Values of Customer Reliability Consultative Committee Meeting Minutes

Date of Meeting: **25 July 2019**
Location: **AER Melbourne office**
Time: **10:00 to 15:30**

Attendees: Committee members: Matthew Webb (ENA), Amber Miller (ESCOSA), Alisa Toomey (AEMC), Rebecca El-Khoury (ENA), Ben Jones (AEMO), Craig Memery (PIAC), Duncan MacKinnon (AEC), Andrew Richards (EUAA), Lynne Gallagher (ECA), Mick Fell (ECA), Aaron Yuen (ESC), Chris Murphy (Reliability Panel), Trevor Armstrong (Reliability Panel)

AER staff: Paul Dunn, George Huang, Ingrid Michel, Danielle Coronel, Alice Gilbert, Anthony Seipolt, Richard Hayes, Su Wu, Mark Feather (pilot survey results only).

AER consultants: Terry Jones (MEI), James Garriock (Insync), Hannah Lawrence (KPMG), Ian Bycroft (Insync), Jane Tyquin (Insync)

Apologies: Tom Walker (AEMC), Mike Smart (IPART), Kimberley McKay (UC NT), Jeremy Cross (ERAWA), Chris Lock (OTTER), Gavin Dufty (Reliability Panel), Professor Kenneth Train (MEI), Jimmy Criticos

1. Welcome

George Huang welcomed Committee members.

2. Introduction and apologies

Committee members, AER staff, Melbourne Energy Institute (MEI) representatives and KPMG/Insync representatives introduced themselves.

3. Minutes from previous meeting and matters arising/action list

Minutes from previous Values of Customer Reliability Consultative Committee (VCRCC) meeting were noted.

George Huang gave a brief recap of the matters discussed at the previous VCRCC meeting and the objectives for today. He summarised the following key objectives of the pilot survey:

- test improvements to survey design compared to AEMO's 2014 survey
- test effectiveness of sampling approach to ensure statistically robust results
- identify and address technical and reporting issues.

4. Pilot survey results and implications for main survey

Hannah Lawrence and James Garriock presented a summary of the pilot survey results and implications for the main survey. Key points covered:

- the two main sections tested in the pilot survey, which were:
    - the contingent valuation question that asks what respondents are willing to pay (WTP) to avoid an outage to establish a 'baseline'

    - the choice modelling section that asks respondents to choose between different outage scenarios with varying attributes (localised/widespread, duration, frequency, summer/winter, weekday/weekend, time of day).
- for the choice modelling methodology, the pilot results were statistically significant, but there were a large number of participants who chose the 'baseline' outage. The purpose of the survey is to understand the preferences of respondents and this is better achieved if a lower proportion of responses select the 'baseline' outage.
- for the contingent valuation methodology, the pilot tested:
    - the two closed prompt style questions used by AEMO in its 2014 study
    - the two closed prompt questions followed by an open-ended question
    - a single open-ended question.
- the pilot results indicated average WTP was influenced by the question asked. The AEMO style question produced the lowest average WTP, the single open-ended question produced the highest, and the closed-closed-open question was in between. Notably, for all methodologies, a similar proportion (around 40%) had a WTP of zero.
- when a cap (based on the cost of a back-up gas generator) is applied, the average WTP decreases significantly for the closed-closed-open and single open-ended questions.

Ingrid Michel presented on proposed changes to implement for the main survey. Key points covered:

- the choice modelling results showed the key attributes of duration, peak and discount levels are statistically significant, which gives us confidence in the choice model design. We consider only some small tweaks are required to:
    - randomise choice sets
    - move discounts to the top
    - increase discount levels.
- we are interested in comments on the contingent valuation methodologies, noting that:
    - closed prompts provide some guidance and are more like a real market situation, but the disadvantages are they create anchoring bias, restrict people to two choices and assume the lowest possible WTP.
    - an open-ended question removes the anchoring bias, but the question is more difficult to answer for many people.
    - there was support for a cap at the last VCRCC, we have decided to adopt a cap for residential customers based on the cost of a back-up generator, and a cap for business customers of 100% of their last energy bill.
- we have engaged MEI to do further work into revealed preferences to see if we could use the method in the future VCR reviews.
- we would prefer greater segmentation than AEMO's 2014 study where possible. The degree of segmentation will depend on the data.

In relation to the choice modelling methodology, members:

- discussed the potential effects of randomising options and moving the baseline option around

- queried whether randomising options removes the problem of people always choosing the left-most option, or simply hides it. AER staff noted 'donkey voters' will not disturb statistical significance because they are random so will not impact results
- suggested including a confidence interval with results.

In relation to the contingent valuation methodology, members:

- noted an implication of the pilot results is that changes since AEMO's 2014 study are likely to be driven primarily by methodological changes
- suggested running the AEMO style survey at the same time as the open-ended question. It was noted this would require a lot of survey responses
- suggested that for respondents who have difficulty answering the question due to financial illiteracy, their WTP response would likely reflect their market behaviour anyway
- suggested looking at the demographic information of respondents (such as income or comfort level) and how it relates to WTP, to understand high responses to the open-ended question. For example, it may show the ability to pay does not correlate with WTP
- suggested providing a fact sheet or explanation with the survey to assist those who have difficulty answering an open-ended question
- noted using closed prompts followed by an open-ended question helps to check for inconsistency, but this does not help us. It was suggested the open-ended question could be framed to reflect responses to prompts – for example "you said no to 10, help us understand what that means"
- suggested changing the range of the prompts and suggested ideally we could do an experiment to see what the range should be, but noted we do not have the time or resources.

In relation to the cap on WTP responses, members:

- noted that looking at the averages from the pilot, the cap is important
- suggested the cap needs to take into account a range of costs relating to the back-up power supply, such as the 'do it yourself' cost, cost of space it takes up, and cost of insurance
- considered $33 may be too high and the cap should be based on a more commonly used type of generator such as diesel or petrol
- suggested, for business customers, it is difficult to tell what percentage of costs energy constitutes, so it is possible a huge increase in bills would be a valid response. However, members noted it is wiser to opt for lower value because it would be detrimental to invest in long-lived assets if people don't need them.

In relation to segmentation, members:

- queried the need for a greater degree of segmentation. AER staff explained current segmentation according to state lines may not be completely accurate, and that climate zone and remoteness would be a more important factor
- noted there should be a distinction made between water businesses and irrigation businesses as they are substantially different industries.

In addition, members:

- pointed out that when people are given information about when an outage will end it makes a significant difference to the impact of the outage. Members noted the way the question is phrased essentially means people know the length of the outage
- discussed whether the average is the appropriate measure to use to determine WTP. Members noted the pilot results show more than 50% of respondents had a WTP of lower than the average, and suggested the median may be a more democratic measure. It was noted that the median would not guarantee the WTP figure better reflects peoples' preferences, and that a respondent changing their choice to anything on either side of the median will have no impact on WTP. It was also noted we are aiming for high granularity and a median would be difficult for this
- considered the possibility of including additional information with the results – for example, information about the percentage of people who provide a lower number than the average. Members suggested if we adopt this approach we would need to clarify this when providing the results by highlighting any additional information to be taken into account before stating the actual number.

ACTION item: members to provide any further comments by email.

5. Annual adjustment mechanism

Danielle Coronel presented a summary of the proposed approach for the annual adjustment mechanism. Key points covered:

- AER staff investigated several approaches to the annual adjustment mechanism, but we have ultimately decided to adjust VCR by inflation only and maintain real values, such as by the Consumer Price Index (CPI).
- adjusting only for inflation promotes certainty and transparency, and it is currently not feasible to identify accurately how potential drivers impact on VCR values. We may pursue a CPI – X approach in future reviews.
- we are open to different options for inflation measures.

Members:

- were divided on whether they prefer indexation or a CPI – X approach
- discussed the benefits and challenges associated with a CPI – X approach. It was noted that one element of the 'X factor' is the impact on people's preferences, but another is the impact on people's energy use – future demands in the energy market could impact on the VCR denominator (unserved energy). Other factors that drive VCR may be unrelated to energy, such as age
- noted there are some concerns with CPI because it may cause VCR to be escalated incorrectly
- discussed the option of using the Producer Price Index (PPI) for indexation, but noted it may not be a broad enough measure
- considered people are more likely to accept CPI because it is more commonly used
- suggested taking a middle path, using factors that have historically been measured and are readily available

- considered there is an option of having an annual adjustment factor equal to 0, but noted this would mean the real value of VCR would not be maintained
- suggested it is likely any significant changes will be over the next 20 years, not changes between regulatory proposals.

AER staff noted our approach to the annual adjustment mechanism would be reconsidered during the next VCR review.

ACTION item: members to provide any further comments by email.

6. Update on High Impact Low Probability (HILP)

Paul Dunn presented an update on the proposed approach to HILP VCRs. Key points covered:

- following meetings with the HILP sub-committee, AER staff examined several widespread, long duration outage scenarios, ranging from low to high severity
- we have some concerns about exploring the more extreme scenarios and note there has not been significant input from consumers about the benefits of developing HILP VCRs. We consider the uses of HILP VCRs need to be clarified
- our intention is to model outages of varying degrees of unserved energy up to and including a similar sized outage to the 2016 SA system black event. The AER's technical advisors considers that this reflects the upper end of the magnitude of plausible but extremely unlikely events which could occur in the NEM
- to reflect the revised scope of the work in this, we are calling this area of work wide and long duration outages instead of HILP

Members:

- in some instances, expressed the view it may be beneficial to include more severe scenarios in the modelling for these VCRs
- queried whether it is possible to use 'standard' VCRs for more severe outages. It was noted that in assessing protected events, AEMO currently uses an arbitrary multiplier of 2, but we should determine what the number actually is
- discussed the option for published widespread and long duration VCRs numbers to be extrapolated if necessary. It was suggested the AER could publish a guideline for use of VCRs to formalise the process where previously businesses developed their own
- noted that uses for HILP or widespread and long duration VCRs include small investments that are not currently being done, such as synchronising states, which could be used if there is an outage in an entire state
- suggested consumers do see value in the development of HILP/widespread and long duration VCRs
- suggested, from a consumer perspective, it is worth refining thinking around use cases to ensure all uses are addressed
- suggested the need the make sure the events simulated involved extreme temperatures.

ACTION item: members to provide any further comments by email.

7. Update on direct cost survey

Alice Gilbert presented an update on the direct cost survey. Key points covered:

- the direct cost survey design is currently being finalised and will be hosted online by Insync and provided to respondents via a link.
- a number of members are assisting us to send out the survey and we appreciate members' ongoing assistance in this process.

Members:

- discussed possible categories for segmentation. One suggested category to include is transport, including road tunnels and rail. AER staff noted that segmentation is not set and we can add or take away segments.

8. Next steps & close meeting

The next VCRCC meeting will be held on 29 August 2019 in Melbourne, where AER staff plan to discuss the following with the VCRCC:

- the draft VCR decision and draft VCR methodology
- the study into revealed preferences undertaken by MEI.