

Values of Customer Reliability Methodology

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program works for better regulatory and policy outcomes so people's needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

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1. Introduction

PIAC does not support the methodology for developing the Value of Customer Reliability (VCR) proposed by the Australian Energy Regulator (AER). The current approach is not fit-for-purpose and the minor amendments proposed do not alter this.

The trade-offs between reliability and energy costs are complex, both in general and in the context of a rapidly changing energy market. A survey approach is wholly inadequate to accurately identify respondents' informed preferences in relation to these. A deliberative approach, involving face-to-face sessions, is required, the outputs of which should then be validated with a large-scale survey.

The AER expects the network businesses it regulates to conduct deliberative engagements in order to validate investment and pricing proposals. It should hold itself to an equal, if not higher, standard than the businesses it oversees.

We consider the justifications the AER has provided for not conducting a substantive review of the VCR methodology to be inadequate. The argument that minimal changes are preferable on the basis of regulatory continuity is not reasonable. 'Regulatory continuity' could be regarded as largely irrelevant in the context of an energy system transition. In any case it is a minor consideration after accuracy, robustness, flexibility, adequacy in scope, and granularity.

On the basis of feedback provided in the webinar on 4 April 2024, our concerns regarding the adequacy of the proposed methodology are shared by a number of other stakeholders. A consultation that considers more substantive changes to the methodology is both needed, and warranted on the basis of stakeholder input.

We appreciate that the AER is obliged to produce the revised VCR by the end of 2024. It is possible to design and implement a robust deliberative approach backed with a newly written survey within this timeframe.

2. Inadequacies in the AER's consultation

There are a number of aspects of the current consultation which have been inadequate.

2.1 An overly circumscribed set of issues

The consultation on the VCR methodology has started from assumptions which should have been tested with input from stakeholders. These include, most importantly, that the existing methodology is fit-for-purpose and that any changes to the VCR methodology will not be material.

The result of this is a circumscribed consultation process that does not provide adequate scope for stakeholders to develop and provide their preferences on issues with material impact.

That is, there are a number of important issues that PIAC would like to comment on, but which are currently not considered in the draft determination. We accept other stakeholders may not share our preferences on these issues or our assessment of their significance. However, the

failure to identify them in the artificially shortened consultation process precludes consideration and results in the AER's being the only assessment of preference or materiality.

PIAC preferences which have been precluded by the process include:

- A stakeholder reference group should be convened, as it was for the 2019 review. The AER's implicit justifications for not convening a stakeholder reference group – that material changes to the methodology are not needed – is not adequate reason as:
 - (a) it is a controversial position, based on the feedback provided by stakeholders at the public forum on 4 April 2024, and
 - (b) it pre-empts the input that a stakeholder reference group would provide, essentially ensuring the AER's assessment of the methodology is unreasonably privileged.
- The five-year review period is not appropriate for the VCR. A four- or three-year regular review would be preferable. This would work better with the cycle of revenue determinations for network businesses so the lag period between VCR changes is not constant for each business. Secondly, as the AER notes in the draft determination, the energy market is changing rapidly and it is logical that VCRs should change (or be capable of changing) in response. A shortening of the traditional review period is appropriate in the context of this of this elevated pace of change.
- The order in which the questions in the survey are asked may impact the responses to them. All surveys (and processes which are not deliberative) run the risk of enhancing cognitive biases of the respondents. This is particularly relevant for the VCR survey, which necessarily compresses complex ideas and trade-offs into short 'understandable' questions. While we do not support reliance on a survey, if the proposed survey was provided in the draft determination in the form the respondents would see it, PIAC could provide advice (on the basis of extensive engagement experience) to mitigate this issue. As it is not, we are limited to raising this concern in an abstract rather than concrete way.
- The consideration of what constitutes 'direct engagement' is overly narrow. The AER justifies the use of surveys on the grounds of being 'direct'. We don't contest this, but note it makes no recognition of the qualitative aspects of engagement, and that engagement can be direct but qualitatively inadequate and inappropriate (as in this case). A survey is the least preferable of all the possible modes of direct engagement for the task at hand.
- The AER's promise in 2019 to consider a 'revealed preference' approach has not been fulfilled, despite the AER's stated opinion that it was likely to give the most accurate VCR. The reason given in 2019 for not employing this approach was not substantive. The AER believed it would not be possible to review, design, and implement it within the Rules' timeframe. This reasoning does not apply here as the AER has known since 2019 that the VCR would need to be reviewed by the end of 2024. The AER has failed to consider implementing such an approach and has secondly failed to consult stakeholders on their views on using such an approach, and is now determining not to employ it.

- Like the Energy Users Association of Australia, we contend there are benefits to considering the VCR and the value of longer duration outages in parallel. This possibility has also not been canvassed in this consultation. We are aware that Energy Ministers have requested work to determine a Value of Customer *Resilience* separately to the VCR. Resilience and reliability are not the same thing and are not interchangeable. We agree with energy ministers that understanding consumer preferences relating to long duration, high impact outages is important and that the AER should undertake this work as part of this review. The review presents the AER with an opportunity (and a need) to engage more deeply and robustly on this complex and very material matter alongside a robust consideration of the VCR

The question posed for stakeholders concerning whether or not to approve the expedited consultation process for the VCR methodology was not the appropriate one. The key question should have been whether or not respondents considered material changes to the VCR methodology were needed. Instead, the AER asked whether or not stakeholders believed the changes proposed by the AER were material or not. This might be a legitimate question in and of itself, but it had the effect of disallowing an answer to the more substantive question. This is not good practice engagement and has the effect of precluding important stakeholder input.

2.2 Timing of consultations

We are extremely concerned that the timing of the consultation suggests the major design choices pertaining to the VCR methodology are a *fait accompli*. There are two dimensions of this: the short turnaround of the consultation process and the impact the pending deadline for completing the review has had on the scope of the consultation.

An expedited consultation process

As Mark Grenning has noted on behalf of the EUAA, the consultation for this piece of work has been short.¹ The draft determination was released on 25 March 2024. A public forum was held five working days later on 4 April. Stakeholders had until 9 April to register disapproval of the decision to expedite the consultation process and 23 April to make submissions. Particularly in the context of an extremely crowded environment for competing processes, this provides unreasonably little scope for stakeholder response.

The curtailed consultation process exacerbates the failure to consult stakeholders on which issues they regard as material considerations for consultation and input. The AER failed to undertake this process themselves and the shortened consultation process has made it difficult for stakeholders to coordinate themselves by creating forums outside of the process in which to exchange ideas and concerns.

We agree with the EUAA that “this engagement is not consistent with what the AER expects from networks under the Better Reset Handbook”.² In particular, PIAC notes that prior network practice

¹ Mark Grenning, 4 April 2024, ‘Public Forum: AER VCR methodology draft determination’.

² *Op. cit.* slide 4.

to undertake curtailed engagement with the excuse of insufficient time has been rightly regarded as unacceptable by the AER, leading to significant improvements in the robustness of network engagement and their ability to garner meaningful stakeholder and consumer preferences. In this context It is disappointing for curtailed timeframes to be cited (at least in part) as justification for expediting such an important process at this stage.

A delay in beginning this consultation

The AER appears to regard the deadline of 31 December 2024 for completing the review as an imposition to considering substantive reform of the VCR methodology. PIAC does not agree with this assessment.

The AER has known about this deadline for more than five years. We are aware of no impediment it has faced to beginning this process earlier.

The VCR has substantial material impacts on consumers. They should not face the risk of being adversely impacted by inaccurate VCR values resulting from an AER decision to not conduct a robust and adequate process for developing a VCR.

A review of the VCR based on a robust and adequate methodology, incorporating substantive input by stakeholders can be designed, implemented, and completed before 31 December 2024.

However, if it is not possible to complete a substantive review in this time, it is in the consumers' interest to delay the deadline, rather than to lock in an inaccurate set of VCR values for five years.³ A precedent for delaying the deadline exists in the review of the Rate of Return Instrument, which was scheduled to be published on 16 December 2022 and was delayed until 24 February 2023.

Alternatively (or additionally) a decision to maintain the existing values until a nominated date, on an interim basis, while a robust and adequate process producing new values is completed is preferable to locking in an inaccurate set of VCR values for five years.

3. The existing methodology is not fit-for-purpose

Reliance on a short survey is not appropriate for determining the VCR. The planned survey is eight to ten questions long. Respondents can be expected to engage with it for between ten and fifteen minutes, which is to say they will engage with each question for up to ninety seconds.

In each question they will be required to understand complex issues relating to the energy system and to provide information on their preferences related to complex trade-offs between reliability and cost.

³ Arguably the values are impactful for even longer, as they will be used for decisions relating to revenue periods that extend beyond 2030.

They will be further hamstrung by the questions necessarily striking a balance between conciseness, avoidance of jargon, and accuracy.

PIAC's position, based on extensive experience with engagement and consumer consultation, is not that surveys cannot be used. Rather, it is that it is inappropriate to use them in isolation and for a purpose for which they are wholly unsuited.

There are a number of key issues that impact the quality of the data produced by surveys:

- There is too much scope for misinterpretation on the part of respondents, due to the factors outlined above. As an example, a respondent may reasonably answer all the questions not on the basis of their own trade-off preferences – the amount they would be willing to pay extra on their bills to avoid an extra period of outage experienced by them – but rather what they imagine the community preference may be, or what they are willing to pay to ensure the community does not experience an extra period of outage. All of these are reasonable interpretations of the key concepts, but may elicit different responses from the same person.
- Surveys, by their nature, rely on, reinforce and enhance existing cognitive biases. Surveys capture respondents' reflexive responses, not their informed consideration of newly presented content.
- Surveys are, by their nature, not able to capture intangible impacts, such as the loss of comfort that customers may experience as a result of outages, consistently across respondents.
- Importantly, as AER work in vulnerability has demonstrated, a significant proportion of the population such a survey would draw on have limited practical literacy in written English, and a larger cohort have potential limitations to their ability to easily process and comprehend complex written information. These limitations are capable of being dealt with in deliberative processes where time and the use of varied communication platforms are possible.

For all these reasons, each of which dilutes the accuracy of the data, there is no sample size that could ensure the results from this data source alone provide accurate and meaningful indications of consumers' aggregated preferences.

These drawbacks can be seen in the 'irrational' responses to some of the questions in the 2019 review, such as that 40% of responses to one question that indicated that the respondents would not pay an extra cent to avoid some kinds of outages.

In addition to these data quality issues, there is a qualitative detriment to relying on surveys, which is that it robs respondents of the ability to generate their own categories, and to introduce new issues or ideas independently of the survey designers. For example, there is no way for consumers to indicate that they would prefer both cost to go down and reliability to go up or remain stable.

We recommend the AER conducts consumer engagement similar to that undertaken by network businesses as part of their revenue determinations and access arrangements. The decisions made by networks in these processes and by the AER in its VCR determination have similarly large and long-lasting impacts on consumers and as such the AER's consultation should be of a similar depth and robustness.

Deliberative, face-to-face engagement with consumers, which mitigates biases that emerge in surveys, enables more consistent comprehension and informed consideration and elicits deeper responses, should be used. Results of this process can then be validated using a survey.

4. Consistency with the VCR objective

For the reasons stated above, we consider that the existing approach is not fit-for-purpose. Neither it, nor the minorly amended methodology proposed, will 'produce estimates of VCR that are a reasonable reflection of consumer reliability preferences'.

As noted, surveys are unable to gauge people's preferences regarding complex trade-offs. They are even more inadequate for gauging how consumers' preferences are likely to change in response to future changes that impact these trade-offs. The engagement process would have to gather data not only about respondents' preferences but also data about their *reasons* for holding them, the logics behind their responses. To access that data, the process must, in some sense, be deliberative.

We do not agree the updated methodology offers any greater flexibility or scope than the alternative possible methodologies. A survey is inherently rigid in the sense that it prescribes the categories and scope of possible responses.

We urge the AER not to conflate granularity with accuracy. A set of data can be highly granular at the same time as being highly inaccurate. Any value that is derived from an increased degree of granularity is predicated on its being accurate to that degree. Any benefits of granularity in the proposed methodology are undermined by the low degree of confidence in the accuracy of any data produced by it.

5. Consistency with the National Electricity Objective

The VCR values balance reliability with cost, not affordability. Affordability refers to ability to pay, not willingness to pay. A VCR that balanced reliability with ability to pay would produce very different results.

The VCR and the methodology used to derive it, as well as any process assessing the methodology, must be consistent with the National Energy Objective (NEO). PIAC does not consider the proposed methodology demonstrates consistency with key aspects of the NEO, particularly in seeming to prioritise aspects other than accuracy and robustness. Possible methodologies should be valued according to their capacity to produce results that are, in order of importance:

- accurate;

- robust, in the sense of producing data which is unambiguous;
- flexible, in the sense of their application being able to be adjusted according to changes in context while remaining faithful to the inputs of the respondents;⁴
- large in scope, in the sense of capturing preferences on as many relevant trade-offs, or trade-offs in as many contexts, as possible; and
- granular.

The draft determination asserts that continuity with the existing regulatory regime is a priority value which should be considered in this decision.⁵ There is no basis for this assertion, particularly in the context of a rapid energy transition, and we disagree with ‘regulatory continuity’ being prioritised above other, material considerations such as those detailed above. To do so would effectively be prioritising continuity of process over accuracy and robustness of results.

Where an established VCR methodology and the new methodology that replaces it produce accurate and robust results, there is a degree of continuity due to their both being grounded in the inputs of consumers’ preferences. That is, there is continuity in VCR being grounded in consumer preference, not necessarily how that preference is derived. ‘Substantive continuity’ imposes no greater cost on the stakeholders, such as investors, who may be impacted by a change in the VCR values (given that such a change could occur even if the same methodology were utilised)

If there is a sharp change in the outputs (VCR values) in the move from one system to the other, this is not a problem as it reflect changes in consumers’ preferences. It is preferable to have VCR values that accurately reflect customers’ preferences, even if this means an adjustment, possibly involving costs, for some stakeholders.

The updated methodology is very unlikely to produce a more accurate set of estimates than a deliberative process validated with a survey. It will certainly be less robust, less flexible, and smaller in scope. Finally, while it is not clear that a deliberative approach backed with a survey would produce data that is any more granular than a survey-only approach, as the deliberative approach backed with a survey encompasses the survey-only approach, it cannot produce data that is less granular.

6. Requirements of Rule 8.12(d)

A survey does qualify as ‘direct engagement’ for the purposes of fulfilling rule 8.12(d). However, we note that in the AER’s own opinion, gleaned from their prescriptions to the network businesses they oversee, it is not a robust, reliable, dependable, or accurate method of understanding consumer preferences on complicated matters, such as trade-offs between

⁴ We note that Sullivan, Collins, Schellenberg, and Larsen (2018) claim only that surveys offer greater flexibility than model-based approaches. The preferable alternative we propose is a deliberative engagement-centred approach, not a model-based approach.

⁵ AER, March 2024, ‘Values of Customer Reliability Methodology; Draft Determination’, p.17.

different values. It is inconsistent to regard a survey as inadequate in decisions applying the VCR, but acceptable for determining what the VCR itself should be.

7. Consideration of alternative VCR methodologies

The AER's internal consideration of alternative methods does not fulfil the intent of the 2019 promise to consider alternative methodologies in the 2024 review. In 2019 the AER determined that a revealed preference approach was likely to be the most accurate. There is no reason given in this draft determination of why the AER's opinion on this has changed.

The AER's process of revisiting the alternative methodologies should have transparently sought input from stakeholders. Ideally, a panel should have been appointed to identify and explore the alternatives.

We agree that VCR values derived from surveys can be applied to most uses of VCR that have been identified in the draft determination. However, this is also true of VCR values derived from alternative approaches, including our own preference of a deliberative approach validated by surveys.

We agree that contingent valuation and choice experiment survey techniques can capture both tangible and intangible effects relating to VCR. However, we have valid concerns about the accuracy of the data produced by these techniques. The purpose of deliberative approaches is to make the intangible tangible, rather than leaving them as intangibles. This is preferable as intangible elements cannot be valued by respondents in anything but instinctive and reactive ways, leaving their responses open to distortions born of context and association. Stated differently, intangibility lies at the core of the type of cognitive biases that render surveys a sub-standard way of gathering consumer preferences on complex matters.

We disagree that surveys are better than alternative methods at ascertaining information about how consumer perceptions of grid reliability change because of solar PV, battery storage and other emerging technologies. Deliberative processes are not only the best but the only ways of accurately accessing this exact information.

The purpose of the VCR data gathering should not be to ascertain what consumers perceive the impacts of these changes on reliability are. It is to ascertain how much they value reliability in relation to cost. This may be different in different circumstances. However, the consumers' interest is not best served when investment and regulatory decisions respond to what the consumer thinks the impact of a given change on reliability is, but rather when they respond to what the actual impact of the change is. The consumer is unlikely to be the best assessor of what the impact actually is, particularly in the context of a survey.

We disagree that the survey-based approach is superior on the bases of offering greater flexibility or granularity and refer to our comments in section 5.

Finally, we disagree with the assertion that alternative methods are too difficult to use.

We understand the concern about 'data constraints' in relation to the need to conduct a process with an adequate sample size for the results to be statistically significant. The AER regularly

requires the network businesses it oversees to conduct deliberative engagement processes and that these are of adequate sample size to serve as a foundation to validate the claims that investment decisions are made that are in the interests of consumers. If this is possible for the network businesses, it is certainly possible for the AER.

It is unclear what 'methodological constraints' refers to without further elaboration and there would appear to be no substance to the claim. A method cannot be regarded as unsuitable on the basis of unspecified 'methodological constraints'.

As noted in section 2.3, we do not agree with the AER's assertion of a timing constraint. The AER has known about this deadline for more than five years. There is adequate time to conduct a deliberative approach alongside the use of surveys and conclude the review before 31 December 2024. If necessary, it is within the power of the AER to undertake other measures to accommodate any more time that may be required.

8. Continued engagement

We welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth. Please contact Michael Lynch at mlynch@piac.asn.au regarding any further follow up.