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B11/1677

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Dear Mr Pierce 

## AUSTRALIAN ENERGY MARKET COMMISSION (AEMC) REVIEW OF DISTRIBUTION RELIABILITY STANDARDS

At the 10 June 2011 meeting of Energy and Resources Ministers, Energy Ministers considered drivers of the recent electricity price rises.

Energy Ministers noted that distribution network investment is a significant contributor to these rises and that in some jurisdictions, such as New South Wales, distribution network reliability standards are potentially driving the cost increases.

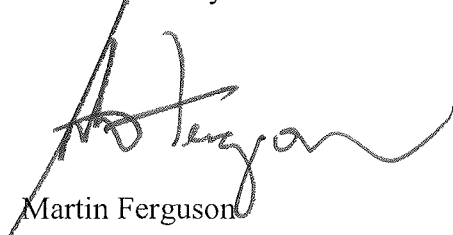
Energy Ministers noted in particular the recent finding of the Independent Pricing and Regulatory Tribunal (IPART) of New South Wales that the application of reliability standards in that state has substantially increased the expenditure of distribution network businesses on infrastructure. IPART noted that this expenditure has been an important driver of recent increases in retail electricity prices and will continue to drive higher prices in the coming years.

In addition, Energy Ministers recognised the New South Wales Government's concerns around the impact of network expenditure on electricity prices in that state.

As reflected in the meeting communiqué, Ministers also agreed to direct the AEMC to conduct a review of the distribution reliability standards framework in the National Electricity Market. Further, on request of the New South Wales Premier, Energy Ministers agreed to direct the AEMC to conduct a review of New South Wales distribution reliability outcomes.

I am writing on behalf of Energy Ministers to request the AEMC undertake these tasks. Please find the terms of reference for the review attached to this letter.

Yours sincerely



Martin Ferguson

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## Terms of Reference

### Australian Energy Market Commission Review of Distribution Reliability Outcomes and Standards

*Approaches to determining reliability outcomes across the National Energy Market and an assessment of reliability outcomes in New South Wales*

#### MCE directed review

Under section 41 of the National Electricity Law (NEL) the Ministerial Council on Energy (MCE) may direct the Australian Energy Market Commission (AEMC) to review, amongst other things, any matter relating to the National Electricity Market (NEM) or any other market for electricity. Accordingly, under section 41 of the NEL, the MCE directs the AEMC to:

- conduct a review of the frameworks and methodologies adopted by the NEM jurisdictions for the delivery of distribution network reliability outcomes ('the national review of distribution reliability frameworks'); and
- conduct a review of the reliability standards in New South Wales (NSW) ('the review of NSW distribution reliability outcomes').

The terms of reference for these reviews are set out below.

Recognising the links between the two reviews, the AEMC will undertake them in parallel. Given the importance of reaching conclusions on NSW distribution reliability outcomes in time for the next regulatory determination period, this work stream will be completed more quickly.

#### National review of distribution reliability frameworks

##### *Purpose of the review*

The AEMC's Final Report (23 September 2009) for the *Review of National Frameworks For Electricity Distribution Network Planning and Expansion*, suggested a separate review be initiated by the MCE into the methodology underpinning security and reliability standards as they relate to the design and planning of distribution networks. The AEMC noted there is currently a lack of consistency and transparency in how standards are determined and described across the NEM and how Distribution Network Service Providers (DNSPs) interpret and comply with these standards. The AEMC argued this lack of consistency may be adversely impacting the efficiency and timeliness of network investments and making it difficult for non-network providers to operate on a NEM wide basis.

The MCE response to the AEMC report (September 2010) '... supported in principle, a consistent approach to the setting of reliability standards operating in the NEM.' However, the MCE noted '...that in accordance with the [Australian Energy Market Agreement (AEMA)], service standards will remain State and Territory functions and that it is appropriate for certain standards to differ across jurisdictions due to differing network characteristics.'

At a joint meeting of Energy and Resource Ministers on 10 June 2011, Energy Ministers noted that outcomes from recent distribution network business regulatory determinations have been a significant contributor to price rises for retail customers. Jurisdictional regulators and the Australian Energy Regulator (AER) have commented on the impacts of network expenditure on energy prices.<sup>1</sup>

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<sup>1</sup> For example, the Independent Pricing and Regulatory Tribunal has indicated that policy changes relating to network regulation could be made to limit future electricity cost increases to more appropriate levels. For NSW, IPART recommended that the NSW Government take actions to limit future increases in network costs by reviewing key aspects of the regulatory framework (Retail Pricing report). Also, refer to statements made by Chair of the AER Board Andrew Reeves on 20 June 2011 at the Energy Users Association of Australia speech. Go to [www.aer.gov.au](http://www.aer.gov.au) for a copy of Mr Reeves's speech.

Energy Ministers seek to ensure that there is an effective balance between ensuring sufficient investment in distribution networks to maintain reliability and pricing outcomes for customers. In recognition that distribution reliability is one aspect of the framework governing network investment, the MCE agreed to direct the AEMC to undertake a national review of frameworks and methodologies for achieving distribution reliability outcomes.

The AEMC's national review of distribution reliability frameworks will provide an analysis of the different approaches to achieving distribution reliability across the NEM and the underpinning methodology behind those approaches. Based on this analysis the AEMC will consider if there is merit in developing a nationally consistent framework for expressing, delivering and reporting on distribution reliability outcomes.

On receipt of this advice, the MCE will consider whether to request the AEMC to undertake further work to recommend a best practice approach that could potentially be adopted by jurisdictions, noting that it is entirely appropriate for standards to differ across jurisdictions due to the differing characteristics of distribution networks.

#### *Approach to the review*

In undertaking the national review of distribution reliability frameworks, the AEMC is requested to:

- identify the different approaches adopted across the NEM jurisdictions for delivering distribution network reliability outcomes. This will build on the work in the early stages of the NSW review to assess best practice approaches to setting distribution reliability standards and outcomes nationally and internationally (see below); and
- assess the costs and benefits of the different approaches in line with the National Electricity Objective. This will particularly focus on assessing the outcomes delivered by different approaches with regard to the balance between consumers' willingness to pay and the costs of delivering different reliability outcomes; and
- consider and advise whether there is merit in developing a nationally consistent framework for expressing, delivering and reporting on reliability outcomes, noting there will be no harmonisation of existing jurisdictional obligations.
- If requested by MCE following the completion of the above work, develop a best practice framework that delivers nationally consistent reliability outcomes that could be voluntarily adopted by jurisdictions or used as a reference to amend aspects of existing approaches.

In undertaking this assessment, the AEMC needs to acknowledge:

- differences between existing methodologies and approaches within each NEM jurisdiction, and should focus on the outcomes of different approaches. For example, whilst input based deterministic standard based planning is adopted in jurisdictions such as New South Wales, other jurisdictions such as Victoria rely on providing distribution network businesses with output or quality of service based incentives that drive improvements in reliability and the need for network investment; and
- that jurisdictional regulators and relevant government agencies are predominantly involved in setting targets for end customer reliability and customer service standards which aim at balancing reliability and costs to consumers.

In making any recommendations to change the current arrangements, the AEMC shall have regard to the need for changes to be proportionate to the materiality of the issue, as well as the value of stability and predictability in the energy market regime. The AEMC shall provide advice on implementation of any recommendations.

## Review of NSW distribution reliability outcomes

### *Purpose of the review*

The NSW Government has concerns about the impact of network expenditure on energy bills in that State with respect to the costs attributable to NSW reliability and quality of service licence conditions imposed on NSW Distribution Network Service Providers. Accordingly, the NSW Government has requested that the MCE direct the AEMC to undertake the review of NSW distribution reliability outcomes.

The AEMC's review of NSW distribution reliability standards work stream will provide a framework and information for the NSW Government to decide whether it would be appropriate to amend NSW's existing licence conditions for distribution reliability standards. This will involve a review of NSW's distribution network reliability and quality of service licence conditions and require the AEMC to make recommendations on how NSW can ensure that distribution networks deliver a level of reliability that most effectively balances the costs of incremental investment and ongoing maintenance with the benefits of reliability.<sup>2</sup> Any changes to NSW's approach to reliability standards would need to apply from the start of the next NSW regulatory determination period, commencing on 1 July 2014.

### *Approach to the review*

In undertaking the review of NSW distribution reliability outcomes, the AEMC is requested to:

- consider best practice national and international reliability standards and outcomes, in particular how the standards that are set and the outcomes that are delivered, take account of the costs of incremental investment and maintenance, and community expectations and willingness to pay;
- verify that the current expression of distribution reliability standards in the NSW licence conditions remains appropriate. In particular, whether the classification of customer groups, regions and the expression of the reliability standard, e.g. customer minutes lost, provide a reasonable basis for setting future standards<sup>3</sup>;
- estimate the efficient costs of achieving a range of different reliability outcomes that are both higher and lower than the current outcomes based on assessing information to be provided by the NSW distribution businesses, expert analysis and any other relevant information, such as evidence from other jurisdictions;
- estimate, based on expert analysis and public consultation (which may include surveys and/or focus groups), the willingness of the NSW community to pay for a range of reliability outcomes. It is noted that there may be different levels that are found to be acceptable based on assessment of willingness to pay of different categories of consumers, for example, for households compared with CBD business customers; and
- compare the estimated efficient cost of different possible reliability outcomes established through the above assessment of best practice, expert analysis and consultation, with the evidence about the reliability outcomes that the NSW community would find acceptable and is willing to pay for. The AEMC is requested to set out a cost-benefit assessment of the range of reliability outcomes that the NSW Government should consider to amend the existing licence conditions. This should include the impact of different possible future outcomes on electricity prices, energy security, and any other factors considered to be relevant.

In developing its recommendations, the AEMC is requested to take into consideration:

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<sup>2</sup> Standards for the provision of services such as street lighting that are not core to the distribution reliability standards will not be considered in the review.

<sup>3</sup> The timetable for the review does not allow for a fundamental re-design of the way in which distribution reliability standards are expressed, so if the initial review of the current approach highlighted major problems with the way the standards are expressed then the timetable for the review may need to be reviewed.

- the expectations of NSW electricity customers;
- the characteristics and differing risk profiles of different types of customers and regions in NSW;
- investment to date by NSW distribution network businesses to achieve the reliability standards required by NSW licence conditions, and the levels of reliability expected to be achieved by the end of the current regulatory determination period (at 30 June 2014);
- Information to be provided by the NSW distribution businesses as to their assessment of the costs of achieving a range of different reliability outcomes that are both higher and lower than the current outcomes;
- reliability standards and outcomes in place in other jurisdictions; and
- the Australian Energy Market Operator's (AEMO) work on developing a National Value of Customer Reliability.

### **Relevant considerations**

In addition to the factors outlined above, the AEMC is to have regard to the following in conducting both Reviews:

- the National Electricity Objective;
- the proposed national framework for distribution network planning and expansion, including the Regulatory Investment Test for Distribution;
- the role of the AER in administering the current frameworks and how this impacts on how reliability standards are set and managed. This includes the current incentive framework applied to distribution businesses to maintain quality and reliability of supply - including the AER's Service Target Performance Incentive Scheme and the Guaranteed Service Level arrangements in relevant jurisdictions;
- any relevant transmission provisions that have applicability to distribution;
- the reporting to the AER on target setting of reliability performance under Chapter 6 of the Rules;
- when released, the MCE's response to the AEMC's Transmission Reliability Standards Review;
- other relevant reviews and Rule change determinations; and
- any other relevant information.

### **Consultation for the review**

In conducting the review, the AEMC must:

- consult with jurisdictional Ministers responsible for implementing clause 19 of Annex 2 of the Australian Energy Market Agreement, which places responsibility for setting service reliability standards, including standards to ensure network security and reliability, with state and territory ministers;
- consult on a regular basis with jurisdictional representatives and the Standing Committee of Officials for Energy Ministers;
- consult with jurisdictional regulatory bodies;
- consult with the AER;
- consult with AEMO; and
- consult and engage with stakeholders, including network companies, market participants and customers and their representatives.

## **Timeframe and deliverables**

### *National review of distribution reliability frameworks*

The AEMC is requested to provide to the MCE and publish:

- advice identifying the different approaches adopted across the NEM jurisdictions, and national and international best practice approaches to delivering distribution reliability outcomes by November 2011;
- an issues paper by May 2012;
- a draft report by September 2012; and
- a final report four months after the MCE has provided advice on the draft report (the final report should be provided to MCE at least two weeks prior to publication)<sup>4</sup>.

### *Review of NSW distribution reliability outcomes*

The AEMC is requested to provide to the MCE and publish:

- an issues paper by October 2011;
- a draft report by March 2012;
- a final report by June 2012 (the final report should be provided to MCE two weeks prior to publication).

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<sup>4</sup> The final report is to include agreed outcomes associated with the development of an AEMC best practice framework that delivers nationally consistent reliability outcomes that could be voluntarily adopted by jurisdictions or used as a reference to amend aspects of existing approaches.