their energy consumption patterns is critical to realising the benefits from a smart meter roll out. In the transition to a large scale smart meter roll out the feedback to customers may not necessarily be in real time in the initial period. However, any feedback should still provide information to customers to enable them to more effectively weigh up the costs and benefits of consuming energy at certain times. • The NSW DNSPs also note that alternative DM options that do not rely on smart meters should also be explored. There is a concern that the rest of the recommendations seem to focus solely on time based pricing. • Benefits may flow to many NEM participants, not just DNSPs, therefore any cost/benefit analysis has to look at a broader audience. The AER may not be best placed to do this.
Recommendation 11.1 *The Standing Council on Energy and Resources should be tasked with overseeing the progressive implementation of cost-reflective, time-based pricing for electricity distribution network services, predicated on the long run marginal costs of meeting peak demand. Amongst other things, the Council should:* • *following consultation with key stakeholders, set timelines for the various*	• Well designed, efficient pricing strategies can send a signal to customers about the true cost of consuming energy at peak times. When customers have feedback available about their energy use they are better placed to make informed decisions about their energy consumption patterns and can more effectively weigh up the costs and benefits of consuming energy at certain times. • The basic metered tariffs faced by the majority of residential and small business

steps in the development and implementation process, having regard to: *– the Commission's specific proposals in relation to this process (draft recommendations 11.2 to 11.7)* *– progress in making necessary changes elsewhere in the system* *• monitor compliance with those timelines* *• address any areas where greater engagement between key stakeholders (distribution businesses, retailers, state and territory governments, the Australian Energy Regulator and customer representatives) would assist the expeditious implementation of the new pricing regime* *• if and as necessary, take specific steps to address implementation delays.*	customers are unable to provide accurate signals about the substantial cost of supplying peak network capacity. To provide more efficient price signals that better reflect the economic cost of supplying network capacity requires a move away from basic metered tariffs to time-based or demand-based tariffs. Basic accumulation meters are not able to accommodate these more sophisticated pricing signals. The costs and benefits of providing "smart" meters is discussed further below. • Faced with more efficient price signals, consumers would have financial incentives to reduce or shift the timing of some or all of their peak electricity use, and network businesses would receive a signal about the value consumers place on additional peak capacity. • While the Commission is confident that retailers will pass on time-based prices for network services to final customers, it should not be assumed. Ausgrid has approximately 325,000 residential customers on a network time of use (TOU) tariff, with the vast majority of these customers believed to also be charged on a TOU basis by their retailer. Ausgrid does not have visibility as to whether the retailers' TOU tariffs mirror the network TOU tariffs or tariff structures. • We also note that the Commission has not sufficiently addressed the costs and benefits of direct load control scenarios. We consider that direct load control has a key role to play in managing peak demand for electricity distribution networks and suggest that this matter warrants more fulsome analysis. We would be keen to assist the Commission in sharing our experiences with direct load control in the lead up to the Final Report. • The NSW DNSPs support the progressive implementation of cost reflective prices, but there are a number of issues that need to be addressed to ensure that customers actually see the price signal (refer Ausgrid Power of Choice submission). Whilst supportive of the pursuit of more cost reflective pricing, we believe that more consideration needs to be given to alternative options in transitioning to that outcome (see response Recommendation 10.1 above). • It is also important that any requirements placed on distribution businesses in relation to pricing do not limit tariff flexibility or inadvertently hinder other innovative demand side participation options. • The NSW DNSPs do not support the implementation of draft recommendation 11.2 to 11.5 and 11.7 as drafted.

Recommendation 11.5 *Clause 6.2.8(a)(3) of the National Electricity Rules should be amended to:* *• require the Australian Energy Regulator to publish guidelines on the methodology or methodologies that are appropriate for estimating the long-run marginal costs of meeting peak demand, and the factors that should be encompassed in those estimates* *• give the Australian Energy Regulator the authority to publish binding guidelines about efficient, time-based tariff structures, including definitions of 'peak' pricing events.* *These guidelines should be developed in consultation with the relevant stakeholders and should be improved over time as the implementation of time-based pricing progresses.*	• The NSW DNSPs do not support this recommendation and believe the distributor, not the AER, is best placed to define and establish appropriate tariffs. For example, peak periods and critical events will be different within and between network areas. • The draft recommendation is contradictory in asking AER to make binding guidelines but the Rules state that the guidelines are not mandatory. The NSW DNSPs do not support the view that guidelines can (or should) be binding, however the guidelines nevertheless provide a useful indication as to how the AER will assess these matters. • Draft recommendation 11.3 requires that tariffs are determined by an estimate of LRMC for the service concerned and draft recommendation 11.5 provides the AER with control over the calculation of LRMC and decisions of tariff structure. Together, these recommendations grant the AER control over tariff levels (ie the prices within each tariff) and issues of tariff design, yet the risks associated with the AER's pricing decisions remain with the business and their stakeholders. • Notwithstanding these comments, it is important that any refinement and strengthening of distribution pricing principles or methodologies do not limit tariff flexibility, inadvertently hinder innovative demand side participation options, or prevent distribution businesses from effectively managing revenue risk.
Recommendation 12.1 *Coinciding with the gradual roll-out of smart meters to allow more cost-reflective network pricing, revenues from all distribution network 'standard control services' should be subject to regulated weighted average price (not revenue) caps. This should not apply to transmission businesses, which, given the complexities and lower net-benefits, should continue to be subject to revenue caps.*	• We agree with recommendation 12.1 that "…*revenues from all distribution network 'standard control services' should be subject to regulated weighted average price (not revenue) caps*" on the basis of strong evidence that efficient pricing is enabled under a weighted average price cap (WAPC) and is (at best) non-existent under a revenue cap. As highlighted in the Draft Report, the AER has advocated the move away from a WAPC for the NSW DNSPs' upcoming regulatory determinations - a move we have strongly opposed. • The NSW DNSPs support the use of weighted average price caps based on their efficient pricing characteristics (which are absent under a revenue cap).
Draft Finding 14.1 *Efficient levels of reliability are based on balancing the benefits to customers of fewer interruptions with the costs to network businesses of building, maintaining and operating reliable networks. Identifying the point at which the costs to network businesses of further increments in reliability exceed the additional benefits for customers should be the first step in regulating reliability.*	The NSW DNSPs agree with the principle outlined in this finding, however implementing this principle for the benefit of consumers has some practical challenges including, but not limited to: 1. A reliable, and up to date, measure of the Value of Customer Reliability is required to measure the benefits to customers. This has been acknowledged in the Commission's report under draft recommendation 14.2

	2. How to take into account the varying values that customers place on reliability. There are often several classes of customers at both feeder and substation level. For example a feeder could service large business customers, small business customers and residential customers. Placing an accurate value on customer reliability by feeder type or at substation level will be complicated by this fact. 3. Ensuring that the appropriate price signals are passed through to customers via their retailer. In submissions to the AEMC as part of the Review of Distribution Reliability and Standards Ausgrid, Endeavour Energy and Essential Energy have each made submissions supported moving to a more outputs based approach to reliability in any National Framework that is developed, as this would lead to more efficient outcomes. However any move to an outputs-based approach must ensure that customers in worst served areas of New South Wales are protected from reduced reliability standards. Those customers would typically be located in rural and regional areas fed by radial sub transmission networks, and are already experiencing reliability levels below major urban and regional centres.
Draft Finding 14.2 *Current estimates of the value that customers place on reliability are based on inadequate sampling, data and methodology and need to be updated regularly.*	The NSW DNSPs raised concerns about the calculation of Value of Customer Reliability (VCR)in their submissions to the AEMC's Review of Distribution Reliability Outcomes and Standards. We agree with the following key point noted in chapter 14 of the Commission's report: *Setting efficient standards requires accurate measures of the value that customers place on reliability. Current estimates are inadequate and more frequent and comprehensive studies should be undertaken to improve them*[1]. If "identifying the point at which the costs to network businesses of further increments in reliability exceed the additional benefits for customers" is the first step in regulating reliability then placing an accurate value of reliability is the logical next step. Without an accurate VCR, reliability balancing the costs of reliability with the benefits to customers will not be possible.
Recommendation 14.3 *The Australian Energy Market Operator should commission and pay the*	• The NSW DNSPs support the draft recommendation and believe that a comprehensive

[1] Productivity Commission, Electricity Network Regulatory Frameworks, October 2012, pg 461

Australian Bureau of Statistics to undertake regular, detailed, disaggregated surveys based on best practice methodologies to reveal the value of reliability for different categories of customers, with the methodologies and results made public. *The Australian Energy Market Operator should commission suitably qualified experts to consider and measure the costs of interruptions not likely to be captured in the Australian Bureau of Statistics surveys. This should include the costs associated with citywide disruptions, including to telecommunications, water services and public transport, and the resulting loss of international reputation from lower reliability. The Australian Energy Market Operator should use these measures to supplement the results of the surveys.*	NEM-wide study on willingness to pay/VCR conducted by independent parties would be appropriate, including the incorporation of flow on economic impacts to wider society of an outage. • We also believe that any comprehensive VCR study carried out by an independent expert should be able to be easily updated in the future, without the need for significant amounts of rework.
Recommendation 16.1 *The Standing Council on Energy and Resources should specify that reliability requirements for distribution businesses be included in the Australian Energy Regulator's Service Target Performance Incentive Scheme, replacing all existing jurisdiction-specific reliability settings.* *• The reliability requirements should reflect the preferences of customers by using the estimated values of customer reliability, as spelt out in draft recommendation 14.1, and should be specific to the distribution business.*	The NSW DNSPs support a move to replace existing jurisdictional specific reliability settings with the Service Target Performance Incentive Scheme subject to: • The costs of moving to STPIS being justified by the benefits to customers; • Customers located in worst served areas being protected from decreases in reliability. In our opinion the STPIS would maintain or improve performance in urban and major regional areas; however we do not believe that it, or a guaranteed service level scheme, provides sufficient incentive to improve the reliability to customers located in the worst served areas of the network; and • The STPIS recognising that reliability is influenced by network specific factors unique to each individual distribution network such as the type of network, its location, size and topography. As noted in the AEMC's Issues Paper on the National workstream: *Consistency for consistencies sake is likely to produce relatively limited benefits. However, a nationally consistent framework could potentially offer significant benefits if that framework represents best practice and is a substantial improvement on at least some aspects of the approaches currently adopted by jurisdictions.* Please also refer to our comments under section 14.1 measuring reliability at feeder and substation level.
Recommendation 16.2	

The Australian Energy Regulator should also make the following amendments to the Service Target Performance Incentive Scheme: *• reliability performance targets for the system average interruption duration index, system average interruption frequency index and momentary average interruption frequency index should be adjusted annually, according to rolling five-year average annual performance* *• revenue at risk should be negotiated as part of the Australian Energy Regulator's revenue determination process* *• the reporting and information component of this scheme should require distribution businesses to report their reliability performance at the zone substation level. Worst performing feeders should be identified as part of this process* *• reporting by all distribution businesses of performance against the parameters in the scheme should be published annually and be at least as detailed and comprehensive as current reporting mechanisms for distribution businesses in Victoria.*	• The NSW DNSPs support a move to rolling five year annual average performance. Adjusting targets annually will provide stakeholders with the latest information on network performance and provide a more realistic target to measure actual performance against. • Revenue at risk is currently negotiated as part of a DNSP's determination process and we agree this should be maintained. • Substations supply a variety of customer classes including large businesses, small businesses and residential, therefore valuing reliability at substation level will have the same challenges as at feeder level (see section 14.1). • We agree that worst performing feeders should be identified as part of this process. Changes to reliability standards need to ensure that customers in worst served areas, who are already experiencing reliability levels below the state average, are protected from any reduction in reliability as a result of any changes to the reliability framework. • The NSW DNSPs have no objection to performance against parameters being published annually if explanations are also published to explain the variances. We also recommend that details of the VCR surveys are published along with this data. • The NSW DNSPs currently report on the various components of the STPIS as part our annual Regulatory Information Notice to the AER.
Recommendation 16.3 *Where a distribution business can show that they are unable to technically comply with one or more parameters of the Service Target Performance Incentive Scheme, and where satisfied that the benefits exceed the costs, the Australian Energy Regulator should:* *• approve the required revenue for the distribution business to install the necessary equipment* *• require compliance as soon as possible.*	• The NSW DSNPs agree with this recommendation, but emphasise that that the benefits to customers, must exceed the costs. For example, Essential Energy is not required to measure the Momentary Average Interruption Frequency Index parameter of the Reliability of Supply component because the cost of complying with this requirement would exceed the benefits to customers.
Recommendation 21.1 *There should be an independent review of the resourcing and capacity of the Australian Energy Regulator to undertake all its functions, including whether there are impediments to its performance and options for improvement.*	Given the significant increase in responsibilities and workload envisaged by the Productivity Commission for the AER we support the intent behind the following recommendations: • an independent review of the resourcing and capacity of the AER to undertake all of its functions and discharge its responsibilities; • the capacity of the AER to share resources with a range of other agencies;

	• the need to ensure that the AER establishes, and retains, the necessary specialist staff to carry out its role; • regular ongoing communication and interaction with network businesses, their customer and other relevant stakeholders which are not just confined to periods around the regulatory determinations.
Recommendation 21.2 *The Australian Energy Regulator should have greater control over, and accountability for, the resourcing and management of its functions. It should:* *• have its own separate budget sufficient to meets its role* *• submit a separate annual report of its performance* *• publicly reveal its strategy for improving its performance* *• have an independent capacity to negotiate resource sharing arrangements with a range of agencies, not just the Australian Competition and Consumer Commission* *• ensure that it establishes and retains the necessary specialist expertise to competently carry out its role, in accordance with draft recommendation 8.6* *• develop a program for regular ongoing communication and interaction with network businesses, their customers and other relevant stakeholders, with those interactions not just confined to periods of regulatory determinations.*	Notwithstanding the findings of any review (as proposed in recommendation 21.1) the NSW DNSPs agree with the Commission that the AER should have greater accountability over its functions. More generally, the AER's role in benchmarking is likely to be more credible if the regulator is given independence from the ACCC and allowed to operate as a standalone independent energy regulator. As noted by the Commission, this would be consistent with the original institutional arrangements proposed for the NEM. The continued co-location in the ACCC (a multi-sectoral body that has competition and consumer protection functions) may present the risk that the regulator might be influenced by political/public pressure, particularly in an environment of rising prices.
Recommendation 21.3 *There should be adequate ongoing funding of a single but broadly representative consumer body with expertise in economic regulation and relevant knowledge and understanding of energy markets. This body would:* *• represent the interests of all consumers during energy market policy formation, regulatory and rule-making processes, merit reviews, and negotiations with providers of electricity networks and gas pipelines* *• subsume the role of the existing Consumer Advocacy Panel into its broader functions* *• be funded through a levy on market participants, drawing on the approach used to currently fund the Consumer Advocacy Panel* *• have a governance structure that involved a board of members appointed on merit, and an advisory panel to give the board advice on the needs of the mix of customers concerned.*	The NSW DNSPs support the establishment of a broadly representative consumer body provided that it subsumes the role of the existing Consumer Advocacy Panel into its broader functions and information is made available on appropriate governance arrangement of the consumer body. We support the establishment and input of a consumer body but do not believe it should have any role in approving a NSPs regulatory proposal. The NSW DNSPs believe a single, but broadly representative body, may assist it comply with a number of proposed changes contemplated by the AEMC's draft rule – Economic Regulation of Network Service Providers. The changes proposed by the AEMC in its Draft National Electricity Amendment Rule – Economic Regulation of Network Service Providers to increase customer engagement and participation include: • Requiring NSPs to indicate in its regulatory proposal the extent it has engaged with

	consumers; • Requiring NSPs to provide an overview paper; • Requiring the AER to publish an issues paper to help assist consumer representatives focus on the key issues; • When setting capex and opex allowances the AER will be required to take into account the extent to which a NSP has engaged with consumers.
Recommendation 21.4 The National Electricity Law should be amended to expedite the making of Rules arising from any appropriately conducted independent review relevant to the National Electricity Market and that are agreed by the Standing Council on Energy and Resources. This should be achieved by giving the: • Australian Energy Market Commission the power to expedite Rule requests and • South Australian Minister a broader power to make Rules.	• The NSW DNSPs do not support this draft recommendation. Expediting rules at expense of appropriate consultation with all stakeholders can lead to inappropriate outcomes and should be largely avoided. • The proposal that the SA Ministers be given the power to make the rules with the agreement of the other SCER Ministers, avoiding the AEMC process altogether is not supported. To date the SA Minister has been given very limited powers by the Parliaments of the participating jurisdictions to make rules which support legislative changes. These rules have generally been developed in consultation with interested stakeholders but there is no guarantee of that so we should resist any expansion of the rule making power which would reduce the accountability of the rule making process by removing the involvement of the AEMC as the expert rule maker and the opportunity for all interested stakeholders to be involved in the rule making process. • In terms of the fast track process we think the productivity commission's proposal is problematic. The fast track provisions already exist where there has been consultation by an electricity market body (the AER, AEMO or the Reliability Panel) on a proposed change to the rules which would justify skipping the initial consultation on the proposal and moving straight to draft determination .The types of inquires referred to by the Commission would not appear to be in the context of a rule change and would not be by an expert body as such but on more general issues. Therefore, avoiding skipping the initial consultation on a proposal would be an inadequacy in the process as there would be no understanding of the nature of the rule change proposal before a draft determination. Whilst the existing process seems protracted, all steps are essential to ensure a proper process and robust rules. There is a need for an initial review and comment on the proposal to inform the AEMC on its approach to draft, then the draft determination and Rule to consult on the proposed response to the proposal for change prior to issuance of a final decision.