public interest
ADVOCACY CENTRE

Value of Customer Reliability

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney.

Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives input from a community-based reference group whose members include:

- NSW Council of Social Service;
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association NSW;
- Tenants Union;
- The Sydney Alliance; and
- Mission Australia.

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Public Interest Advocacy Centre

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The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

Overview

PIAC welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) consultation on its draft decision on Values of Customer Reliability (VCR).

The VCR informs significant decisions around energy market design, planning, regulation and investment. As such it has a material impact on how the future energy system works for consumers. An inaccurately high VCR will result in higher than required investments in reliability, with consumers footing the costs but not receiving commensurate benefits. An inaccurately low VCR will mean cheaper bills but less reliability than they're prepared to endure. This potential impact makes it critically important that the VCR is accurate and representative.

The National Energy Market (NEM) is transforming from an energy system relying primarily on large scale, centralised, firm, mechanical, fossil-fuel generation and passive demand, to one with a small scale, decentralised, variable, electronic, low-emission generation fleet interacting with more sophisticated and active demand-side behaviour.

While this is happening, real electricity prices have increased for households and become a major cost of living pressure. This has left many people without proper access to an essential service, with detrimental impacts on their health, wellbeing and options for improving their circumstances.

Against this backdrop, PIAC welcomes the work the AER has undertaken so far to develop a robust, relevant and fair VCR and broadly supports its draft decision. We appreciate being closely involved in the AER's VCR process through the VCR Customer Council, which has added value and confidence to the process. This submission addresses the AER's proposed methodology for calculating VCRs and matters concerning its application, and outlines areas where we consider more work should be done.

AER's VCR guideline

The current energy landscape requires developing a guideline for the application of VCR that acknowledges, reflects and accommodates uncertainty and fast-paced change. This guideline should be underpinned by an agreed set of principles designed to promote consumer interests.

The AER has guidelines for a number of its most significant decisions and we consider it appropriate that it has one for VCR as well.

Through a guideline, stakeholders can work from a set of principles so that across different time periods and environments decisions involving VCR can be driven by the same principles and towards the same outcomes. Doing so will ensure accountability, consistency and reliability as systems and environments change.

Importantly, a guideline will ensure end users of VCR, such as network businesses, work from the same values and are subject to the same standards and methodologies. This would prevent businesses from choosing VCRs at their discretion, and increase transparency and efficiency in

decision making. TransGrid's choice of VCR in its Powering Sydney's Future proposal is an example of where, if guidelines for the use and applicability of VCR were in place, the project approval process would likely have been smoother and more efficient. As it was, the process was controversial and subject to challenges.

PIAC recommends that, as AEMO did for its 2014 VCR[1] and as the AER does for similar processes, the AER should develop a guideline for the application of VCR which provides guidance on matters including (but not limited to):

- the interpretation and application of AER's VCR values;
- the limited circumstances in which the use of alternate VCRs may be appropriate; and
- what are acceptable approaches to develop alternate VCRs.

These changes will help support the NEO, insofar as having stronger guidance for industry, along with appropriate prescription that supports the AER's approach to determining VCR, affords businesses less discretion in the matters to which they must have regard. This will:

- support the consistent application of AER's VCR values as the 'default';
- provide certainty over the longer term for businesses, consumers, energy market institutions, governments and other stakeholders;
- minimise regulatory compliance burden on network businesses; and
- limit - and ideally eliminate - grounds on which businesses may seek judicial review of AER decisions regarding VCR.

Rather than adopt a guideline, the AER outlines assessment criteria for choosing a VCR methodology and lists examples where VCR is applied. PIAC supports these criteria but reiterates is position that a guideline be developed and endorsed as soon as possible.

PIAC recommended a guideline be developed and implemented in its submission to the AER's consultation to develop this draft rule, and does not support the AER's decision not to develop one or outline a process for developing one as part of its draft determination. We see this as a missed opportunity that will likely have future detrimental consequences.

As such, we recommend the AER produce a VCR guideline and consider seeking a rule change to the National Electricity Rules to make the guideline binding.

Methodology

PIAC broadly supports the AER's methodology for estimating VCR for standard outages and widespread and long duration outages. We also support the AER's decision not to formally calculate VCRs for momentary outages at this stage.

PIAC understands the AER did not adopt its preferred method – revealed preference techniques – because it was unable to review, design and implement it within the Rules' timeframe. We consider priority should be given to exploring the revealed preference method in future VCR

[1] AEMO, 2014. *Value of Customer Reliability Review*. https://www.aemo.com.au/-/media/Files/PDF/VCR-final-report--PDF-update-27-Nov-14.pdf

reviews as the AER considers it likely to give the most accurate VCR. We also suggest further investigation of model-based approaches which may elicit results more in line with international standards. These model-based approaches could be used in conjunction with surveys to fulfil the obligation to engage directly with customers and as a way to sense check results on both ends.

PIAC considers direct engagement with customers is essential to calculating an accurate and representative VCR and recommends the AER go further than just surveys in determining VCR. We support the AER's use of direct customer surveys in its VCR methodology, however, we recommend more direct customer engagement similar to that undertaken by network businesses as part of their revenue determinations and access arrangements. The decisions made by networks in these processes and by the AER in its VCR determination have similarly large impacts on consumers and as such the AER's consultation should be of a similar depth and thoroughness. Deliberative face-to-face engagement with customers can eliminate biases that emerge in surveys and elicit deeper responses.

Standard outages

PIAC supports the AER's alteration of AEMO's 2014 contingent valuation question in its calculation of the value of avoiding standard outages. We consider the change will allow a more accurate reading of customers' preferences.

PIAC considers the open-ended question following the closed Willingness to Pay questions is a good step to ensuring more accurate measures of value. PIAC suggests that, to understand the value placed on reliability by customers, the AER use the lower of: the maximum value a customer is willing to pay for reliability, and the lowest cost substitution option for reliability.

We support the AER's attempt to address concerns around biases by testing the language of surveys. We recommend this testing be undertaken with each new survey to ensure biases are limited in future surveys, which may take place under different conditions. While testing language is a good first step, we reiterate that deliberative, face-to-face consultation should be included as a means to determine accurate VCR and to reflect the impact VCRs have on consumer outcomes.

Widespread and long duration outages

PIAC supports the AER's proposed methodology to value the impact of widespread and long duration outages. We agree with the AER's assessment that general consumers are unable to provide accurate or useful feedback on these kinds of outages and support the its macro-economic model-based methodology for including them in the VCR.

Smoothing

PIAC appreciates the AER considering consumer outcomes in decisions on whether to smooth the transition to new VCRs. We agree that large jumps between VCRs may be disruptive, although we question whether this disruption will be primarily felt by consumers. In light of this, we support decisions of whether or not to smooth being based on whether there is a net customer benefit in doing so.

This approach will require a methodology for calculating the benefits and costs to customers of smoothing. We recommend the AER undertake consultation on how best to measure the benefits and costs.

Adjustments and review periods

Given the importance of the VCR in informing significant decisions around energy market design, planning, regulation and investment it is essential that it is accurate, representative and up-to-date. As such, we do not support the AER's decision to review VCRs every five years and recommend a shorter duration. Specifically, we recommend review every 4 years to avoid network VCRs becoming out of date, to align with market price and reliability standard settings and to keep up with the fast pace of technical and other changes.

PIAC supports adjusting the VCR by inflation in between reviews, however, we highlight that adjusting by inflation should not be a substitute for regular review of the VCR. PIAC supports the CPI-X approach, noting X is challenging to accurately measure and that more regular recalculations of VCR may achieve a similar or better result for the amount of effort and low uncertainty.

Other matters

Load shedding

PIAC supports the AER's proposal to load shed according to VCR, with lowest VCR customers being shed first. However, in making these decisions, we suggest the AER consider the potential for harm that can result from load shedding in residential areas.

Large industrial energy users account for large proportions of state loads and can have consumption equivalent to that of residential suburbs or even cities. These types of commercial users will usually have a higher average VCR than average residential users, however, the value they place on reliability may start low and increase with the duration of an interruption. For example, an aluminium smelter may see almost no financial cost from a short interruption to supply but, over a certain threshold pot lines will freeze, making continued interruptions very costly.

Residential users will on average have a lower VCR than large industrial users however some residences will have an extremely high VCR, for example due to life support requirements.

PIAC suggests the AER look at how varying VCRs within customer groups can be incorporated into load shedding decisions to produce better and fairer outcomes for all consumers.

Overstating value

There may be an incentive for large energy users to overstate the value of reliability. Large users are often higher up the network and may not pay for distribution costs. Higher VCR may benefit these users who do not pay for distribution services, as their transmission costs are socialised among a large number of customers and they are load shed last due to their high VCR.

PIAC suggests the AER should investigate ways to mitigate the incentive for some large users to overstate the value they place on reliability.

Segmentation

We support the AER's intention to segment VCR values based on climate zone and remoteness for residential customers. We understand the AER will be asking respondents about dwelling characteristics, type of energy supply and use of DER among other things and suggest making this more granular data available for analysis by interested parties.

Continued engagement

PIAC looks forward to continued constructive engagement to further explore issues concerning Values of Customer Reliability. We view this as a valuable opportunity to ensure that all consumers benefit in a future energy system.