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Tasmania

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Service Target Performance Incentive Scheme

Dear Mr Pattas

Thank you for providing the opportunity to comment on the proposed Service Target Performance Incentive Scheme (STPIS) for electricity distribution network service providers (DNSPs).

In February 2007, a new set of distribution network performance standards were agreed for Tasmania. Currently the Office of the Tasmanian Energy Regulator (OTTER) administers these standards. It is envisaged that sometime during the current Determination the administration will be passed to the Office of Energy Planning and Conservation (who also played a role in the development of the standards). This submission is made following discussions with the Regulator.

During the most recent Distribution Pricing Investigation, the Regulator undertook an extensive review of the then current Service Incentive Scheme operating in Tasmania and determined to change a number of aspects of the scheme in light of the experience over the previous few years. Some of the reasons for the changes are worth highlighting as they show where the Tasmanian jurisdiction would have some concerns with the proposed STPIS.

In 2003 a Guaranteed Service Level (GSL) scheme was introduced into Tasmania, very similar to the scheme in Victoria at the time. The scheme has been assessed as successful and only a few changes were made to the scheme to take effect on 1 January 2008. One change was to introduce a second threshold for the Duration of Outage GSL payment. This was done to provide a further incentive to the distributor to restore power as rapidly as possible once the original threshold was passed. However the Regulator determined not to include in the scheme an automatic exclusion from making GSL payments on Major Event Days (MEDs). Customers are generally unconcerned as to the reason for their power being out. The level of inconvenience from unplanned outages remains the same and the expectation of a GSL payment remains the same regardless of cause. For the STPIS to be truly customer focussed, and to maintain financial incentives for avoidance and rapid restoration in all circumstances, it needs to have as few exclusions as possible and to use alternative means to minimise the financial exposure on DNSPs.

In Tasmania this was achieved by introducing a 'pain sharing' mechanism into the GSL scheme. This was done by adjusting the GSL threshold on MEDs according to the scale of the event. Half of the costs of any GSL payments made to consumers who experienced an outage of duration between the original and the revised threshold can then be recovered from customers in the next year through an allowance in the Pricing Determination. A fuller description can be found in Schedule 1 to the Declared Electrical Services Pricing Determination available from the Regulator's website[1]. This methodology ensures the DNSP has an incentive to restore power to all customers as quickly as possible whilst acknowledging that as an event increases in magnitude it becomes more and more difficult to respond to all customers.

In 2003 the Regulator introduced an s-factor scheme which financially rewarded or penalised the DNSP depending on its performance compared a predetermined target level of service measured using state-wide SAIDI and SAIFI targets. This part of the service incentive scheme was not deemed to have been as successful for a number of reasons, including:

- The difficulty of establishing a starting point for such a scheme, given the variability of performance outcomes as a consequence of variability of weather conditions and the lack of consistent historical data, especially for SAIDI;

- the difficulty in establishing the impact of past reliability improvement programs, leading to uncertainty about the actual current performance levels, and thus the starting point for such a scheme;

- the difficulty in forecasting the impact of future reliability improvement programs, leading to potentially unachievable or too easily attainable targets with the consequent financial implications; and

- the risk of incorrectly matching performance targets to capital expenditure forecasts.

These remain concerns with the proposed STPIS. As stated in section 5.2.1 of the discussion paper, any incentive scheme needs to avoid rewarding the DNSP for service improvements already paid for by customers through the capital expenditure allowance. It is highly likely that any network investment (including investment not specifically targeted at performance improvements) will see consequential improvements in performance. It is also a common part of any Pricing Investigation that the DNSP will ask for an increase in capital expenditure to improve reliability to some areas of its network. The improvements arising from such expenditure are almost impossible to quantify as are the improvements assumed to have occurred during the past due to previous expenditure on the network. This makes the establishment of both initial and future targets highly subjective. The experience in Tasmania was that there was insufficient understanding of the drivers behind performance leading up to 2003 and thus the performance targets based on historic performance were potentially inappropriate for the period 2003 to 2007.

There is also concern about how the AER would approach the calculation of the incentive rate. It would be very useful for the AER to publish some worked examples to indicate how the incentive rate would be calculated. This would indicate whether the proposed rate would actually achieve the desired aims of being based on the customers' willingness to pay whilst providing an incentive for the DNSP to spend money on improving reliability. One of the reasons a financial incentive on performance was not continued in Tasmania was that the calculations did not add up. For the scheme to have an annual cap that would not be regularly breached whilst acknowledging the variability in year on year performance required an incentive rate that was insufficient to achieve the overall aims of the scheme. For example, the proposal to base year X's performance target on performance in year X-1 coupled with a cap on the

[1] www.energyregulator.tas.gov.au - Click on Electricity and then Pricing and then 2007 Investigation.

possible financial exposure could end up with a DNSP being rewarded over a 5 year period even though the end performance is worse than the initial performance.

As a result of the concerns with the original s-factor scheme a working group undertook a review of the distribution network performance standards in Tasmania. The aim of the review was to develop a set of performance standards on which the Regulator would establish a performance incentive regime, including penalty and incentive rates.

The distribution reliability standards aim to:

- ensure reasonable levels of electricity supply reliability;
- define what the community may expect; and
- guide investment in electricity distribution infrastructure to correct those areas operating below standard.

The standards include limits for the number and duration of electricity supply outages that customers might be reasonably expected to endure in a year, relative to the nature of the community in which they live and the cost to supply electricity to that area. It also contains recommended reliability areas and classifications that define the level of reliability that different communities in the state should receive.

This move to community based standards was seen as an improvement on the previous feeder based standards. By measuring performance against actual community expectations, whilst taking into account the reasonable costs to provide supply to those areas, provided more direction to the DNSP as to where to prioritise investment. The Regulator opted to not impose any financial incentive in the current pricing period due to the lack of historical data based on the new reliability areas. Once adequate data was available it was envisaged that financial incentives would be linked to performance against the new standards.

Both the Regulator and the Office of Energy Planning and Conservation encourage the AER to move towards community based performance standards and to apply financial incentives to performance at this level rather than at a network wide level. There will be difficulties with this approach, not least of all those arising from the increased variability in performance that will arise from measuring performance over smaller areas. However, the benefits of targeting investment towards customers and communities that are experiencing poor performance are worth pursuing.

Yours sincerely

AVan de Vusse

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