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# Submission

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

29 August 2014

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## 1 EXECUTIVE SUMMARY

Aurora supports the adoption of a revenue-linked service quality scheme. Aurora has previously supported revenue-quality linkages, and is pleased to see that the Commission proposes to introduce this incentive scheme.

We consider that there will be considerable scope to improve and enhance the revenue-linked service quality scheme over time (particularly by linking revenue to consumers' willingness to pay), but that it makes sense to take a tentative approach for the initial introduction of the scheme.

We broadly agree that the incentive scheme represents an improvement over the current 'pass/fail' approach. We support the following features of the Commission's proposal:

- A relatively weak starting incentive;
- Normalisation of unplanned interruptions only;
- Introduction of an EDB specific k-value to adjust for the effect of zero event days; and
- A 50% weighting on planned events.

As it stands, however, Aurora considers that there are number of issues in the Commission's proposal that would benefit from reconsideration and/or refinement. Such issues include:

- Transition to a SAIFI trigger for maximum event day normalisation;
- Removal of breach amounts in target calculations;
- A target-based compliance standard; and
- Vague enforcement criteria.

Some of these features fundamentally alter the general stability of the quality path, beyond recalculation of boundaries and targets, to the extent that Aurora is unable to support them.

## 2 INTRODUCTION

Aurora welcomes the opportunity to provide this submission on the Commerce Commission's "Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015", 18 July 2014. We support the submissions of the ENA and PricewaterhouseCoopers on this matter.

We have previously submitted, on 15 August 2014, on the Commission's "Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015", and "Low Cost Forecasting Approaches for Default Price-Quality Paths" consultation papers (both released 4 July 2014). This submission, by necessity, reinforces our views expressed in that submission.

No part of our submission is confidential and we are happy for it to be publicly released.

If the Commission has any queries regarding this submission, please do not hesitate to contact Alec Findlater:

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### 3 INCENTIVE BASED SERVICE QUALITY REGIME

Aurora supports the adoption of a revenue-linked service quality scheme. Aurora has previously supported revenue-quality linkages<sup>1</sup>, and is pleased to see the Commission's proposes to introduce this incentive scheme.

As part of the specification of the scheme for the 2015 EDB DPP reset, the Commission should consider the extent to which it would be desirable to incentivise EDBs to improve service quality over-time, and the linkages between opex/capex and service quality, and how these linkages are reflected in this and future resets.

We also consider that there will be considerable scope to improve and enhance the revenue-linked service quality scheme over time (particularly by linking revenue to consumers' willingness to pay), but that it makes sense to take a tentative approach for the initial introduction of the scheme.

We broadly agree that the incentive scheme represents an improvement over the current 'pass/fail' approach. We support the following features of the Commission's proposal:

- A relatively weak starting incentive: In our view, the proposed approach allows EDBs to become familiar with the principles of incentive based regulation, without excessive risk. We note incentives are likely to strengthen over time, and we are relatively comfortable with that, provided the underlying reliability measures remain objectively and rationally derived. We do question, however, whether an asymmetric incentive may be more appropriate in the long run. In our view, the incentive to maintain quality through a revenue penalty for poor performance is likely to be much stronger, naturally, than the incentive to improve reliability performance through a revenue reward, given the scale of off-setting investment required to effect a veridical reliability improvement.
- Normalisation of unplanned interruptions only: This Commission's rationale for normalising unplanned interruptions only is, in our view, sound. In our experience, restoration activities during maximum event days are generally so resource intensive that planned outages are deferred as a matter of necessity anyway.
- Introduction of an EDB specific k-value to adjust for the effect of zero event days: We consider that the proposed methodology results in a material improvement to boundary level calculations for those EDBs with a significant number of zero-event days.
- A 50% weighting on planned events. We agree with the Commission's view that planned interruptions are less disruptive to consumers than unplanned interruptions.

As it stands; however, Aurora considers that there are number of issues in the Commission's proposal that would benefit from reconsideration and/or refinement. Such issues include:

- Transition to a SAIFI trigger for maximum event day normalisation;
- Removal of breach amounts in target calculations;
- A target-based compliance standard; and
- Vague enforcement criteria.

Some of these features fundamentally alter the general stability of the quality path, beyond recalculation of boundaries and targets, to the extent that Aurora is unable to support them.

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<sup>1</sup> Aurora Energy, Submission to the Commerce Commission on its Discussion Paper on Starting Price Adjustments for Default Price-Quality Paths, 10 September 2010, page 16

**Interrelationship between service quality performance setting and DPP resets**

Vector has expressed the view that:

*“... the reliability target for the next regulatory period should not be changed from the reliability target in the current regulatory period without corresponding adjustments in prices. For example, if the Commission were to set a reliability target that is lower than exists in the current regulatory period, that would require the EDB to invest to deliver a higher quality of service to its customers after 1 April 2015 than they had previously been required to. It is not reasonable to require the EDB to deliver this higher quality of service without compensating them for it through increased revenues (this is at the core of the price-quality trade-off).”<sup>2</sup>*

This statement is worth considering in the context of the Commission’s views on the opex base year, and the revenue-linked service quality scheme. The revenue-linked service quality scheme, if working well, will result in EDBs increasing opex (and capex) in order to improve service quality (where the increased costs are less than the benefit to consumers of improved service quality). This should be reflected in higher base year opex (and RAB) and, in turn, in higher allowed revenue for the next regulatory period.

The Commission’s “Low Cost Forecasting Approaches for Default Price-Quality Paths” paper signals that there will be a risk that the Commission will treat the higher opex as “atypical” and instead rely on an earlier/lower opex base year.

EDBs would need to consider whether the 1% reward is sufficient if the improved service quality results in a higher service quality performance standard in the next regulatory period, but requires higher opex to be sustained that might not be reflected in the next regulatory period’s allowable revenues. The Commission’s decisions on opex base year and capex allowances will be critical to EDBs’ perception of this risk (and “reasonable investor expectations”). Adoption of a 2012/13 base year (in part or in whole) could undermine the revenue-linked service quality scheme and limit incentives to improve service quality to options that don’t require increased capex or opex.

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<sup>2</sup> Vector, Submission to Commerce Commission on the Default Price-Quality Paths from 1 April 2015: Process and issues paper, 30 April 2014, paragraphs 125.

## 4 PROPOSED NORMALISATION METHODOLOGY

### ***Transition to a SAIFI trigger for maximum event day normalisation***

Under the Commission's proposal for resetting the quality path, the current arrangement of using a SAIDI maximum event day as a normalisation trigger will be discontinued, and normalisation will occur only on SAIFI maximum event days. That is, SAIDI may only be normalised if both the SAIFI and SAIDI boundary values are exceeded.

The Commission has stated that this change is necessary to ameliorate a potential weakness in the current approach that EDBs might exploit to the detriment of consumers. The Commission considers that, under the current approach, when a SAIDI maximum event day occurs, the ability to normalise removes all incentives for the EDB to restore service as quickly as possible, because SAIDI is limited to the boundary value. Aurora takes exception to any suggestion that we would disregard service quality on these grounds. The Commission's WACC percentile consultation material also makes it clear the Commission considers there are wider disciplines on service quality than the DPP/service quality standards. In Aurora's judgement, the Commission should not base its decisions on hypothetical propositions. The Commission's argument completely lacks any empirical evidence to back the assertion that this is happening in practice or might be actively considered by EDBs.

### ***EDBs face natural incentives to restore service promptly***

EDBs are faced with a range of incentives to restore service promptly, that more than adequately compensate for any lack of incentive to "minimise the duration of an event once the boundary has exceeded".<sup>3</sup> In this regard, we consider the Commission is wrong to state that there are "potential perverse incentives using SAIDI as the normalisation trigger".<sup>4</sup> The absence of an incentive to do something does not automatically give rise to the corollary that an incentive exists (perverse or otherwise) not to do that thing.

Aurora considers the following factors give impetus to prompt restoration of service:

- A significant component of Aurora's revenue is determined by the quantum of energy delivered to consumers. Accordingly, outages have a direct revenue impact that provides a significant incentive to restore service without delay. The larger the event, the stronger that this incentive becomes.
- Aurora's use-of-system agreements with electricity retailers provide for the payment of compensation for service failure where outages exceed defined durations.
- Changes to the Consumer Guarantees Act, and pre-empted by/duplicated in the Electricity Authority's 2012 amendment to the Electricity Industry Participation Code (Part 12A), has increased the likelihood of additional consumer compensation claims. Although this is an emerging issue, with little certainty as to how this will play out in practice, the uncertain nature and potential significant cost impact provides a fairly strong driver for service continuity.
- Outages frequently result in customer complaints all of which take time and associated cost to resolve. In this regard, EDBs have the same incentives to maintain service levels as faced by any business.

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<sup>3</sup> Commerce Commission, Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015, 18 July 2014, paragraph 3.21.

<sup>4</sup> Commerce Commission, Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015, 18 July 2014, paragraph 3.22.

- Aurora is concerned about ensuring consumer wellbeing/satisfactory service and about the reputational risks of poor service quality performance.

### **SAIFI trigger fundamentally reconfigures the quality path**

The consequence of moving to a SAIFI trigger is, in Aurora's case, a fundamentally harder quality standard to achieve than under the current regime, and which is not reflected in any price trade-off.

The Commission has justified the move to a SAIFI trigger, in part, because "...extreme events are most likely to affect a large number of customers ...";<sup>5</sup> however, this is not necessarily correct. Major event days are, in our view, just as likely to occur as a consequence of significant damage to relatively confined areas. The extent to which SAIDI or SAIFI dominates is likely to be different for each EDB, influenced by network topology and regional geography. For the Aurora network, SAIDI tends to dominate.

Figure 1, below, using the Commission's modelling data<sup>6</sup>, describes the underlying relationship between SAIDI and SAIFI for the Aurora network. Whilst a direct observation of SAIDI and SAIFI is not particularly useful, graphing on a log-log scale causes the plot to trend towards the linear. Using the indicated trend line, it then becomes a matter of fairly simple mathematics to determine that, for the proposed SAIFI boundary of 0.262 system interruptions to adequately trigger a maximum event day, the corresponding SAIDI boundary would need to be 34% lower than proposed, at 7.26 system minutes (compared to the 10.92 system minute boundary proposed).

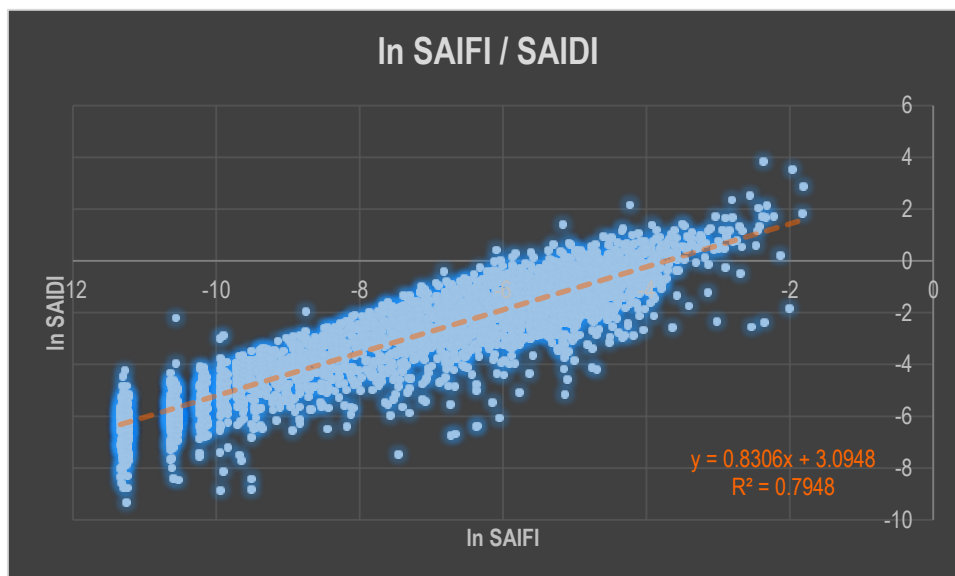


Figure 1: SAIFI/SAIDI relationship for the Aurora network

That the proposed reliability boundaries do not correspond to each other, consistent with the underlying relationship described above, is not surprising since they have been determined independently. On this basis, Aurora does not oppose the view of the ENA that boundaries should be independently triggered;<sup>7</sup> however, we note that the IEEE considers SAIDI to be the appropriate normalisation trigger.<sup>8</sup> Given the wide acceptance of the IEEE as an international industry standards setting body, Aurora supports the IEEE view in preference.

<sup>5</sup> Commerce Commission, Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015, 18 July 2014, paragraph 3.20.

<sup>6</sup> Commerce Commission, Model 17a – Quality of service targets supporting data and intermediate calculations (excel version) draft EDB reset, 18 July 2014.

<sup>7</sup> Electricity Networks Association, Pathway to Quality: Quality of Service Incentives Working Group Report, February 2014, page 47.

<sup>8</sup> Refer to the discussion below: SAIDI normalisation.



The ultimate effect, for Aurora, of moving to a SAIFI trigger is illustrated below, again using data from the Commission's modelling.

Table 1 shows that under a SAIDI trigger, Aurora would have been able to normalise SAIDI for 4 maximum event days during the 10-year reference period. In that time, Aurora would have exceeded the SAIDI target three times, but would not have exceeded the incentive cap. In respect of SAIFI, Aurora would have been unable to normalise SAIFI at any time, and would have exceeded the SAIFI target 6 times, and exceeded the incentive cap twice.

Disclosure Year		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
SAIDI	Planned	3.65	5.86	6.59	6.64	4.41	5.59	8.46	6.73	10.9	11.66
	Unplanned	73.21	70.8	83.52	79.63	59.15	61.3	93.02	100.49	53.8	71.18
	Total	76.86	76.66	90.11	86.27	63.56	66.89	101.48	107.22	64.7	82.84
	Normalisations				1			1	2		
	Target Exceed?			Yes				Yes	Yes		
	Cap Exceed?										
SAIFI	Planned	0.036	0.043	0.052	0.051	0.027	0.043	0.059	0.045	0.058	0.053
	Unplanned	1.386	1.401	1.588	1.372	1.172	1.252	1.361	1.704	0.929	1.104
	Total	1.422	1.444	1.640	1.423	1.199	1.295	1.420	1.749	0.987	1.157
	Normalisations										
	Target Exceed?	Yes	Yes	Yes	Yes			Yes	Yes		
	Cap Exceed?			Yes					Yes		

Table 1: Historic reliability performance under the Commission's proposal - SAIDI trigger

Table 2 shows the effect of the proposed SAIFI trigger. As expected, the SAIFI picture remains unchanged; however the fact that no SAIDI normalisation can occur means that the SAIDI target is now exceeded four times (3 times under SAIDI trigger) and the incentive cap is now exceeded twice (0 times under SAIDI trigger).

Disclosure Year		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
SAIDI	Planned	3.65	5.86	6.59	6.64	4.41	5.59	8.46	6.73	10.9	11.66
	Unplanned	73.21	70.8	83.52	115.99	59.15	61.3	94.62	131.39	53.8	71.18
	Total	76.86	76.66	90.11	122.63	63.56	66.89	103.08	138.12	64.70	82.84
	Normalisations										
	Target Exceed?			Yes	Yes			Yes	Yes		
	Cap Exceed?				Yes				Yes		
SAIFI	Planned	0.036	0.043	0.052	0.051	0.027	0.043	0.059	0.045	0.058	0.053
	Unplanned	1.386	1.401	1.588	1.372	1.172	1.252	1.361	1.704	0.929	1.104
	Total	1.422	1.444	1.640	1.423	1.199	1.295	1.420	1.749	0.987	1.157
	Normalisations										
	Target Exceed?	Yes	Yes	Yes	Yes			Yes	Yes		
	Cap Exceed?			Yes					Yes		

Table 2: Historic reliability performance under the Commission's proposal - SAIFI trigger

Aurora is gravely concerned that the proposed move to a SAIFI trigger would mean that future normalisation is unlikely to occur due to the specific underlying relationship between the two indices for the Aurora network and, as a consequence, target and incentive cap breaches are more likely, with the very real consequence that Aurora's reliability performance may be perceived by the Commission as deteriorating when, in fact, underlying long-term performance may be unchanged or improved.

We consider our concerns to be reasonable, given that Aurora's proposed target is calculated as the arithmetic average of historic data, without normalisation. The law of averages would dictate that Aurora should expect to exceed its targets 50% of the time.

### **SAIDI Normalisation**

As noted above, the IEEE considers that SAIDI is the appropriate trigger for maximum event day normalisation:<sup>9</sup>

*“An ideal measure of unreliability would be customer cost of unreliability—the dollar cost of power outages to a utility’s customers. This cost is a combination of the initial cost of an outage and accumulated costs during the outage. Unfortunately, the customer cost of unreliability has so far proven impossible to estimate accurately. In contrast, the reliability indices above are routinely and accurately computed from historical reliability data. The ability of an index to reflect customer cost of unreliability indicates the best one to use for MED identification.”*

*Duration-related costs of outages are higher than initial costs, especially for major events, which typically have long duration outages. Thus, a duration-related index will be a better indicator of total costs than a frequency-related index like SAIFI or MAIFI.” (emphasis added)*

Aurora considers that, given the significant extent to which the IEEE 1366 standard informs and underpins the Commission’s approach to quality of service regulation, the Commission’s contemplation of such a significant deviation from the standard risks a material compromise to the integrity of EDB price-quality regulation.

With this in mind, the Commission should maintain the use of a SAIDI trigger for normalisation of maximum event days, as recommended by the IEEE 1366 standard. As an alternative, owing to the independent derivation of SAIDI and SAIFI boundaries, Aurora would also support the view offered by the ENA, that SAIDI and SAIFI should be separately triggered.

Aurora does not support the proposal to use SAIFI as the maximum event day trigger.

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<sup>9</sup> IEEE Std 1366-2012, IEEE Guide for Electric Power Distribution Reliability Indices, 31 May 2012.

## 5 TARGET CALCULATION

### *Removal of breach amounts in target calculations*

The Commission has proposed that EDBs that breached the quality standards during the current regulatory control period should have the amount of the breach deducted from the target calculation. That is, in the breach year, the offending EDB's normalised annual value will be set to its existing limit (before adjustment for the 50% weighting on planned outages).

The Commission has reasoned that this adjustment is necessary to ensure that “distributors should not receive a higher (less challenging) target due to past quality breaches”.<sup>10</sup> Whilst we understand the Commission's view on this matter, we consider that this approach is inconsistently applied, without merit generally, and unwarranted in the specific case of Aurora.

In Aurora's view, such an approach merely carries the consequences of a poorly designed quality compliance regime from the current regulatory control period, into the next. While not wishing to dismiss the disruptive effect that reduced reliability has on consumers, the fact is that the current compliance standard contains an inherent element of chance. An EDB will breach the current standard if it is unlucky enough to exceed a quality target in two consecutive years; however, should the EDB record the same results in non-consecutive years, no breach occurs. Exceeding the target on consecutive years is not a valid indicator that an EDB's underlying reliability trend is deteriorating, as we demonstrate below. The question must be asked, all other things being equal, are consumers materially more disadvantaged when an EDB exceeds quality targets in consecutive years, over exceeding the targets in non-consecutive years? In Aurora's view, they are not, and a longer-term view of quality should be taken.

The issue that should be considered, before applying punitive adjustments to the 2016-2020 quality target calculation, is whether underlying quality performance has materially degraded. Table 3, below, shows Aurora's reliability performance over the proposed reference period, calculated using the Commission's dataset, and normalised using the proposed boundary values and SAIFI trigger<sup>11</sup>. The only adjustment we have made is to place a 100% weighting on planned interruptions, so that the result may be directly compared to the current reliability targets. The results indicate that the average SAIDI and SAIFI performance has been below the current target (SAIDI - 2.74% below target, SAIFI - 14.92% below target), and demonstrates that an improvement in reliability performance has been achieved. On this basis alone, Aurora considers the breach adjustment to be unwarranted.

	Disclosure Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Average	Limit	% Var.
SAIDI	Planned	7.30	11.72	13.17	13.29	8.82	11.17	16.92	13.46	21.81	23.32			
	Unplanned	73.21	70.80	83.52	115.99	59.15	61.30	94.62	131.39	53.80	71.18			
	Total	80.51	82.52	96.69	129.28	67.97	72.47	111.54	144.85	75.61	94.5	95.59	98.29	-2.74%
SAIFI	Planned	0.073	0.086	0.104	0.103	0.055	0.086	0.117	0.091	0.117	0.107			
	Unplanned	1.386	1.401	1.588	1.372	1.172	1.252	1.361	1.704	0.929	1.104			
	Total	1.459	1.487	1.692	1.475	1.227	1.338	1.478	1.795	1.046	1.211	1.421	1.670	-14.92%

Table 3: Historic reliability performance, normalised under Commission's proposal, 100% weighting on planned outages – SAIFI trigger

As a matter of principle, Aurora considers the proposed breach deduction to be additional enforcement action for its 2012 quality breach, in such a manner as to offend the principles of natural justice. Following an investigation into the underlying causes of Aurora's 2012 breach, the Commission decided, in respect of enforcement action, to issue Aurora with a warning letter.<sup>12</sup> The

<sup>10</sup> Commerce Commission, Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015, 18 July 2014, paragraph 4.16.

<sup>11</sup> Due to the consequences of the SAIFI trigger no normalisation is permitted and the stated annual values are effectively the “raw” values for that year. Refer to: Transition to a SAIFI trigger for maximum event day normalisation

<sup>12</sup> Commerce Commission, Warning letter to Aurora energy Limited in response to 2012 quality standards non-compliance, 26 June 2014.

warning letter identified that “In terms of conduct, having assessed the circumstances of the non-compliance, we considered that there was no serious fault on Aurora's part” and “...we did not identify any significant specific detriment to consumers on Aurora's network as a result of the non-compliance...”. In the content of the warning letter, no mention was made that the breach would also result in consequences that would be carried into the next regulatory control period. Aurora considers that for this approach to be procedurally fair, the Commission should have noted the consequence in its warning letter, and provided Aurora with the opportunity to respond.

Aurora also notes that the manner in which the proposed breach penalty is applied is inconsistent, in that it selectively applies to non-compliances within the current regulatory control period only. If the approach was to be consistently applied, adjustments for EDBs breaches of thresholds under the former targeted control regime would also have been made. At this juncture, and for the reasons stated above, we stress that we are not advocating that the Commission take such an approach.

Finally, we note that the quality target reset mechanism tends to apply a “sinking lid” that ratchets up service quality requirements over time. Like all sinking lid mechanisms, this could ultimately result in targets that are unsustainable (unless offset by an exponential increase in reliability investment). Aurora considers that the Commission's proposed breach adjustment simply accelerates the path toward the potential unsustainability tipping point.

***The compliance standard should be cap-based***

Our preference would be to have non-compliance judged on the basis of the incentive cap being exceeded, with a breach of regulation being determined on the current two out of three year assessment rule. While we do not like the element of chance that such an approach would re-introduce, it may have the effect of suppressing false positives, in terms of identifying material deterioration of reliability performance.

## 6 GENERAL COMPLIANCE ISSUES

### **Greater clarity around compliance enforcement would be desirable**

Aurora notes the Commission's statements that:

*"Failure to meet the SAIDI target or SAIFI target would constitute non-compliance with the quality standards. The Commission may take enforcement action and seek pecuniary penalties under section 87 of the Commerce Act, or criminal sanctions under section 87B of the Commerce Act, for failure to meet the quality standards."*

*"In the case of unintentional breaches, we do not propose to take enforcement action for performance worse than the quality targets but still the below the cap except in exceptional circumstances..."<sup>13</sup>*

We consider these statements to be unnecessarily vague, and somewhat contradictory. As an illustration, we question why the Commission would consider that any EDB would intentionally breach the quality standards? Further, the Commission could be clearer on such matters as what would constitute exceptional circumstances.

We recommend the Commission take steps to develop enforcement guidelines for the DPP that better reveals the Commission's intentions with regard to compliance. This is particularly important given the "average-based" reliability targets which, if the Commission's proposal remains unchanged, is likely to increase the incidence of non-compliance, in our view.

While the Commission has generic Enforcement Criteria to assist it in its discretionary activities when making decisions on whether to open an investigation, and what enforcement action it will take at the end of an investigation, and Enforcement Response Guidelines, it also has specific compliance guidelines on matters including Fair Trading Act, credit fees under the Credit Contracts and Consumer Finance Act etc.

Aurora agrees with Alpine Energy's views on the need for guidelines on compliance enforcement:<sup>14</sup>

*"While the process and issues paper does not invite views on the release of enforcement guidelines we would like to take this opportunity to once again raise our concerns about the lack of guidelines with the Commission."*

*Uncertainty around the process that the Commission will take when it exercises its enforcement discretion presents a serious concern for us. Part 4 of the Commerce Act gives the commission significant discretion to take enforcement action for breaches. Regulated suppliers currently only have limited precedent upon which to base how the Commission is likely to exercise its discretion when taking enforcement action."*

*To date the Commission has released two enforcement responses for breaches of the DPP at the 2011 and 2012 assessment dates. The Wellington Electricity Lines Limited settlement agreement provides some indication of the process that the Commission will take. However the Orion New Zealand limited warning letter provides none."*

*In the process and issues paper the Commission expressed the view that '[e]nforcement guidelines and informative precedents will contribute to reducing this uncertainty...', which is encouraging as it indicates that the Commission may be considering the release of enforcement guidelines."*

*We are of the view that enforcement guidelines will go a long way in providing regulated suppliers, including EDBs, with an appropriate level of certainty. And agree that while enforcement guidelines will reduce uncertainty the guidelines will never eliminate uncertainty entirely. Accordingly, we encourage the release of enforcement guidelines for the start of the next regulatory period"*

<sup>13</sup> Commerce Commission, Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015, 18 July 2014, paragraphs 2.19 and 2.20.

<sup>14</sup> Alpine Energy, Submission to the Commerce Commission on Default Price-Quality Paths from 1 April 2015 for 17 electricity distributors: Process and issues paper, 30 April 2014, paragraphs 4.1 – 4.5.



## 7 EFFICACY AND REFINEMENT

### ***Revenue-linked service quality scheme***

It is evident from the Commission's 2015 DPP reset proposals, that it is only taking tentative steps towards introduction of a price-service quality link. It probably makes sense to take a cautious approach the first time round, particularly as there are only two years between the initial and 2015 DPP resets, which limits the time and resources the Commission has for considering such a mechanism. We would welcome a more comprehensive review of such mechanisms for the 2020 reset, with the added advantage of experience with the initial basic version the Commission is proposing.

It would be desirable if the Commission could complete this exercise well before the determination of the 2020 reset, so that EDBs have time to review the implications of the enhanced service reliability incentive scheme for how they should operate their businesses. The more complex or sophisticated the scheme the more time that would be desirable.

We would like to emphasise that while the Commission's proposal adopts a "cautious" approach, it needs to start somewhere. Pursuit of the perfect should not be the enemy of the good.<sup>15</sup>

### ***Development based on consumer willingness to pay***

We agree with the Commission's arguments that "in principle, the incentive rate should reflect consumers' willingness to pay for changes in service reliability, as suggested by Vector. However, given that revenue at risk is set at 1%, applying an incentive rate comparable to a type of value of lost load measure would result in a very narrow band between cap and collar for many distributors".<sup>16</sup>

This is a matter that the Commission should revisit for future (2020 and beyond) resets, in conjunction with the percentage revenue at risk; e.g., 5% revenue at risk, based on VoLL, may make sense if the revenue-linked quality incentive scheme is successful.

We suggest that the Commission liaise with the Electricity Authority on the establishment of an appropriate VoLL that could potentially be used for future resets. The Authority has established a VoLL of \$20,000/MWh, and this is incorporated in the Electricity Industry Participation Code.<sup>17</sup> The Commission proposes to use this VoLL value for setting the quality incentive rate in Transpower's IPP.

Last year, the Authority completed a study on VoLL, which produced a national VoLL estimate of \$50,031/MWh.<sup>18</sup> This brings into question whether the \$20,000/MWh VoLL should be relied on, though the Authority has not formed a public view on the merit of the alternative VoLL calculation, and has not consulted on this. Care needs to be taken to ensure that the benefit to consumers of service quality improvements are not overstated, as this could result in over-investment/expenditure. This is not a matter that we would expect the Commission and Electricity Authority to be able to resolve with the timeframe of the 2015 EDB DPP reset, even if the Commission was planning on applying VoLL to the revenue-linked service scheme.

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<sup>15</sup> The section of this submission "Revenue-linked service quality scheme" discusses some potential areas for future development.

<sup>16</sup> Commerce Commission, Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2015, 18 July 2014, paragraph 6.9.

<sup>17</sup> Clause 4 of Schedule 12.2 of the Electricity Industry Participation Code 2010.

<sup>18</sup> Electricity Authority, Investigation into the Value of Lost Load in New Zealand: Report on methodology and key findings, 23 July 2013, paragraph C.39.