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Dr Paul Grimes, Commissioner
c/o Secretariat
Review of Victoria's Electricity Network Safety Framework
By email to delwp.secretariat@delwp.vic.gov.au

Dear Dr Grimes

Review of Victoria's Electricity Network Safety Framework

The Australian Energy Regulator (AER) welcomes the opportunity to make a submission in response to the issues paper on the Review of Victoria's Electricity Network Safety Framework.

We are responsible for the economic regulation of electricity transmission and distribution systems in all Australian states and territories, with the exception of Western Australia. The National Electricity Law (NEL) and National Electricity Rules (NER) provide the economic regulatory framework for electricity networks. In this role we promote the efficient investment in and use of electricity services for the long term interests of consumers.

The issues paper identified that a key objective of the electricity network safety framework is to protect the Victorian community by reducing the risk of bushfires and electrocution. It sought stakeholder views on any matters that may be relevant to the terms of reference.

We understand that the review will include an examination of the objectives of the safety framework in Victoria and an assessment of its effectiveness in achieving electricity network safety outcomes. In this regard, we note that in relation to the interaction of safety regulation and economic regulation of energy networks, there is a two-stage process for network safety in Victoria:

- In stage 1, the relevant government departments and Energy Safe Victoria (ESV) set the safety standards following relevant cost benefit analysis for all safety programs, consistent with the 'as low as reasonably possible' (ALARP) principle.
- In stage 2, the AER calculates in its revenue determinations the efficient amounts of capex and opex required to meet these standards. Over time, the safety regulator, ESV, monitors the delivery of the safety programs that it has approved to ensure its safety objectives are met.

The result of this process should achieve the best level of risk avoidance at an efficient cost. To achieve this result, it is important for us to continue to work closely with the Victorian government authorities to ensure this process works as intended.

In regards to the relationship between the economic regulatory framework and safety regulation, the issues paper posed two key questions:

- Does the current economic regulatory framework present any barriers to achieving acceptable network safety?
- Could current economic incentives to promote safety and reliability be improved? If so, what changes might be considered?

Our responses to these two specific questions are provided in **Attachment A**.

We look forward to further participating in the consultation process. Our contact for this submission is David Chan, telephone (03) 9290 1446.

Yours sincerely

Chris Pattas
General Manager, Networks

Attachment A: AER response to the Review of Victoria's Electricity Network Safety Framework

- ***Does the current economic regulatory framework present any barriers to achieving acceptable network safety?***

We do not consider that current economic regulatory framework presents a barrier to achieving acceptable network safety.

In Victoria, the safety obligations of major electricity companies are contained in the Electricity Safety Act 1998 (Vic). Section 99 of this Act mandates that major electricity companies must submit an approved Electricity Safety Management Scheme (ESMS) to Energy Safe Victoria (ESV) for acceptance. These schemes are regulated by ESV. Each of the five Victorian distributors is classed as a 'major electricity company' under this Act.

We are responsible for the economic regulation of electricity transmission and distribution networks in all Australian states and territories, with the exception of Western Australia. The National Electricity Law (NEL) and National Electricity Rules (NER) provide the economic regulatory framework for electricity networks. In this role we promote the efficient investment in and use of electricity services for the long term interests of consumers. In particular—in promoting the long-term interests of consumers—we have regard to price, quality, safety, reliability, and security of supply of electricity; and the reliability, safety and security of the national electricity system.

As part of our regulatory determinations that set the revenues of network businesses on a periodic basis, we either accept or provide our own forecasts for two key types of expenditure prior to the start of each regulatory period—total capital expenditure (capex) and total operating expenditure (opex). We assess the efficiency of all capex and opex against prescribed parameters in the NER, including the capex and opex objectives, criteria and factors. One of the objectives is that the capex and opex forecasts must be sufficient to enable the network operators to meet their regulatory obligations, including safety obligations.

To facilitate the implementation of electricity safety and bushfire prevention regulations, we ensure that appropriate and efficient levels of capex and opex necessary to meet the regulatory obligations are funded. We have worked closely with ESV to understand the relevant regulatory requirements, such as those associated with recent changes to bushfire safety obligations.

Also, under the economic regulatory framework, there are a variety of mechanisms to facilitate adequate funding of new or modified safety regulations. The mechanisms are:

- regulatory determinations (where a program is known well in advance and forms part of the forecast expenditure)
- pass-throughs (for material changes during a regulatory control period)
- contingent projects (where a new obligation is expected to occur during the forthcoming regulatory control period, but where the costs and timing are uncertain).

Safety regulations can impose costs on electricity networks, which will ultimately be borne by the consumers. As the economic regulator, it's important that funding to meet the safety standards and other requirements, as set by the safety regulations, is prudent and efficient. In this way, consumers are paying no more than necessary for services they value to achieve the safety regulation objectives.

In applying the National Electricity Rules we seek to allow a forecast of the efficient level of costs that:

- allows the electricity network to comply with all applicable regulatory obligations and requirements and

- maintain the safety of the electricity networks.

To achieve the expenditure objectives, we work closely with ESV to understand the relevant regulatory requirements.

- ***Could current economic incentives to promote safety and reliability be improved? If so, what changes might be considered?***

We consider that economic incentives can be used to promote appropriate service and efficiency outcomes. In particular, service and other improvements will be encouraged where they are valued by customers or justified on cost-benefit grounds.

For example, we currently administer two incentive schemes, the Service target performance incentive scheme (STPIS) and Victoria F-factor scheme. Both schemes are:

- symmetrical, in terms of the reward and penalty rates
- based on historical actual outcomes–hence, the effectiveness can be measured
- based on customers' value on supply reliability (the STPIS) and cost-benefit assessment (the F-factor).

The following examples demonstrate how improvements have been made to incentive schemes.

Service target performance incentive scheme (STPIS)

We develop, administer and maintain the STPIS in accordance with the requirements of the National Electricity Rules (NER). The STPIS is intended to ensure that distributors' service levels (level of reliability) do not reduce as a result of the distributors' efforts to achieve efficiency gains, which typically are associated with a reduction in expenditure.

The STPIS also provides incentives to the distributors to improve on the existing level where electricity consumers are willing to pay for these improvements. In other words, the scheme provides incentives for the distributors to be cost effective in their attempts to improve services to customers.

The current version of the STPIS has operated since 2009. In light of our experience to date and to further improve the economic incentives to promote reliability, we have commenced the process to review the STPIS. In this review, we have explored the potential of how new technologies may impact, or be impacted by, the scheme—and whether new measures in addition to supply reliability matters should be included.[1]

Victorian F-factor scheme

The F-factor scheme is a Victorian Government initiative designed to lower the number of fire starts by electricity distributors' networks in Victoria. It is implemented through the *National Electricity (Victoria) Act 2005.*

This scheme was first introduced in 2011. Based on a cost-benefit analysis, this scheme has recently been modified by the Victorian Government to focus fire start reduction effort at high fire risk locations and times, such as code red days, which are subject to the highest penalty rates.[2] The modified scheme has been operating since July 2016, and the first reports will be released by early 2018 for the 2016/17 financial year. It is therefore too early to form any view on the new scheme.

[1] Further details on the process can found from our website https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/service-target-performance-incentive-scheme-2017-amendment.

[2] Victorian Department of Environment Land Water and Planning: *Powerline Bushfire Safety Program f-factor Incentive Scheme: Regulatory Impact Statement*, August 2016.