ALPINE
ENERGY
LIMITED

Submission to the Commerce Commission

on

Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015

29 August 2014

Introduction

1. We welcome the opportunity to submit on the Commerce Commission's paper *Proposed Quality Targets and Incentives for Default Price-quality Paths from 1 April 2015*.

2. In this submission's we express our views on the.

    - Premise that two-out-of-three rule may have provided incentives for distributors to exceed the reliability limit once, but not two times in a row.
    - Dismissal of the ability of EDBs to bank, part or all, of the reward for reliability performance that is better than the target.
    - Compliance with the quality standards—we do not support the commission's proposal to determine an EDB's failure to meet the SAIDI and SAIFI targets as non-compliance.
    - Use of SAIFI as a means to determine a major event day.
    - Existing incentives for electricity distribution businesses to restore supply in a major event, which make the proposed boundary value unnecessary.
    - Dismissal of the idea that major events that span multiple days could be normalised into one event; and that the incentive scheme could be suspended to take account of significant repairs following a significant event.
    - Setting of caps and collars to one standard deviation.

3. In all other matters our views are expressed by the Electricity Networks Association's and PricewaterhouseCooper's (PwC) submissions.

4. This submission does not contain confidential information.

Proposed quality incentives

5. We support the introduction of a revenue–linked incentive scheme under the DPP from 1 April 2015. We agree that in principle a revenue–linked quality incentive scheme.

    - Is an appropriate mechanism to incentivise EDBs to maintain and improve service quality.[1]
    - Will provide better incentives for us to:
        (i) understand the cost-quality trade-off on our network; and
        (ii) manage reliability levels recognising the costs and benefits to our consumers.[2]
    - Will encourage EDBs to take action to deliver a level of reliability that better reflects consumer demands.[3]

[1] Commerce Commission, *Proposed Quality Targets and Incentives for Default Price-quality Paths from 1 April 2015*, 18 July 2014, paragraph 2.3
[2] Supra n1, paragraph 2.8.
[3] Supra n1, paragraph 2.10.

- Is an improvement on the existing pass/fail approach under the DPP.[4]

6. On the whole we support the commission's proposed approach to implementing its proposed incentive scheme with the exception of:

   - the premise that two-out-of-three rule may have provided incentives for distributors to exceed the reliability limit once but not two times in a row[5]
   - dismissal of the ability to bank rewards in the year immediately following the derivation of the reward[6]
   - failure to meet the SAIDI and/or SAIFI targets would constitute non-compliance with the quality standards.[7]

The two–out–out–of–three rule should be maintained

7. We are surprised by the commission's statement that the two-out-of-three rule may have provided incentives for distributors to exceed the reliability limit once but not two times in a row. The commission has provided no evidence that EDBs are gamming the rule, and we cannot see how it would even be workable to game the rule in such a way.
8. The commission introduced the rule in 2010 to address the natural variability of performance that was seeing a EDBs performance above targets 50% of the time and below the target 50% of the time under the targeted threshold regime.
9. To game the rule an EDB would have to have complete control over its performance in any given year, otherwise risk a breach when it exceeded the targets at two out of three years. If EDBs had that type of control over their performance the quality standards would not be needed as by default EDBs would be in complete control of their performance.
10. When considered in conjunction with the commission's approach to compliance under the proposed incentive scheme (which we object to at paragraph 14 over page) removing the rule is a significant step backwards for EDBs. It is a step backwards as the risk of enforcement action under the reset DPP is now twice what it is under the current DPP.
11. We are of the view that the proposal to remove the rule would increase EDBs compliance costs and the commission's enforcements costs to address a problem that does not, in our view, exist. Accordingly, we do not support the removal of the two–out–of–three rule under the commission' proposed incentive scheme.

Ability to bank rewards

12. We agree with the commission that penalties, i.e., reduction of revenue, should be passed on to consumers as soon as is practically possible after the performance has been determined (i.e., following the publication of the annual compliance statement). We however believe that rewards can and should be treated differently.

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[4] Commerce Commission, *Resetting the 2010-15 Default Price-Quality Paths for 16 Electricity Distributors*, 30 November 2012.
[5] Supra n1, paragraph 2.15.
[6] Supra n1, paragraph 2.18.
[7] Supra n1, paragraph 2.19.

13. We are of the view that EDBs should be permitted to 'bank', part or all, of the reward for the period immediately following the derivation of the reward. This approach would give EDBs the:

    (i) choice to increase prices at a rate and time that best suits their consumers

    (ii) flexibility to keep the increase in reserve to offset a potential penalty being faced in the next year

    (iii) ability to smooth price increases especially those that are facing significant price increases under the DPP reset.

Failure to meet targets will result in no-compliance

14. As previously submitted by us we do not support the commission's proposal to determine a failure to meet the SAIDI and/or SAIFI targets as non-compliance with the quality standards.[8] Accordingly, we recommend that the commission change the determination of non-compliance to the circumstance by which a EDBs performance is above the cap[9].

15. We are of the view that the proposed compliance with the quality standards is a significant step backwards from the status quo and dulls the incentives under the proposed incentive scheme to the extent as to make the scheme pointless.

16. For example, say our SAIDI target for the year is 10 SAIDI minutes and our year to date performance as at 31 January is 8.5 SAIDI minutes. In February the Timaru District Council (TDC) is forced to dig up the road in the central business district (CBD) following a burst water main. We had planned to dig up the same road after April that year to do significant planned work that would result in a planned outage of 2 SAIDI minutes.

17. If we were to decide to bring forward the planned work we could save $50,000 in costs, as TDC has already dug up the road, and more importantly save businesses in the CBD the inconvenience and disruption of having the road in front of their business dug up twice in one year.

18. Under our recommendation if we went ahead with the planned outage our SAIDI performance at year end would be 10.5 SAIDI minutes and we would be penalised for exceeding the target by 0.5 SAIDI minutes, but remain compliant with the quality standard. However, under the commission's proposed approach our decision would mean that we would be penalised for the breach via a reduction of revenue and be determined non-compliant. As we would be non-compliant we would face the risk of a pecuniary penalty of up to $5 million should the commission take enforcement action under s87 of the Commerce Act.

19. The commission have stated that 'in the case of unintentional breaches, we do not propose to take enforcement action for performance worse than the quality targets

[8] Alpine Energy, *Proposed Default Price-quality for Electricity Distributors from 1 April 2015*, 15 August 2014, paragraphs 2.1 to 2.9 and Alpine Energy, *Proposed Compliance Requirements for the 2015-2020 Default Price-Quality Paths for Electricity Distributors*, 29 August 2014, paragraphs 24 to 27.

[9] Should the commission accept our recommendation then the two-out-of-three rule discussed at paragraphs 7 to 11 would not be needed and could in our view be removed from the quality standards.

but still the below the cap except in exceptional circumstance'[10]. The commission state that this will provide EDBs with certainty of the enforcement action they might take following non-compliance.

20. However, looking at the example above we would have 'intentionally' exceeded the cap as we would have known that by bringing forward a planned outage, we would exceed the target. We are of the view that there is no certainty about the enforcement action the commission might take following a determination of non-compliance.

21. No board is going to agree to an action that would put a company into a position of non-compliance. Under the commission's proposed approach there is no incentive for us to bring forward the planned work and instead we are incentivised to dig up the road in the Timaru CBD a second time later in the year causing unnecessary inconvenience and disruption to businesses.

22. As demonstrated by our example above the commission's proposed incentive scheme becomes pointless as by exceeding the target based on an informed decision there is no incentive for us to[11]:

    - give effect to the trade-off between price and service quality; or
    - improve or maintain our understanding and reaction to the cost of providing a given level of reliability

    as we would be determined non-compliant the moment we exceeded the target even though doing so results in less cost to us, and in turn to consumers, and less inconvenience and disruption to businesses.

Normalisation methodology for reliability targets

SAIFI as a means to determine a major event day

23. We support the commission's proposal that interruptions that are planned by EDBs are given a lower weighting than those that are unplanned.[12] And that the normalisation of performance only be applied to unplanned interruptions. As we agree that major events that severely disrupt the network cannot be planned.[13]

24. We do not support the change of major event day's normalisation from a SAIDI trigger to a SAIFI trigger. We are of the view that the commission's premise that SAIFI is a superior normalisation trigger than SAIDI because a major event is likely to affect a large number of customers is flawed. This premise might stand for EDBs with a large urban customers base, but given that most New Zealand EDBs operate networks with long, stringy, rural networks that are sparsely populated this premise does not stand.

25. Our analysis on our network shows that under the proposed approach the number of major event days falls from seven to one over a 10 year period. The one major event

[10] Supra n1, paragraph 2.20.
[11] Supra n1, paragraph 2.8.
[12] Supra n1, paragraph 3.6.
[13] Supra n1, paragraph 3.7.

day would account for the snow storms of 2006. The flood, snow, and wind events of 2013 would not be considered major events days, which seem ridiculous.

26. The difference appears to be that the snow storm events of 2006 effected the major urban centres of Timaru, Geraldine, Pleasant Point, and Temuka whereas the 2013 extreme weather events effected the rural areas of Fairlie, Waimate, Tekapo, and Twizel. If adopted the commission's approach will result in very few major event days on our network not because of few extreme events but rather as a result of the method by which those events are captured not being representative of our consumer base.

We support the removal of event days in entirety from a EDBs performance data set

27. We agree with the commission that EDBs do have some control over the duration time of any outage resulting from a major event.[14] Our approach to restoring power in a major event is set out in our *Emergency Preparedness Plan*.

28. Our plan helps us to 'plan to plan' at the time of each event. Major events are by their nature unplanned, the scale of intensity or such events are unpredictable. Hence our reaction to an event cannot be predetermined thus requiring a thorough assessment of the situation before committing resources to restore supply.

29. Health and safety considerations will always be the first driver to our response to a major event. For example, in a snow storm event that resulted in wide spread outages across our network crews would be dispatched as soon as it was safe to do. Visibility, wind speeds, and icing conditions will all be taken into account before crews are dispatched.

30. We do not agree however that there needs to be an incentive under the DPP to restore supply following a major event. We are of the view that there are already existing and appropriate incentives on EDBs to minimise the duration of a major event.

    - Health and safety of our crews, the public, and property will always be our first concern. The decision of when and how to respond to an outage is always assessed first on a health and safety basis.
    - Our *Participant Outage Plan*, in accordance with the requirements of the Electricity Authority's *Security of Supply Outage Plan*, sets out how we will response following a generation or transmission constraint on our network. Though constraints rarely lead to a major event give the right series of events it could and the restoration time would be carried out accordance with the plan.
    - EDBs have agreed service standards under our use of system agreements with retailers and large, direct billed customers. Many EDBs have guaranteed service levels that require consumers be compensated if these are not met.
    - Consumers have become very active about their power supply expectations on social media channels. Consumers are very quick to notify us of an outage and then the local media if the outage has gone on too long. We are finding that consumer's tolerance for outages are getting shorter and shorter. Acceptable duration has significantly decreased from hours to minutes.

[14] Supra n1, paragraph 3.21.

- We are trust and council owned[15] our shareholders hold public offices and so are available to consumers who can, and do, voice their dissatisfaction of restoration times following outages, including major events.

31. Looking at the incentives above it can be seen that an incentive under the DPP becomes superfluous when these incentives are taken into consideration.

32. Accordingly we recommend that the commission remove the impact of major events days from EDBs data set in entirety. Thereby making the performance data set representative of the underlying service reliability being provided by EDBs.

We have taken exception to the commission's messaging

33. On the whole we appreciate the commission's plain English approach that it has taken in recent years. We have found this round of papers to be particularly well laid out and much easier to submit to than has been the case in previous consultations.

34. It is therefore with some trepidation that we raise an issue with the commission's phrasing at paragraphs 3.21 and 3.27. We object to the commission's premise that there may be an incentive for EDBs not to provide the best possible quality performance if it were nearing a major event day[16] and/or to provide our consumers with suboptimal performance in order to achieve a major event day.[17]

35. In principle the premise might appear to be plausible however, in practice a major event day cannot be determined until after the event. It is impossible for a crew supervisor to stand around in the yard with a calculator and a watch for the purpose of holding crews back while he, or she, determines whether, or not, if they leave it just a bit longer the outage will become a major event day. The method by which a major event day is derived makes both statements illogical.

36. What is most concerning to us is that the comments show a level contempt for our crews that work very hard in incredibly difficult conditions when a major event does occur.

37. We ask that the commission consider how its message might be taken by the wider public. As we stated in our submission to the commission on 15 August, ill thought messaging by the commission could lead to EDBs being inappropriately pressured to restore supply in unsafe conditions.[18]

The idea of normalising multiday events should be explored further

38. We are of the view that normalising multiday event into one major event day has been too quickly dismissed by the commission.[19] Similarly we are of the view that the idea that the incentive scheme could be suspended where there are significant events that require significant repair work should be considered further before being dismissed.[20]

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[15] Alpine Energy is owned by the Timaru District Council, Line Trust South Canterbury, Waimate District Council, and the MacKenzie District Council.
[16] Supra n1, paragraph 3.27.
[17] Supra n1, paragraph 3.28.
[18] Supra n1, paragraph 2.15.
[19] Supra n1, paragraph 3.45.
[20] Supra n1, paragraph 2.30.

39. The consultation period for the papers have been short and have coincided with other regulatory obligations such as submission of the information discourse schedules and market consultations to the Electricity Authority. As a result we have not had time to sufficiently gather evidence why these two ideas have merit.

40. Accordingly, we request that commission give EDBs the time to collect the evidence and to submit it to the commission before making a decision on these two points. The commission might consider allowing submitters to put out of consultation submissions to it on these matters.

Caps and collars and incentive rates

41. We support the commission's proposal to set symmetric caps and collars under the incentive scheme. We agree that there is no evidence to suggest that consumers value reliability differently for under-performance and over-performance.[21]

42. We also support the setting of the caps at one standard deviation above and collars at one standard deviation below the target[22] provided that the commission changes the determination of non-compliance to performance that is above the cap.

43. As discussed at paragraph 15 above if the commission keeps its proposed determination of non-compliance then the incentive scheme is pointless. As currently proposed it does not matter how the cap is set as there is no incentive for an EDB to understand the cost-quality trade-off on its network; or to manage reliability levels recognising the costs and benefits to consumers, as exceeding the target comes with a determination of non-compliance.

44. Change the determination non-compliance to when a EDBs performance is above the cap and the incentive being set at one standard deviation works.

Closing Remarks

45. We hope that our submission is helpful to the Commission in making its determination of the quality targets and incentives under the DPP effective from 1 April 2015.

46. We are happy to discuss our views with you further if you would find it useful to do so. The primary contact for this submission is:

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[21] Supra n1, paragraph 6.4.
[22] Supra n1, paragraph 6.2.2.