

23 May 2003

Dr T. G. Parry  
Chairman  
Independent Pricing and Regulatory Tribunal of NSW  
Level 2, 44 Market Street  
PO Box Q290  
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SYDNEY NSW 1230

Dear Dr Parry

## **Review of Guaranteed Customer Service Standards and Operating Statistics**

The attached submission is made on behalf of AGL Gas Networks Limited in response to the Tribunal's Discussion Paper DP61 dated 1 April, 2003.

Yours sincerely



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General Manager  
Regulation and Policy

## **IPART REVIEW OF GUARANTEED CUSTOMER SERVICE STANDARDS AND OPERATING STATISTICS**

This submission is made on behalf of AGL Gas Networks Limited in response to the Independent Pricing and Regulatory Tribunal's Discussion Paper DP61 dated 1 April, 2003. For the most part our comments reflect the point of view and interests of a gas reticulator.

Firstly, the Tribunal's premise that "the need for service quality regulation is particularly important in regulatory regimes where the form of regulation creates strong incentives to cut costs, potentially at the expense of service quality (as is the case under CPI-X regulation, which is used to regulate prices in the NSW gas and electricity industries)." (p3) reflects an incomplete view of the incentives under CPI-X regulation.

While controlling costs provides one avenue for increasing returns, it is not the only one. CPI-X price cap regulation provides equally strong incentives to increase returns by increasing system throughput, and that will be achievable only if the price/quality mix is competitive.

It is noteworthy that, in New South Wales with its relatively mild climate, gas can be regarded as a discretionary fuel, whereas electricity is an essential service in the sense that very few people choose to live without it. In the majority of applications, and certainly for residential purposes, the consumer can choose between gas and electricity, and perhaps other options, at the time of initial connection and when an appliance replacement decision is made'. At those times, consumers can be expected to choose gas only if the price/quality mix is attractive and so there is market pressure on gas service providers (including the distributor) to maintain that mix. Electricity suppliers are similarly exposed to competition from gas for some applications such as space and water heating. Volume growth will be achieved only if a competitive price/quality mix is maintained.

The observation in the Discussion Paper also overlooks the commercial incentive for distributors to maintain and operate their systems so that contractual obligations are met, thereby avoiding actions for breach and associated adverse consequences.

### **Choice of relevant factors**

Under the current regulatory regime, gas distribution and supply are carried out by different entities by law, and it is the supplier rather than the distributor who is responsible in the first instance for managing and delivering on most aspects of the relationship with consumers. This includes billing, connections, disconnections and re-connections. However, in many cases it is the network operator who actually performs the relevant action (or a related action such as meter reading) under contract to the supplier. If GCSS payments were linked to the performance of such actions then, under current arrangements, it is still the supplier who would make the payment to the consumer. The supplier would be reimbursed by the network operator. If payments are to be made before reimbursement, it would also be appropriate for the supplier to obtain confirmation that the network operator accepts liability before the

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<sup>1</sup> On average domestic gas appliances are replaced every 12 to 15 years so a significant proportion of residential volume – approximately 6% to 8% of load per year – is continuously exposed to competition.

payment is made. It follows that AGLGN has a real interest in the process of setting the level of any GCSS and the amount of any such payments.

The service attributes to be taken into account in any GCSS or operating statistics scheme must be selected carefully, particularly given the potential for poorly designed arrangements to result in perverse incentives and undesirable or inefficient outcomes. Attributes must be measurable and within the control of the service provider, and the value that consumers attach to the service standards set under the scheme must be at least as great as the cost of delivering those standards. Those costs include the costs of data collection and the commercial and compliance processes required to support the scheme.

As a general proposition, any scheme should be incentive based or at least symmetrical – service providers will always respond more positively to incentives than to the avoidance of penalties. It is also critical that whatever is to be measured be defined clearly and precisely.

In the case of gas distribution, it is AGLGN's view that safety and reliability of supply are the principal quality measures.<sup>2</sup> Current levels of both these measures in NSW, and throughout Australia for that matter, are generally such that gas consumers and the public do not regard them as issues of concern – they are not high in the public consciousness. An individual consumer is affected very infrequently by planned maintenance and, while there may be some instances of localised network constraints, the majority of unplanned interruptions to supply are the result of random third party "hits" on distribution assets. A safe and reliable gas distribution service is largely taken for granted. That is not to say that the industry can afford to relax its standards or become complacent, and this is reinforced by the legislative/regulatory regime which places a strong emphasis on maintaining safety and reliability. It follows that we do not see a case for establishing GCSS for gas distribution, unless there is a level of customer dissatisfaction of which we are not aware.<sup>3</sup> GCSS should be established for gas distribution only where there is evidence e.g from properly conducted customer surveys, that a need exists.

The Tribunal refers to the timely provision of connections as an example of a GCSS (pages 3 and 6). Whereas demand for new electricity connections is driven largely by the level of housing completions, a large part of demand for new gas connections is seasonal and related to the level and success of marketing activity. Heating appliances will invariably be marketed more heavily in the lead-up to winter, and a proportion of the resulting sales will be to consumers who do not have an existing gas connection. As a consequence there is always an increase in demand for new gas connections on line of main during that period – in 2002, accepted new connections on line of main averaged about 200 per week in late Autumn and early Winter compared with about 130 per week in Spring and Summer. However, the network operator cannot respond immediately to an increase in demand for new connections

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<sup>2</sup> The level of distribution system losses/UAG is also mentioned as an issue. However, we would see that measure as being beyond the scope of the current process given that an incentive mechanism to improve performance on UAG is already provided for in distribution pricing. The Tribunal also refers to gas composition as an aspect of quality of supply. In that case we note that the distributor has no direct control over gas composition other than to refuse to receive off-specification gas into the network. A gas specification is contained in gas transportation contracts.

<sup>3</sup> We note that existing regulatory instruments already impose obligations in respect of a number of service attributes which the Tribunal lists in Table 2 as "Not a GCSS". Items in this class include (for reticulators), timely provision of new connections, hotline services, disconnections, reconnections, and safety. There are other items listed in Table 2 as "Not a GCSS", such as security deposits and payment methods, that do not apply to reticulators.

because they must be made by personnel who are appropriately qualified, trained and equipped. It would be inefficient to maintain a work force large enough to ensure that a tight new connection time constraint could be met throughout the year.

Demand for new gas connections varies according to the level and success of suppliers' marketing activities, so it is inevitable that there will be occasions when the network operator will have difficulty maintaining delivery standards unless he can be given adequate forewarning and time to prepare for any anticipated increase in demand. Codes should continue to provide, as they do at present, for the service provider and consumer to agree on a connection date that is different from the default/standard.

## **Implementation**

We note the key issues identified by the Tribunal (Section 1.2) and strongly endorse the qualification that "the total costs of administering any GCSS scheme (for both the regulatory and regulated company) [should] not outweigh the benefits." The additional costs of the scheme, if it is to proceed, must be understood and accepted by consumers. A further important qualification from our point of view is that regulated network tariffs must be adequate to cover the costs of providing and maintaining services at the target standard. It follows that any decision to set the target standard above the levels corresponding to the current "regulatory contract" should be made only after:

- (a) Establishing that consumers have a genuine preference for improvement in the particular aspect of service, and that they are willing to pay for the proposed improvement. The Discussion Paper itself highlights the tension between willingness to pay and quality: "In addition to keeping prices low, the two other highest priorities were ... " (p13). Any evaluation must also take into account the fact that gas consumers are invariably also electricity consumers, and that consumers have a limited overall capacity to pay. Given this constraint, it is likely that there are aspects of electricity service which consumers would prefer to see improved ahead of aspects of gas service, or vice versa. The results of recent customer surveys, as summarised by the Tribunal (section 4.4), would appear to be an inadequate basis for this type of assessment.
- (b) Ensuring that the desired service standard is delivered by the most efficient means. It is likely to be more efficient to deliver improvements in some aspects of service to those consumers who require and value the improvement by modifying or installing special facilities at the consumer's premises, at the consumer's expense, rather than applying a network-wide solution. Examples might be requirements for improved levels of surge protection or voltage stability in electricity.
- (c) Providing revenue and, where necessary, time for the service provider to make the changes required.

The corollary to the final point is that if changes are to be made, they must be made only at the time of a pricing review.

Importantly, any GCSS scheme should not inhibit the development of innovative offerings by service providers. For example, some consumers may be attracted by a "vanilla" retail offering which provides for account/telephone enquiries only during normal business hours instead of the "standard" 24/7 service. It would be inappropriate if GCSS precluded such

offerings. In the end the market can provide valuable information on what aspects of service consumers value, and what they are willing to pay.

We have noted previously that only those factors that are within the control of the service provider should be included in any scheme – it is unreasonable that a service provider should be accountable for outcomes that are beyond its control. It follows that the service provider should not be penalised where a service failure occurs because of an exceptional event. Of course the definition of an exceptional event then becomes critical. The costs of administering the process for assessing claims for relief, including the commitment of resources, must also be considered. Our experience of the scheme operating in Victoria is that it is resource-intensive and expensive to administer given the amounts normally at stake. It is also unduly restrictive and inflexible in terms of the types of events that are accepted as exceptional.

The definition of exceptional event should at least include consideration of what a prudent operator acting in accordance with good industry practice should have been able to achieve in the circumstances. This would include taking into account the scale of the event relative to the total size of the operation. For example a rare, severe event that is relatively localised might over-stretch a small provider or even a large provider if the event is remote from the centre of operations, whereas the same event occurring near the centre of operations of a large provider might be managed relatively comfortably. The assessment process must also take account of any constraints imposed through the "regulatory contract".

### **Operating statistics**

The Discussion Paper canvasses views on the range of operating statistics that should be reported. In the case of gas distribution, we note that a standardised reporting regime was established only last year with the MEU after an extensive process of consultation. The process took into account factors such as the Ministry's reasonable requirements for information, the availability of reliable data and the cost of providing it. We see no justification for revisiting that regime in the short term.