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EnergyAustralia®

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Mr Chris Pattas
General Manager
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Australian Energy Regulator
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Dear Mr Pattas

EnergyAustralia's submission on AER's proposed changes to STPIS

On 16 February 2009, EnergyAustralia provided initial comments on the AER's proposed amendments to the Service Target Performance Incentive Scheme (STPIS). This was in the context of our Further Submission on the AER's draft regulatory determination for EnergyAustralia. Our comments were limited to the reporting requirements under the STPIS as this was the only element of the scheme which would impact EnergyAustralia's 2009-14 regulatory determination. We noted that we would provide further comments on the scheme as part of the consultation process for the proposed amendments.

EnergyAustralia's comments can be summarised as follows:

- High powered incentives such as the 5% proposed by AER would incentivise EnergyAustralia to heavily focus on improving reliability for customers over and above the standards mandated within NSW.
- The proposed changes to the definitions for the major event day threshold are appropriate; however, we remain concerned with the general inconsistency in definitions between the STPIS and our licence conditions.
- The worked example provided by the AER appears to inappropriately weight the calculation of the s-factor for SAIFI compared to other reliability measures.
- The AER should seek the agreement of the affected DNSP if it decides to amend the STPIS immediately before or subsequent to the submission of a regulatory proposal by the DNSP.
- It would be beneficial for the AER provide further detail on its process for assessing a DNSP's regulatory proposal with respect to the application of the STPIS for a regulatory period.

These comments are discussed in detail below.

Proposed amendments to financial incentives
The AER's proposed amendments to increase the rewards and penalties under the scheme would provide EnergyAustralia with an opportunity to recover an additional $500 million above the revenue requirements over a regulatory period.[1] Under these high powered incentives, EnergyAustralia would focus heavily on the STPIS parameters determined by the AER when making investment decisions targeting reliability. This increased focus may not be consistent with the intent of the scheme. For example, EnergyAustralia could theoretically over spend its reliability capital allowance in a regulatory period (by up to $5 billion[2]), and trade off the lost revenue from the overspend to gain the maximum reward available under the STPIS.

We question whether an overspend of this magnitude would be the right outcome for customers given that our jurisdictional regulator has already determined the appropriate reliability standards for customers. This example demonstrates how a DNSP may react to high powered incentives and the fact that perverse outcomes may result. It is important that the AER design a scheme that will result in the right incentives over the longer term.

In this context, we note that consumer groups recently raised concerns about higher prices being paid by customers for electricity network services. Any increase in rewards under the STPIS would be recovered from customers through additional price increases (ie additional to what the AER has already determined). We have no evidence to suggest that customers are willing to pay more for improvements in service beyond the minimum standards determined by jurisdictional authorities. It would be useful if the AER clarified whether it has evidence to suggest that this is the case.

We also note that the additional price increase will affect all customers. However, depending on the STPIS parameters determined by the AER, EnergyAustralia may be incentived to improve reliability for some customer groups at the expense of others.

More generally, we note that the AER has proposed high powered incentives without explaining how it will determine performance targets for the DNSP. There is a risk that the AER may set targets for the DNSP which could diverge from existing performance trends and in the case of a high powered incentive regime, could magnify any reward or penalty under the scheme. We discuss this issue later in the submission.

We support the AER's proposed amendment to remove the carry forward mechanism and to calculate rewards and penalties based on performance relative to the target set by the AER for each year of the regulatory period. We consider these changes simplify the operation of the scheme and ensure rewards are better linked to performance against underlying target levels.

Proposed amendments to definitions under the scheme
We support the AER's proposed amendments to major event day calculations. We note however that the definition in the scheme remains inconsistent with our jurisdictional licence requirements (DRP Licence conditions). This may result in 'valid' major event day exclusions under our licence requirements not being excluded under the STPIS (and vice versa). Consequently, reported performance under our jurisdictional obligations is likely to be different to what we provide the AER

[1] This is based on the forecast average annual revenue requirement of $2 billion for transmission and distribution assets over the 2009-14 regulatory period.
[2] This is based on an assumed rate of return of 10 per cent. However, this may be impacted by depreciation profiles of existing assets and taxation liabilities, in which case the lost revenue from investment may be higher or lower.

under the STPIS and will lead to two sets of reliability results being published each year. For NSW DNSPs, the AER should use the definitions in the DRP Licence Conditions.[3]

More broadly, EnergyAustralia is disappointed that the AER has not addressed the general inconsistencies in definitions between the STPIS and the DRP licence conditions. In our view, the Rules contemplate that the AER develop the STPIS with regard to the definitions in jurisdictional licences. We do not consider that the AER has sufficiently considered the relevant service standards and service targets specified in jurisdictional electricity legislation when developing the STPIS as it is required to do under the Rules.[4] It is also unclear whether the AER has complied with the Rule requirement to consult with the authorities responsible for the administration of relevant jurisdictional electricity legislation when developing the STPIS.[5]

There are clear reasons why the STPIS to apply to NSW DNSPs should be based on improving performance relative to DRP licence conditions. In particular, we note the purpose of the service standard incentive regime is to incentivise a DNSP to improve service standards within the capital and operating expenditure allowance determined by the AER.

Under the Rules, the capital and operating expenditure allowance must be sufficient to enable a DNSP to meet its regulatory obligations, including its jurisdictional licence conditions. However, the proposed STPIS rewards or penalises DNSPs using definitions which are different to those used to determine the capital and operating expenditure allowances. This results in a disconnect between the incentives under the STPIS and the capital and operating expenditure incentives and may lead to perverse outcomes.

In addition to this, there are practical reasons for addressing the issue of inconsistent definitions. The scheme's reporting requirements which will apply to EnergyAustralia for the 2009-14 regulatory period, will require us to develop two sets of similar, but different, reliability statistics. This will require new systems and additional cost and resources.

The AER should address the issue of inconsistent definitions when making its constituent decision on the applicable STPIS to apply to EnergyAustralia's 2009-14 distribution determination. We refer the AER to section 14.3 of our revised regulatory proposal and interim submission of 14 January 2009.

Comments on worked example of the scheme

While we welcome the inclusion of a worked example, we request that the AER provide stakeholders with an electronic copy of this example. This would eliminate the need to manually transcribe the formulas to replicate the worked example.

EnergyAustralia has not had sufficient time to examine the worked example in detail however we have experienced difficulty in reconciling the SAIFI incentive rate calculation. The SAIFI incentive rate calculation (formula 1) appears to introduce a multiplier of 0.01. This multiplier is not discussed in section 3.2.2(i) and, as outlined in the Appendix E worked example, appears to make the SAIFI s-factors 1 to 2 orders of magnitude less significant than the SAIDI s-factors. We seek clarification as to whether this underweighting of SAIFI is an intentional incentive property of the STPIS.

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[3] As noted in our Further Submission of 16 February 2009, the AER should allow the definition used in the NSW Licence Conditions, which specifically clarifies that the TMED methodology is based on unplanned data after allowed exclusions with the exception of planned outages removed.

[4] Clause 6.6.2 (b)(2) of the National Electricity Rules.

[5] Clause 6.6.2 (b)(1) of the National Electricity Rules.

Proposed amendments to consultation process
EnergyAustralia has concerns with the proposed amendment to allow the AER to amend the STPIS that will be applied to a DNSP after it has submitted its regulatory proposal. We understand that the AER's intention is to remove unnecessary restrictions to amend and apply the STPIS in the event that the scheme is inconsistent with the NER. As noted in the section below, a DNSP already has an opportunity to propose how the scheme will apply to its regulatory control period.

We consider that changing a scheme immediately prior to, or after, the submission of a regulatory proposal does not provide a DNSP with certainty about the calculations and formulas in the model. It would also not provide a DNSP with an opportunity to propose how the amended scheme would apply as part of its regulatory proposal. As such, we consider that the AER should be required to seek agreement of the DNSP in the event that the AER wishes to amend the scheme.

General comments on the AER's assessment of a DNSP's proposal
More generally, we would like the AER to provide more information on the manner in which it will assess a DNSP's regulatory proposal for service standard performance targets and weightings. We note that Clause 2.2(a) of the STPIS states that a DNSP can make a proposal to vary the application of the scheme (where the scheme indicates) through a regulatory proposal. This is consistent with the Rules which require a DNSP to provide a description of how it proposes the scheme should apply for the relevant regulatory control period.[6]

In this context, we note that the model appears to incentivise improvements in the average reliability for urban customers. EnergyAustralia's understanding is that we will be able to propose weightings that incentivise a DNSP to improve average reliability for worst affected customers, for instance customers receiving energy from non-urban feeders. We request that the AER's final decision on the proposed amendments provides more detail on how the model accounts for such proposals from DNSPs.

In respect of performance targets, EnergyAustralia considers that the scheme does not provide sufficient detail on the AER's assessment of performance targets proposed by a DNSP. We note the AER should not mechanistically determine performance targets based on a 5 year average without taking into account outlier results that do not accurately reflect the level of underlying performance.[7] We also note that reporting of historical performance will be impacted by changes in outage reporting systems. For example, EnergyAustralia notes that data on MAIFI in the early years of the regulatory period is likely to unreliable and potentially should not be used to establish MAIFI performance targets for the next period.

Should you have any questions, please contact Ms Catherine O'Neill on (02) 9269 4171.

Yours sincerely

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[6] Schedule 6.1.3(4) of the National Electricity Rules
[7] A relevant example is EnergyAustralia's CBD SAIDI for 2003/04 of 105.96 which was unusually high due to a single event which did not meet exclusion criteria.