Jemena Electricity Networks (Vic) Limited Submission

AER's Proposed Changes to Service Target Performance Incentive Scheme

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Executive Summary

Jemena Electricity Networks (Vic) Limited (JEN) welcomes this opportunity to comment on the Australian Energy Regulator's (AER) proposed amendments to the Service Target Performance Incentive Scheme (proposed STPIS). JEN's comments are made without prejudice to any positions or approaches JEN may take in its regulatory proposal to be submitted to the AER by 30 November 2009. JEN's key comments are summarised below.

1. JEN supports most of the major changes proposed by the AER to the STPIS, including:
    a. incorporating the s-factor—the AER's proposed approach for incorporating the s-factor into the weighted average price cap for standard control services
    b. pre-set targets—computing the s-factor primarily on the basis of deviations in performance from the underlying targets, rather than the previous year's performance
    c. targets based on five year average—a five year timeframe for past average performance is suitable, as it reflects the recent (and more relevant) network configuration and environmental factors more so than a longer-term average
    d. risk cap—ensuring that the cap on revenue at risk limits the extent to which weighted average prices can depart from the underlying baseline level (rather than each year setting an incremental rate of change on previous year's prices)
    e. exclusion methodology—using the exclusion methodology published by the United States Institute of Electrical and Electronics Engineers (IEEE) in standard 1366—2003.
2. JEN does not support the AER's proposal to increase the magnitude of the revenue-at-risk cap from 3 percent to 5 percent. The decision to adopt the current 3 percent cap was based on sound analysis. No sound incremental analysis has been put forward to support this proposed increase.
3. In the absence of a superior methodology at this point in time, JEN accepts the AER's proposed estimates for the value of customer reliability (VCR) at this stage of the regulatory process. JEN will consider whether a different methodology should be used to better estimate VCR and may choose to put forward a different set of incentive rates as part of its regulatory proposal.
4. Consistent with National Electricity Rule S6.1.3(4) and section 2.2 of the proposed STPIS, JEN will put forward, as part of its regulatory proposal, a description of how JEN proposes the STPIS should apply to JEN for the 2011-2015 regulatory control period.

1 Introduction

Jemena Electricity Networks (Vic) Limited (JEN) welcomes this opportunity to comment on the Australian Energy Regulator's (AER) proposed amendments to the Service Target Performance Incentive Scheme (proposed STPIS) and the associated explanatory statement.

In section 2 below, JEN has provided general comments on the amendments proposed to the STPIS and the reasons put forward by the AER for proposing the amendments. In section 3, JEN has also provided detailed comments on the proposed changes to the STPIS.

The comments in this submission are made without prejudice to any positions or approaches JEN may take in its regulatory proposal to be submitted to the AER by 30 November 2009.

2 General Comments

This section provides JEN's high-level comments on the proposed amendments to the STPIS.

2.1 Most Major Amendments Supported

JEN supports most of the major changes proposed by the AER to the STPIS:

- incorporating the s-factor—the AER's proposed approach for incorporating the s-factor into the weighted average price cap for standard control services
- pre-set targets—computing the s-factor primarily on the basis of deviations in performance from the underlying targets, rather than the previous year's performance
- targets based on five year average—a five year timeframe for past average performance is suitable, as it reflects the recent (and more relevant) network configuration and environmental factors more so than a longer-term average
- risk cap—ensuring that the cap on revenue at risk limits the extent to which weighted average prices can depart from the underlying baseline level (rather than each year setting an incremental rate of change on previous year's prices)
- exclusion methodology—using the exclusion methodology published by the United States Institute of Electrical and Electronics Engineers (IEEE) in standard 1366—2003.

In relation to the last bullet above, JEN appreciates the clarification that the AER will exclude the entire duration of the outages originating within the midnight-to-midnight period of a major event day. This issue had recently caused considerable confusion between the Essential Services Commission and Victorian distributors.

2.2 Incentive Rate Update Conditionally Accepted

The AER has proposed to update the estimates of the value of customer reliability (VCR), using the latest figures that Charles River Associates (CRA) derived for VENCorp. JEN notes that CRA's estimates of VCR are uncertain and may over- or under-estimate the true value of VCR. However, in the absence of a superior methodology at this point in time, JEN accepts the proposed rates at this stage of the regulatory process. JEN will consider whether a different methodology should be used to better estimate VCR and may choose to put forward a different set of incentive rates as part of its regulatory proposal (and as provided for by the proposed STPIS).

2.3 Increase in Revenue-at-Risk Cap not Supported

JEN does not support the AER's proposal to increase the magnitude of the revenue-at-risk cap from 3 percent to 5 percent. No sound analysis has been put forward to support this proposed increase.

In setting the current 3 percent cap for the STPIS less than 9 months ago, the AER stated that:

> "The AER considers that imposing a notional 3 per cent cap maintains a sufficient enough incentive for a DNSP to improve service performance without imposing undue risk. …
>
> In forming its view on the level of revenue at risk the AER considered that:
>
> - a consistent national approach would be fair
> - an uncapped scheme may introduce an unreasonable level of risk for DNSPs that have not previously operated under a service performance incentive scheme
> - to date, the greatest change in annual revenue under a jurisdictional s-factor scheme has been 2.6 per cent."[1]

The 3 percent cap was also supported by most stakeholders during the consultation on the June 2008 decision.

The AER's reason for suggesting the change to the cap focuses on the need to "offset the possible decrease in the power of the incentive which results from the removal of the carry-forward mechanism" (i.e—from comparing actual performance to pre-determined targets, rather than previous year's performance).

The AER provides a theoretical example of a situation where the incentive would be weakened should a 3 percent cap remain, with all other proposed changes being implemented. The example is a situation where sustained year-on-year deterioration (or improvement) occurs in each year of the regulatory period, with

[1] AER, "Final Decision: Electricity network service providers – Service target performance incentive scheme", 26 June 2008, page 16.

the cap being binding in each of the five years. JEN notes that this example does not reflect a realistic expectation of distributors' performance, and the AER itself agrees with this view in its explanatory statement:

> "The AER notes that this is a theoretical example, and that it is highly unlikely that a DNSP's performance would either increase or decrease to such an extent over the regulatory control period…"[2]

In practice, as the AER's own analysis for the June 2008 decision has shown, reliability performance is generally stable and a 3 percent cap is unlikely to be binding in any given year of a regulatory period, let alone in multiple years. This fact will not change even if targets are set on the basis of five year averages, rather than previous year's performance. JEN therefore suggests that the 3 percent cap be retained.

2.4 Scheme Flexibility

JEN notes that the National Electricity Rules (NER) provide the AER with flexibility to tailor the application of the STPIS to a particular distributor. As required by rule S6.1.3(4), JEN will put forward, as part of its regulatory proposal, a description of how JEN proposes the STPIS should apply to JEN for the 2011-2015 regulatory control period. JEN also appreciates the AER making specific provision for scheme flexibility under section 2.2 of the proposed STPIS.

3 Detailed Comments

Below JEN provides a number of detailed comments on the proposed amended STPIS.

3.1 Additional Guaranteed Service Level—Notice of Planned Interruptions

The proposed amended STPIS introduces a new Guaranteed Service Level (GSL) that requires the distributor to make a payment of $50 if the distributor fails to provide a customer with at least 4 days notice of planned interruptions.

JEN notes that, while distributors currently have the obligation to notify customers of planned interruptions (and JEN has processes in place to ensure compliance with this obligation), the requirement has never involved verifying whether the notification has been received by the customer.

JEN currently notifies customers of planned interruptions through card drops in customers' letter boxes. The cards are dropped by JEN's contractors and are not mailed. JEN therefore does not keep records that verify whether a particular customer has been notified. With the implementation of the proposed new GSL,

[2] See reference above, page 9.

issues could arise where a customer claims not to have received the notification card.

JEN notes that, if this GSL is implemented, JEN will need to incur additional costs to implement a new system for notifying customers of planned interruptions and confirming receipt of the notification.

3.2 Method of Calculating the Momentary Average Interruption Frequency Index (MAIFI)

Note 4 of Appendix A of the proposed amended STPIS states that:

> "In calculating MAIFI, each operation of an automatic reclose device is counted as a separate interruption."

JEN does not agree with this proposed approach to calculating MAIFI because:

- the approach is not consistent with the way MAIFI is currently calculated by Victorian distributors in accordance with guidance from the Essential Services Commission (ESC), and
- adopting this approach will create perverse incentives.

The AER's proposed approach would discourage distributors from applying fast protection (through reclosing) to reduce the probability of sustained secondary damage resulting from transient faults, which are especially common in rural areas.

In rural areas, it is not uncommon for a protection device, such as an automatic circuit re-closer (ACR), to be set up with a reclose sequence lasting less than one minute, but comprising multiple recloses in one sequence. In practice:

- a reclose is often successful after two recloses within a single reclose sequence, and
- the customer is unlikely to notice the difference between a single reclose or a single sequence comprising multiple recloses.

Currently, in accordance with the ESC's specifications for measuring momentary outages and interruptions,[3] Victorian distributors treat one sequence as one interruption for the purposes of measuring MAIFI (also referred to as event MAIFI or MAIFIe). This approach is also consistent with the IEEE standard 1366.

The effect of the AER's proposed change would be to potentially double MAIFI for a single event. If this were to occur, targets would also have to be adjusted to ensure a like with like comparison.

[3] Essential Services Commission, "Information Specification (Service Performance) for Victorian Electricity Distributors", June 2008, pages 27-28.