



SUBMISSION TO THE QUEENSLAND COMPETITION AUTHORITY

PROPOSED SERVICE QUALITY INCENTIVE REGIME FOR QUEENSLAND DISTRIBUTORS

24th October 2003

1. Introduction and Summary

The Energy Users' Association of Australia (EUAA) is pleased to have an opportunity to comment on the service quality incentive regime proposed in the report by Meyrick and Associates and Pacific Economics Group, dated 11th August 2003 (Meyrick/PEG report).¹

The EUAA generally supports the application of service standards to distributors based on their performance against quantifiable measures of the actual service they provide to end-users. It also supports the use of (positive and negative) incentives for distributors based on their performance against these service standards. However, such incentives need to be meaningfully related to either the costs to customers of the standard not being met, or the benefit of it being exceeded. They also must be based on meaningful, independent and robust measurement.

We note that under the form of regulation adopted in Australia generally, and in Queensland in particular, unless there are sensible service quality standards established for Distribution Network Service Providers (DNSP's), the temptation will exist to skimp on maintenance and operational expenditure to maximise profitability, at the expense of quality of supply to end users. This is a well understood and documented side effect of regulatory systems employing a revenue cap or price cap.

Other States in Australia have already moved to establish service quality standards and the Regulators Forum has published a set of guidelines for such standards.² What is being recommended for Queensland in the Meyricks report is generally similar to the schemes already in operation in the other States and is consistent with the guidelines from the Regulators Forum.

As this submission makes clear, we support the idea of service quality standards in Queensland, generally along the lines of those recommended in the Meyrick/PEG report, but have some real concerns about the proposed delay in implementing any regime which will have a credible impact on the Queensland DNSP's and the service they actually deliver to electricity users.

Customers in Queensland should not have to wait until 2010 to gain the benefits possible from a well designed service quality regime. This is an inordinately long time and will disadvantage Queensland electricity users in the meantime, particularly as other States either have, or are expected to introduce, service standard regimes well before then.

We are also concerned that the proposed service quality regime does not cater for the needs of larger customers, and especially continuous process industries.

The EUAA is concerned at Meyricks' use of the largely discredited "Monash Study" of VoLL commissioned by VenCorp as part of the review of VoLL considered by the ACCC some years ago. The results of this study are questionable to say the least, a point made in the EUAA's submission to the VoLL review, and they refer to values associated with a loss of load in the

¹ Meyrick and Associates, Pacific Economics Group, "Development of and Electricity Distribution Quality Regime to Take Effect in Future Regulatory Periods", Draft Report dated 11th August 2003

² National Regulators Forum, "National regulatory reporting for electricity distribution retailing businesses", Discussion Paper dated March 2002.

energy market rather than in distribution networks.³ This concern impacts on the values proposed for the penalty/reward scheme proposed by Meyrick/PEG. We set out our concerns in this submission.

As this submission makes clear, we see no reason why an (appropriately limited) incentive scheme could not be implemented as part of the 2005 Electricity Distribution Review. Other States have found ways to overcome the problems raised by Meyrick/PEG, and we see no valid reason why Queensland cannot resolve the issues in time for implementation early in 2005.

It is not the task of this submission to be suggesting specific values that the QCA should use, but we raise these matters for the QCA's consideration, and would be happy to discuss details at a later date. However, we note that aligning incentives (rewards/penalties) to a very small percentage of distribution revenue (say, 1-2%) is unlikely to have a significant impact on distributor performance and is a very crude approximation to actual costs to end-users.

2. Proposed Service Quality Measures

The service quality measures proposed in the Meyrick/PEG report are generally in accordance with the set of measures proposed in the Discussion Paper produced by the Regulators Forum in 2002

They are primarily based on the industry standard SAIDI and SAIFI indicators, applied separately to urban and rural areas (further segregated into short and long feeders in the case of Ergon), and with SAIDI experienced by the worst 10% of feeders, similarly segregated. Also included would be the number of complaints and the percentage of phone calls not answered within 30 seconds.

The recommendations do not, however, include the use of MAIFI (momentary interruptions to supply — a matter of increasing importance to EUAA members and other energy users — nor do they include the timely provision of services (especially connections), or the timely repair of street lights, which are all included in the recommended measures arising from the Regulators Forum.

The EUAA expects to see Queensland follow the national systems proposed by the Regulators Forum, and the missing elements should be included in any new Queensland scheme, even if they are (initially) on a report-only basis and not included in a penalty/reward scheme until adequate data is assembled.

Regulators elsewhere have had an unfortunate tendency to accept, without further thought, the view that service standards need only take account of smaller customers, holding a view that large customers “can look after themselves”. This is a mistaken position. The experience of EUAA members, many of whom are larger users, is that they are also in need of some protection in this area, but are not getting it.

In particular, the existing measures mean little to them, being largely engineering concepts that many of them find difficult to follow. This presents a number of problems:

³ See *Impact on End-Use Customers of an Increase in VoLL – Submission Responding to the ACCC Draft Authorisation*, prepared for the EUAA by Pareto Associates (with Bardak Management Services), August 2000

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- These users are more concerned with ‘quality of supply’, which is reflected in momentary interruptions such as voltage dips, surges and flickers, but these are of secondary importance to – and poorly captured – in the present approach to service standards.
- They sometimes experience difficulty in having their concerns attended to by distributors. Their issues often need immediate or specific attention but too rarely receive it. EUAA members also confirm a consistent national problem in getting distributors to take action to deal with their problems and frequently comment on “how difficult it is to deal with a monopolist”.⁴ Problems in getting information on the causes of outages (eg was it distribution, transmission or generation related) and in determining who was responsible are also common.⁵

The measures adopted by regulators also suffer from a reliance on network averages, which can mask important outcomes, including significant variations around the average and geographic variations (eg regional area or feeder related). Some attempt has been made to respond to this by paying particular attention to “hot spots”, or the worst performing areas (e.g. the worst 10% of feeders). However, this has been only partially successful, especially if it concentrates on minutes off supply, as opposed to momentary interruptions, which are more difficult to measure, and as it neglects areas that are only marginally better off (e.g. the next worst 10% of feeders).

By focusing on a particular measure, or measures, and quantifying service levels in a certain way, service incentive regimes can also concentrate the efforts of distributors in particular matters, which will be only partially relevant to users and can even divert their resources into these areas at the expense of other service factors that are also important to users.⁶

Discussions with our members operating in Queensland (and elsewhere) confirm their concerns about these matters. They also confirm that connection agreements with distributors, whether standard or customer-specific, do not cover well the area of service standards.

The EUAA therefore believes that the QCA should examine carefully the need to take specific account of the needs of larger customers in developing a service standard regime for distribution in Queensland for the next regulatory period. Options could include the use of measures that are of more direct concern to such users, or the development of a set of mandatory guidelines that specify rights and responsibilities in relation to matters such as network connection, service performance, benchmarking, reporting, complaints, dispute resolution and account management.⁷

⁴ Distributors in all parts of the NEM have generally steered away from dealing directly with customers on such issues, leaving it to retailers. However, United Energy, one of the Victorian distributors (who do not have a retail arm), have introduced an innovative system where they have created “account managers” to work with larger customers in their network. Feedback from EUAA members is that this approach is appreciated and valued.

⁵ We appreciate that sometimes customers’ equipment can affect the distribution system, although customers are often in a relatively disadvantaged position in terms of getting access to information on the causes of faults.

⁶ The EUAA (together with the Energy Action Group) recently commissioned a study of the impacts on customers of Victoria’s service standard regime for distributors (see MacClure, G., *Relating Distribution Service Measures to the Real World*, presentation to EUAA *Energy Price & Market Update* seminar, Melbourne, 4 June 2003 and available from the EUAA). This shows the extent to which incentives can be distorted by such regulatory regimes and how they provide incentives for distributors to behave in certain ways.

⁷ The EUAA has previously made attempts to negotiate, on behalf of its members, with NSW distributors on service levels and connection and developed a model connection agreement for this purpose (see

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In addition, measures segregated by voltage level (high voltage, medium voltage and low voltage), or measures targeted to specific industries, such as continuous process industries, need to be considered.

The EUAA would welcome an opportunity to work with the QCA on these options.

3. Quality of Data Issues

The primary reason given for the very long timetable leading up to introduction of a service standard regime in Queensland proposed by Meyrick/PEG is the absence of suitable data collection systems in the two Queensland DNSP's, with references made to the Victorian situation as being more satisfactory.

Whilst we agree that the Victorian approach is, at this point in time, the most advanced in Australia, the Electricity Supply Association of Australia (ESAA) has been publishing reliability results for its member companies for many years — in some cases extending back as far as 1990/91 and with complete records from 1994/95. By the latter date, each of the Queensland authorities now forming Energex and Ergon, were reporting measures equivalent to SAIDI and SAIFI.⁸ It seems to us, therefore, that a base of past performance records already exists for Queensland — even though the quality of the record keeping probably needs to be improved — and one comparable to the base data which has been used by other States to establish service quality regimes.

Whilst this data is not perfect, we believe that the QCA needs to carefully assess it as a basis for the introduction of a service standard regime in Queensland during the next regulatory period.

It seems to the EUAA that the absence of data should not be used as an excuse to not begin a service quality scheme along the lines of those introduced in the other States, in the distribution regime operating from 2005. Naturally, we would want to see improvements in measurement — and additional measures focused on quality of supply — introduced as soon as possible during the next regulatory period.

4. Selection of Target Values

The set of data published by ESAA and referred to above, has been augmented by more segregated data in other States, especially those that have established a service quality regime (Victoria, South Australia, and now Tasmania). Adequate data would seem to exist to enable realistic targets to be set by the QCA for Energex and Ergon, based in part on their historical performance record, but more particularly, on the performance of other DNSP's operating in service territories with similar urban/rural mixtures as face Energex and Ergon in Queensland.

For example, from the point of view of energy users in the State, it would seem reasonable for Queensland as a whole to be aiming to at least match the SAIDI and SAIFI performance of similar distributors in the other Australian States by the end of the next regulatory period (about 2010) — with a lower set of targets for Energex and a higher set for Ergon to recognise the very different nature of their service territories.

We have already outlined above the areas where we see a need to extend the service regime and the need for regulators, including the QCA, to begin recognising that even larger users have a

Contracting for Connection & Sale of Electricity, Discussion Paper, by R. Jacobs & B. Byrne, Feb 1997. The EUAA is presently giving thought to a possible future project in this area.

⁸ See successive publications of "ESAA — Electricity in Australia" annual reports.

need for coverage by a service standard regime, albeit one that could well include different measures or even a different approach (eg more individually negotiated around a set of mandated guidelines, segregated by voltage level, or by industry/process type).

4. Values used in the Penalty/Reward Proposals

EUAA has some concerns with the values proposed by Meyrick/PEG to be used in any penalty/reward scheme which may be established in future.

However, EUAA supports the principle of providing distributors with meaningful incentives (positive and negative) to provide an acceptable level of service, or to improve service levels in appropriate circumstances.

Whilst we believe that incentives could be provided through the addition of an ‘S-factor’ to the price (or revenue) capping formula for efficiency, *CPI-X*, there are several important qualifications to this:

- First and foremost, it must relate to a set of meaningful (for users) and measurable service standards.
- The reward/penalty needs to be sufficient to actually provide an incentive to meet (or better) the target that has been set and should broadly relate to the costs/benefits to users associated with the service.
- Preferably, the system of rewards/penalties should include a system of charges and rebates that relate to, and can be shared with, the users (or groups of users) actually benefiting from the improvements, or suffering a service level that is below par, rather than be all captured by the distributor.
- Next, distributors should not be rewarded merely for providing a level of service that is no more than appropriate to the needs of users.
- However, they should be penalised for lowering service below this level, or for providing customers with a level of service that is already below par.
- Care needs to be taken in determining and rewarding service standards that are in excess of the standard, lest this reward improvements that end-users do not want or value. For example, we remain quite skeptical of ‘market surveys’ and other techniques that purport to measure the willingness of customers to pay for improvements in service. These can be made to produce predetermined outcomes and do not always reveal the true preferences of customers. There is therefore a risk that they will lead to excessive (or misdirected) investment in networks, which would be counter to the efficiency enhancing role of incentive regulation practiced by the QCA and other regulators.

We are very disappointed to see that the incentive values proposed by Meyricks/PEG have been based largely on the original and flawed study of VoLL conducted by Monash University for Vencorp. This study was put forward as the basis for a Code Change by NECA seeking to increase the level of VoLL used in the National Electricity Market from \$5,000/MWh to \$20,000/MWh.

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As mentioned above, the EUAA provided a submission to this review that strongly opposed the Code Change proposal and intervened in the various ACCC hearings and the Pre-Decision Conference held on the subject matter. As well as dealing with the particular applications of VoLL in the National Electricity Market — where it is used as both a price cap and as its name literally indicates, the “value of lost load” — the EUAA was very critical of the Monash study and included a detail critique of the study in our submission to the ACCC. This submission can be made available to the QCA upon request.

In large part due to the EUAA interventions, the NECA request was refused by the ACCC, and a value of \$10,000/MWh (half that proposed and supported by the Monash study) was authorised for use in the National Electricity Market. While not as low as was sought by EUAA, it represented a better outcome than that supported by NECA.

Given this past involvement in the matter, and Meyrick/PEG’s reliance on the Monash study and its revision by CRA, the EUAA is of the view that the estimates derived by Meyrick/PEG for the value to be placed on units of improvement of SAIDI and SAIFI are in need of further consideration; and should be symmetrical as well as relate to distribution networks not the energy market (eg have a relationship to the actual costs to distribution customers affected or at least a concept such as the value of unserved energy in distribution).⁹

The recently announced Tasmanian service quality regime for Aurora Energy uses much lower values than those proposed by Meyrick/PEG (\$26,000/0.01 interruption and \$26,000/minute of outage deviation from the baseline targets). However, the symmetrical change in regulated revenue in the Tasmanian scheme has been limited to \$1.6 million, or just 0.43% of expected 2004 revenue, compared to the 2% proposed by Meyrick/PEG.

It is not the task of this submission to be suggesting specific values that the QCA should use, but we raise these matters for the QCA’s consideration, and would be happy to discuss details at a later date.

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⁹ There have been various specific studies done to help determine this value including as part of the 2000 distribution price review in Victoria and specifically the submission by United Energy.