ENVESTRA'S JURISDICTIONAL SERVICE STANDARDS FOR THE 2016-2021 REGULATORY PERIOD

Issues Paper

March 2014

REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (**the Commission**) invites written submissions from all members of the community on this paper. Written comments should be provided by **Thursday, 24 April 2014**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to publish any submission based on content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to:

Envestra's Jurisdictional Service Standards for the 2016-2021 regulatory period - Issues Paper

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BACKGROUND

The Essential Services Commission of South Australia (**Commission**) is the independent economic regulator of essential services in South Australia, established under the *Essential Services Commission Act 2002* (**ESC Act**).

In undertaking its regulatory functions, the Commission's primary objective is the:

> *"…protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services".*

The ESC Act also sets out seven other factors that the Commission must have regard to in performing its functions, particularly the need to:

- promote competitive and fair market conduct;
- prevent misuse of monopoly or market power;
- facilitate entry into relevant markets;
- promote economic efficiency;
- ensure consumers benefit from competition and efficiency;
- facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and
- promote consistency in regulation with other jurisdictions.

The ESC Act and industry regulation Acts together provide the Commission with regulatory powers and functions in the electricity, gas, ports, rail and water industries. Each industry Act defines the specific scope of its regulatory powers and functions.

ECONOMIC REGULATION OF ENVESTRA

Envestra Ltd (**Envestra**) is the owner of a monopoly natural gas distribution network in South Australia.

Economic regulation of the gas distribution services provided by Envestra is undertaken jointly by the Commission and the Australian Energy Regulator (**AER**).

The Commission's powers and functions in relation to Envestra are contained in the Gas Act 1997 (**Gas Act**) and the Australian Energy Market Agreement (**AEMA**).[1]

Under the Gas Act, Envestra is required to hold a licence authorising it to operate the gas distribution system in South Australia. The Commission is the licensing authority for the purposes of the Gas Act.

The Gas Act mandates certain licence terms and conditions, while providing the Commission with the discretionary power to include additional licence terms and conditions.

In addition, the AEMA provides for State and Territory Governments to retain responsibility for developing service reliability standards to ensure network security and reliability (**jurisdictional service standards**). The Commission is responsible for developing, implementing and administering the jurisdictional service standards for Envestra.

The current jurisdictional service standards for Envestra are set out in:

- the terms and conditions of its gas distribution licence;
- the Gas Distribution Code;

[1] Refer Annexure 2 of the Australian Energy Market Agreement 2004 (**AEMA**) as last amended in December 2013 at http://www.scer.gov.au/files/2014/01/Final-Amended-AEMA-Dec-2013-signed.pdf.

- the Gas Metering Code; and
- Gas Industry Guideline Number 1.

Envestra is subject to the terms of a binding Access Arrangement, regulated by the AER under the National Gas Law (**NGL**) and National Gas Rules (**NGR**), which:

- sets out the default terms and conditions on which Envestra will provide access to its distribution system; and
- controls the revenue that Envestra may recover from customers.

Service standard and price regulation must work together:

- to ensure that customers receive the quality of service that they value and is cost-effective and feasible to deliver;
- to inform the prudent and efficient level of expenditure for the price determination/access arrangement; and
- to allow monitoring of performance to ensure that the set standards and targets are delivered.

Under the NGL and NGR, the AER assesses the efficient expenditure for distribution services overall, (including consideration of the expenditure required to deliver the service levels determined by the Commission), and determines the allowed revenues and/or prices for distribution network service providers, such as Envestra.

Envestra is subject to five-yearly regulatory determination periods, with the current period ending 30 June 2016. Envestra is required to submit a Regulatory Proposal for the next regulatory period 2016-2021 to the AER in June 2015.

Accordingly, the Commission is now consulting on the jurisdictional service standards to apply to Envestra for the next regulatory period. This will allow Envestra sufficient time to ensure its Regulatory Proposal includes consideration of the expenditure required to deliver service levels determined by the Commission.[2]

CURRENT JURISDICTIONAL SERVICE STANDARDS

A broad overview of the current jurisdictional service standards applicable to Envestra is set out below.

Good Gas Industry Practice

Envestra's gas distribution licence provides overarching guidance on the manner in which Envestra is expected to conduct the operation of its gas distribution network.

The requirement is that Envestra "*exercise that degree of skill, diligence, prudence and foresight that reasonably would be expected from a significant proportion of operators of gas distribution systems forming part of the Australian gas supply industry*". This provides an external measure of whether or not Envestra is conducting its operations in accordance with the required industry standard.[3]

Unaccounted for gas

Unaccounted for Gas (**UAFG**) is the difference between the measured quantities of gas entering and leaving the distribution network.

At the time of undertaking the last review in 2010, it was estimated that approximately 80-90% of the UAFG was attributed to gas leakage from the older cast iron and unprotected steel gas pipelines in Envestra's network. Those pipelines are more

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[2] Two such reviews have been undertaken by the Commission, the first in 2006 and the second in 2010. Refer http://www.escosa.sa.gov.au/projects/115/gas-access-arrangement-review-associated-review-of-regulatory-instruments.aspx and http://www.escosa.sa.gov.au/projects/139/review-of-the-gas-regulatory-instruments-to-apply-to-envestra-for-2011-2016-regulatory-period.aspx.

[3] Refer Envestra's licence, clause 5.

susceptible to corrosion, ground movement and joint failures. [4]

The Commission's attention to this issue was driven by the need to ensure the ongoing safe operation of Envestra's gas distribution network in the long-term interests of South Australian gas consumers. High levels of UAFG reported by Envestra had raised concerns around the potential for gas accumulation to create a risk of fire and/or explosion.[5]

Envestra proposed an accelerated Mains Replacement Program to address the UAFG issue, on the assumption that the increasing levels of UAFG suggested that the remaining cast iron and unprotected steel mains were deteriorating at an increasingly rapid rate.

While the accelerated Mains Replacement Program was expected to drastically reduce UAFG levels over an 8-year period, it was acknowledged that other factors can also contribute to the overall level of UAFG.[6]

The Commission introduced a requirement for Envestra to include a UAFG Plan as part of its Safety, Reliablity, Maintenance and Technical Management Plan.[7] The UAFG Plan must include a Leakage Management Plan; Asset Management Plan and Mains Replacement Plan.

4 Refer http://www.escosa.sa.gov.au/projects/139/review-of-the-gas-regulatory-instruments-to-apply-to-envestra-for-2011-2016-regulatory-period.aspx.

5 Clause 5.1(b) of Envestra's licence requires it to operate its gas distribution network so as to minimise the leakage of gas. Clause 5.1(c) further requires Envestra to account for the total amount of gas lost from the distribution system as a result of that leakage. It is important to note that clause 5.1(c) is not merely an accounting issue; rather, it relates broadly to Envestra's conduct in the operation of the gas distribution network.

6 Such as timing differences in meter readings, inaccuracy in metering measurement, billing errors (meter readings), theft of gas and changes in ambient pressure and temperature.

7 Refer Envestra's licence, clause 8.1.

To monitor the effectiveness of the UAFG Plan, the Gas Distribution Code[8] includes a UAFG target, requiring Envestra to use its its best endeavours to:

- achieve a level of UAFG for its distribution system of no more than 1,626 TJ by the end of the 2015/16 regulatory period; and
- reduce the levels of unaccounted for gas in each year of the current regulatory period.

Active monitoring and public reporting on Envestra's performance against the plan is required under Gas Guideline 1, with Envestra required to report:

- the level of UAFG each month; and
- the kilometres of cast iron and unprotected steel mains replaced each month

for each of the key networks identified for mains replacement.

Envestra is also required to prepare an annual report on its performance against the approved UAFG Plan, for public release.[9]

Operating pressure

Envestra is required to ensure that the pressure of gas delivered from the distribution system to each meter is within defined limits and within the meter manufacturer's designated pressure operating range.[10]

Preconditions to connection

Subject to the provisions of the National Energy Retail Law (**NERL**) and the NGR, Envestra must connect a customer to its distribution system on fair and reasonable terms.[11]

8 Refer Gas Distribution Code, clause 2.1.1(e).

9 Refer Envestra's licence, clause 8.1(f).

10 Refer Gas Distribution Code, clause 2.1.1(b).

11 Refer Gas Distribution Code, clause 2.3.

Reconnection after disconnection

Envestra is required to use its best endeavours to reconnect a disconnected customer's supply address within sufficient time for a retailer to meet its contractual obligations to the customer as set out in the NERL.[12]

ISSUES FOR CONSIDERATION AS PART OF THIS REVIEW

Consumer engagement by Envestra

The Commission recognises that jurisdictional service standards for utility businesses are best set by reference to customers' needs, expectations and willingness to pay for distribution services.

In the absence of a competitive market for the relevant services, effective customer engagement attempts to mimic the workings of competitive markets, by requiring monopoly service providers to engage with customers to determine the best price-service delivery outcomes. Such outcomes achieve the trade-off between the value to customers of service levels versus the costs of providing them.

To properly achieve this, it is essential that customers are informed on service level-cost trade-offs, that is, be provided with sufficient information to assess whether their preference would be for a lower/higher level of service in return for a reduction/increase in bills.

The Commission requires other regulated entities, such as SA Power Networks (the electricity distributor) and SA Water (the largest water and sewerage provider), to engage directly with their customers to understand customers' service requirements.

This approach is also advocated by the AER.

Under the National Electricity Rules (**NER**), electricity network businesses are required to consult with their customers in preparing Regulatory Proposals for the AER. SA Power Networks is currently undertaking such consultations with its customers.

While the NGR do not contain the same explicit customer engagement requirements for gas distribution businesses, such as Envestra, the AER's *Customer Engagement Guideline for Network Service Providers* notes that it regards consultation as applicable to gas service providers even without the NER requirements.[13]

Noting that:

- there is currently no specific obligation for Envestra to undertake customer consultation; and
- there are benefits in such consultation occurring as an integral part of the regulatory process,

the Commission is seeking community views on this matter.

Should Envestra be require to consult with customers in relation to service standards?

If so, what should the parameters for consultation be and on what areas of service (e.g. reliability and/or customer service) should Envestra be required to engage with its customers?

[12] Refer Gas Distribution Code, clause 2.4.

[13] Refer http://www.aer.gov.au/node/18894.

Customer service standards and targets

With the adoption of the NERL and National Energy Retail Rules (**NERR**) in South Australia in February 2013, for the first time Envestra has a direct contractual relationship with its end-use customers of gas.

In other industries regulated by the Commission, a minimum level of customer service responsiveness is delivered through telephone and written responsiveness standards and targets.

Should Envestra have the same/similar customer service obligations as energy retailers, SA Power Networks and SA Water (i.e. telephone and written responsiveness standards and targets)?

Are any other customer service measures considered more appropriate?

Measures of network reliability

Most reliability indices are average values of reliability data for a particular reliability characteristic for an entire system or for a specific operating region.

Two commonly used reliability indices are:

- System Average Interruption Duration Index (**SAIDI**): a measure of the total duration of interruptions for the average customer over the course of a year (for a fixed number of customers, SAIDI can be improved by reducing the number of interruptions or by reducing the duration of interruptions); and
- System Average Interruption Frequency Index (**SAIFI**): a measure of how often the average customer experiences an interruption over the course of a year (for a fixed number of customers, the only way to improve SAIFI is to reduce the number of interruptions experienced by customers).

Together, SAIDI and SAIFI measure how long and how frequently customers are without supply, on average.

While not currently used for Envestra's South Australian network, Envestra measures and reports on the reliablity performance of its Victorian gas distribution network[14] using the SAIDI and SAIFI indices.

Noting that the measures are currently used in Victoria, should Envestra be required to monitor and report on network reliablity in South Australia using SAIDI and SAIFI?

Are any other reliablity measures considered more appropriate?

Unaccounted for gas target

Envestra is on track to meet the UAFG target in the Gas Distribution Code by the end of the current regulatory period.

The Commission is seeking advice from the Technical Regulator on whether the level of UAFG in Envestra's network is now at a safe and acceptable level or whether additional work is required in this area.

Is a revised UAFG target required for the 2016-2021 regulatory period?

Are any other approaches to managing UAFG more appropriate than a UAFG target?

Guaranteed Service Level Scheme

Ultimately, it may be uneconomic to ensure all customers receive average service level targets.

Guaranteed Service Level (**GSL**) payment schemes used in other industries regulated by the Commission are designed to make payments to customers where it is too costly to provide the average service standards to an individual customer.

The principles underlying any GSL payment scheme developed by the Commission are:

- customers value that area of service;
- the GSL target is a reasonable measure of the customer's expectation;

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14 Refer http://www.aer.gov.au/node/23302.

- the GSL payment is made to customers receiving a level of service below a predetermined level; and
- the reason for failure to meet the GSL is within the control of the network operator.

Areas of service targeted by a GSL payment scheme can include (but are not limited to):

- customers experiencing multiple or lengthy interruptions; and
- timeliness of connections or other appointments.

Envestra is not currently subject to a GSL payment scheme for its South Australian gas distribution network. Envestra's Victorian gas distribution network has a GSL payment scheme of this nature.[15]

While GSL payments are directed at individual customers, by their nature, they provide a financial incentive for the network business to assess the trade-off between making the GSL payments or undertaking capital and/or operational expenditure to address any underlying issues.

Should Envestra be required to investigate areas of service where GSL payments should be made to individual customers?

Are there any areas of service that should be subject to a GSL payment scheme?

Other issues

The Commission invites submissions on any other issues considered relevant to the review of Envestra's jurisdictional service standards for the 2016-2021 regulatory period.

Are there any other issues that should be considered as part of this review?

NEXT STEPS

The Commission invites submissions on the issues raised in this paper, or any other issues considered relevant to the review of Envestra's jurisdictional service standards for the 2016-2021 regulatory period.

Following consideration of the issues raised, the Commission will release its Draft Decision for a further period of public consultation in August 2014. The Final Decision will be released in December 2014.

STAGE	TIMING
Issues Paper released	7 March 2014
Public Consultation	7 March – 24 April
Draft released	August 2014
Public Consultation	August-September 2014
Final released	December 2014

FURTHER INFORMATION

Any queries relating to this consultation should be directed to:

- Amber Miller, Senior Policy Officer

If you would like to keep up to date with the Commission's activities and the release of papers for consultation, subscribe at http://www.escosa.sa.gov.au/subscribe.aspx.

15 Refer http://www.aer.gov.au/node/23302.

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