



**ENERGY
CONSUMERS
AUSTRALIA**

A Suite 2, Level 14, 1 Castlereagh Street
Sydney NSW 2000

T 02 9220 5500

W energyconsumersaustralia.com.au

T @energyvoiceau

in /energyconsumersaustralia

f /energyconsumersaustralia

ABN 96 603 931 326

25 October 2019

Mr Mark Feather
General Manager, Policy and Performance
Australian Energy regulator
GPO Box 520
Melbourne Victoria 3001

Draft Decision: Values of Customer Reliability

Dear Mark,

Energy Consumers Australia appreciates the opportunity to comment on the Australian Energy Regulator (AER) Draft Decision on the Values of Customer Reliability (VCR).

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments (COAG) Energy Council in 2015, our objective is to promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We have valued the opportunity to raise issues with the AER throughout the VCR Review process through our membership of the Consultative Committee, and in our direct engagement with the project team and Board. These discussions have always been constructive and valuable, in sharing a consumer perspective on what are often complex technical matters.

Evidence from consumers in the Energy Consumer Sentiment Survey shows that consumers continue to express lower satisfaction with affordability and higher satisfaction with reliability. Where reliability has been low in response to particular events, trends indicate this has recovered without significant additional expenditure.

The “direction of travel” of policy and regulation and technology in the energy sector is reflecting new emphasis on consumer-controlled demand responses to a range of transition issues. The early potential for which was shown most clearly in difficult heatwave circumstances in New South Wales and the Australian Capital Territory in 2017. In both cases Ministers in ad hoc radio communications asked consumers to reduce their energy use. Enough consumers responded quickly enough to enable the system to manage the reliability risk at no cost or detriment to the consumers. We are in the early days of a shift to more risk-based communication, with local technology and consumer responses being part of a suite of responses to reliability risk. This context must be considered in reaching the VCR decision.

The importance of VCR estimates in underpinning a least cost electricity network, with not one more dollar invested than necessary, or one day earlier than required for meeting consumers need for reliability, cannot be understated. Energy Consumers Australia sees this work by the AER as critical to the achievement of the AER’s strategic objectives, and the outcomes of the work program that is focused on network revenue and reliability incentive payments and on building consumer confidence. For this reason, we see the determination of an AER methodology for estimating VCRs and the publication of initial estimates in December 2019, as the beginning of an on-going process in the context of a transitioning energy system.

Energy Consumers Australia is broadly supportive of the overall approach set out in the September 2019 Draft Decision, with our focus being on the methodology for deriving VCRs for standard outages (those typically less than 12 hours) for residential and small business customers with a peak demand



of less than 10 MVA. The AER's methodology for determining initial estimates have been produced within the constraints imposed by the National Electricity Rules, and the consequent time, budget and resourcing constraints. However, while the methodology satisfies the rules it is an open question as to how long the methodology can remain fit-for purpose in a rapidly transforming electricity system.

Our specific comments are therefore focused on areas for further work, and/or potential for improvement.

1. The assessment criteria
2. International benchmarking
3. Techniques for estimating and adjusting VCR
4. Use and application of VCR

Assessment criteria

We support the inclusion of an assessment criteria in the Draft Decision. Assessment criteria is critically important, as it links what could otherwise be seen as a technical task of estimating a parameter that is applied in network investment decision making to the long-term interests of consumers.

We agree with the AER that the National Electricity Objective will be promoted where the VCR methodology is able to reflect customer reliability preferences today, and over time (as described in Table 5.1 of the Draft Decision).

However, we believe that the requirement set out in clause 8.12 of the National Electricity Rules is unnecessarily prescriptive in its wording. The requirement that the current and all future methodologies "must include a mechanism for directly engaging with customers which may include the use of surveys" could have the consequence of enshrining surveys as the preferred approach.

The emphasis on "directly engaging with consumers" in the Rule is correct. There have been cases, notably in New South Wales and Queensland, where past decisions without such direct engagement with customers on reliability preferences resulted in over-investment in networks to consumers' detriment. However, "may include...survey" provides just one example of a methodology that could be applied.

Alternative approaches have been put forward, that combined with surveys, should be considered in the future. These include:

- the use of modelling combined with surveys (the so-called hybrid approach) to sense check survey design and survey results, and the VCR estimates themselves. This was proposed by Energy Consumers Australia in our submission on the Consultation Update Paper, and we remain of this view; and
- the use of deliberative processes or customer forums, the effectiveness of which has been demonstrated in the use of focus groups to test the survey questions in this current process, as well as by Essential Energy in its consideration of reliability issues in its recent revenue determination process. This was proposed by the Public Interest Advocacy Centre.

International benchmarking

Expert advice provided by Energeia to Energy Consumers Australia has demonstrated the importance of international benchmarking, in testing whether estimates of VCR are within established norms. To date, in Australia and elsewhere there have been a number of factors that go to whether we can be confident that the estimates produced "reasonably reflect" consumer preferences (the AER's terminology in the assessment criteria).



These include:

- whether surveys in isolation can be meaningful, given the difficulty of communicating to households and small businesses what is really being asked for in the survey and how it will be used;
 - we note the KPMG/Insync report's finding that willingness to pay (WTP) values ranged from \$2.39 to \$19.27 over the last two reviews, depending on the survey version used;
- a reliance on stated preference surveys rather than revealed preference surveys;
- frequent changes in methodology, that make comparisons over time and across countries problematic; and
- variations in the sample size of surveys, whether it is representative and who finances them (businesses versus regulators).

In the evidence provided to the AER by Energy Consumers Australia we have shown that:

- there have been significant shifts in Australian estimates over time, that cannot be explained as changes in consumer preferences; and
- Australian estimates of VCR are high by international standards, with Energeia finding that AEMO's 2014 approach yielded VCR's that were over 20% higher than peer countries including the UK and New Zealand. This discrepancy is not readily explained by factors that could lead consumers in Australia to value reliability more than their counterparts in like economies.

We propose that the AER in the next stage in undertaking its function for VCR estimation, consider how it might work with regulators in similar or relevant jurisdictions to undertake international benchmarking.

Ensuring that trends in estimates over time can be explained by shifts in consumer preferences, rather than being an outworking of methodology changes, is critical to ensuring consumer confidence in the AER's on-going functional responsibility and to mitigating the risk of potential swings in network investment. The report from KPMG/Insync shows that when the methodology is held constant as it was with a control group in the pilot survey undertaken for the AER, consumer preferences *declined* in real terms between the 2014 and 2019 surveys: the willingness to pay results were \$3.32 in 2014 and \$2.39 using the AEMO equivalent survey in 2019.

Techniques for estimating and annually adjusting VCR

The Draft Decision provides a methodology for estimating VCRs for standard outages by December 2019, using the results of the survey of WTP and estimates of consumption to arrive at dollar per kilowatt hour values.

In our view it is important that the data on consumption is robust, and fit for purpose, otherwise the credibility of the VCR estimates is open to question. At an aggregate level, consumption has declined between 2014 and 2019, due to factors that are exogenous to consumer preferences for reliability, including the growth in roof-top solar PV systems and more energy efficient appliances. We would appreciate advice from the AER on the sources for consumption data at the next Consultative Committee meeting.

The approach to annually adjusting the initial estimates "within period" to maintain the real dollar value of the VCR estimates is pragmatic. We note the reported results from KPMG/Insync suggest consumer preferences constant in nominal and not in real terms. The ECA therefore suggests the AER remain open to a positive 'X', particularly in light of the empirical evidence that Australia's VCRs are already above peer country levels, and the cost of batteries is falling at an annual rate faster than inflation.



In this context, the decision to set the initial value of X to zero results in a risk that these adjustments could lead to “overshooting” given the transition underway in the electricity market, with the potential for consumers to take more actions that enable them to manage outages (through the use of batteries) and to be active in demand response mechanisms.

Should annual adjustments be shown to have resulted in overshooting when the next VCR estimates are produced, there may be some difficulties in them being wound back. What cannot be unwound for consumers is the over investment in networks that will continue to have to be paid for through the Regulated Asset Base. The Draft Decision is silent on how this risk can be monitored and mitigated, given that the X factor in the adjustment mechanism will be set to zero for this period.

Consumers value certainty, and a predictable trajectory for network costs, and we would appreciate the opportunity to discuss the management of this risk in the Consultative Committee.

Use and application of VCR

An important next step in the process should be the development by the AER of a guideline for the use and application of the VCR estimates, once published in December 2019. In December 2014, the Australian Energy Market Operator (AEMO) published an VCR Application Guide, to provide stakeholder guidance on the current and potential application of the results of AEMO’s VCR review. The final Application Guide incorporated feedback following stakeholder consultation on an earlier draft.

We see an Application Guide as a valuable addition to the work that has been undertaken by the AER and will be critical to developing stakeholder practice that is consistent with the final methodology and VCR estimates determined by the AER.

Thank you again for the opportunity to participate in this important process. If you have any questions regarding our submission, please contact Lynne Gallagher on 02 9220 5500 or email on lynne.gallagher@energyconsumersaustralia.com.au.

Yours sincerely,

Rosemary Sinclair AM
Chief Executive Officer