DRAFT DECISION

AusNet Services
Distribution Determination
2021 to 2026

Attachment 10
Service target performance incentive scheme

September 2020

AUSTRALIAN
ENERGY
REGULATOR

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

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Attachment 19 – Tariff structure statement

Attachment A – Victorian f-factor incentive scheme

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10 Service target performance incentive scheme

Under clauses 6.3.2 and 6.12.1(9) of the National Electricity Rules (NER) our regulatory determination must specify how any applicable Service Target Performance Incentive Scheme (STPIS) is to apply in the next regulatory control period.

This attachment sets out our draft decision on how we will apply the STPIS to AusNet Services for the 2021–26 regulatory control period where STPIS 2.0 will apply.

AER’s service target performance incentive scheme

Our distribution STPIS provides distributors with incentives for maintaining and improving network reliability performance, to the extent that consumers are willing to pay for such improvements. The STPIS is intended to ensure that distributors' service levels do not reduce as result of efforts to achieve efficiency gains. The current version (version 2.0) of STPIS was published in November 2018 and will apply to all revenue determination from that date. This newer version 2.0 replaces the earlier version 1.0 of the scheme.[1]

AER's framework and approach to the application of STPIS

Our final Framework and Approach (F&A) paper for Victorian distributors outlined that we will apply the latest version of STPIS (version 2.0) to AusNet Services for the next regulatory control period and we will:

- set revenue at risk at ± 5.0 per cent
- segment the network according to the urban, short and long rural feeder categories
- apply the System Average Interruption Duration Index (SAIDI), System Average Interruption Frequency Index (SAIFI), Momentary Average Interruption Frequency Index (MAIFI) and customer service (telephone answering) parameters
- set performance targets based on the distributor's average performance over the past five regulatory control period years
- apply the method in the STPIS for excluding specific events from the calculation of annual performance and performance targets
- apply the method and values of customer reliability (VCR) as indicated in the Australian Energy Market Operator's 2014 Value of Customer Reliability Review final report, unless a more up-to-date value is available
- apply STPIS 2.0 if the revised scheme is completed on time for the Victorian distributors revenue determination

[1] AER, *Electricity distribution network service providers—service target performance incentive scheme version 2.0*, November 2018. (AER, *STPIS v2.0*, November 2018).

- not apply the guaranteed service level (GSL) component of the STIPS, as the Victorian distributors remain subject to a jurisdictional GSL scheme.[2]

10.1 Draft decision

Our draft decision is to apply the STPIS 2.0 to AusNet Services for the 2021–26 regulatory control period.

We have taken into account AusNet Services' revenue proposal, submissions raised by stakeholders and our F&A for Victorian distributors in reaching our draft decision.[3] Our response to the matters raised by AusNet Services and stakeholders about the application of STPIS are discussed below.

Table 10.1 and Table 10.2 present our draft decision on the applicable incentive rates and performance targets that will apply to AusNet Services for the 2021–26 regulatory control period.

Table 10.1 Draft decision – STPIS incentive rates for AusNet Services for the 2021–26 regulatory control period

	Urban	Short rural	Long rural
SAIDI	0.0243	0.0231	0.0099
SAIFI	1.5003	1.4670	0.6922
MAIFI	0.1200	0.1174	0.0554

Source: AER analysis.

2 AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 76.

3 AusNet Services, *Electricity Distribution Price Review 2022–26 Part III*, January 2020, p. 239.

Table 10.2 Draft decision – STPIS reliability targets for AusNet Services for the 2021–26 regulatory control period

	Value
Urban	
SAIDI	76.748
SAIFI	0.828
MAIFI	2.696
Short rural	
SAIDI	188.097
SAIFI	1.977
MAIFI	5.758
Long rural	
SAIDI	270.869
SAIFI	2.582
MAIFI	10.557

Source: AER analysis.

10.2 AusNet Services' proposal

AusNet Services' revenue proposal accepted our F&A on how STPIS will apply. AusNet Services' however opted to apply our Customer Service Incentive Scheme (CSIS) instead of the STPIS telephone answering parameter.[4]

10.3 Assessment approach

We are required to make a decision on how the STPIS is to apply to AusNet Services under the NER.[5] When making a distribution determination, the scheme require us to determine all performance targets, incentive rates, revenue at risk and other parameters under the scheme that will apply to the distributor.[6]

4 AusNet Services, *Electricity Distribution Price Review 2022–26 Part III*, January 2020, p. 239.

5 NER, cl. 6.12.1(a).

6 AER, *STPIS*, November 2018, cl. 2.1(d).

10.3.1 Interrelationships

We must take into account any other incentives available to the distributor under the NER or relevant distribution determination in implementing the STPIS.[7] One of the objectives of the STPIS is to ensure that the incentives are sufficient to offset any financial incentives the distributor may have to reduce costs at the expense of service levels. For the 2021–26 regulatory control period, the STPIS will interact with the Capital Expenditure Sharing Scheme (CESS) and the operating expenditure (opex) Efficiency Benefit Sharing Scheme (EBSS).

The reward and penalty mechanism, under the STPIS (the incentive rates) are determined based on the average customer value for the improvement, or otherwise, to supply reliability (the VCR). This is aimed at ensuring that the distributor's operational and investment strategies are consistent with customers' value for the services that are offered to them.

Our capital expenditure (capex) and opex allowances are set, to reasonably reflect the expenditures required by a prudent and efficient business to achieve the capex and opex objectives. These include complying with all applicable regulatory obligations and requirements and, in the absence of such obligations, maintaining quality, reliability, and security of supply outcomes.

The STPIS provides an incentive for distributors to invest in further reliability improvements (via additional STPIS rewards) where customers are willing to pay for it. Conversely, the STPIS penalises distributors where they let reliability deteriorate. Importantly, the distributor will only receive a financial reward after actual improvements are delivered to the customers.

In conjunction with CESS and EBSS, the STPIS will ensure that:

- any additional investments to improve reliability are based on prudent economic decisions
- any reduction in capex and opex are achieved efficiently, rather than at the expense of service levels to customers.

10.4 Reasons for draft decision

We will apply STPIS 2.0 to AusNet Services in the next regulatory control period. This approach is consistent with our F&A and recent determinations for SA Power Networks, Ergon Energy and Energex.[8] The following section sets out our detailed consideration on applying the STPIS to AusNet Services for the 2021–26 regulatory control period.

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[7] NER, cl. 6.6.2(b)(3)(iv).

[8] AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 76.

10.4.1 Revenue at risk

Revenue at risk, caps the potential reward and penalty for AusNet Services under the STPIS. We consider an incentive of ± 5.0 per cent of the annual forecast revenue is appropriate for AusNet Services because it has demonstrated strong reliability performance; hence, a ± 5.0 per cent limit is a good balance between the incentives to maintain reliability versus the price impact to customers funding the reliability outcomes.

10.4.2 Reliability of supply component

Applicable components and parameters

We will apply the unplanned SAIDI, unplanned SAIFI and unplanned MAIFI parameters under the reliability of supply component to AusNet Services' feeder segments for the 2021–26 regulatory control period. Unplanned SAIDI measures the sum of the duration of each unplanned sustained customer interruption (in minutes) divided by the total number of distribution customers. Unplanned SAIFI measures the total number of unplanned sustained customer interruptions divided by the total number of distribution customers. Unplanned MAIFI measures the total momentary interruptions divided by the total number of distribution customers.[9]

Exclusions

The STPIS allows certain events to be excluded from the calculation of the S-factor revenue adjustment. These exclusions include the events specified in the STPIS, such as the effects of transmission network outages and other upstream events. They also exclude the effects of extreme weather events that have the potential to significantly affect AusNet Services' underlying STPIS performance.[10]

We accept AusNet Services' proposal to calculate the major event day (MED) threshold using the 2.8 beta method in accordance with our F&A and scheme.[11]

Performance targets

The STPIS specifies that the performance targets should be based on the average performance over the past five regulatory control years. It also states that the performance targets must be modified for any reliability improvements completed or planned where:

- the planned reliability improvements are included in the expenditure program proposed by the network service provider and

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9 Sustained interruption means supply interruption longer than three minutes. Momentary interruptions are those supply interruptions lasting less than three minutes.

10 AER, *STPIS v2.0*, November 2018, cl. 3.3, 5.3 and 6.4.

11 AusNet Services, *Electricity Distribution Price Review 2022–26 Part III*, January 2020, p. 239.

- it is expected to result in a material improvement in supply reliability.[12]

AusNet Services' revenue proposal has no reliability improvement capex and therefore no adjustments to its reliability targets are required.[13]

Our calculated performance targets for AusNet Services for the 2021–26 regulatory control period are presented in Table 10.2. These performance targets have been calculated using revised STPIS 2.0 historical data submitted by AusNet Services.[14]

Stakeholders should be aware that published historical reliability performance data is not comparable to the data submitted in AusNet Services' revenue proposal. This is due to a change of the definition of sustained interruptions from longer than one minute to three minutes. This change was recommended by the Australian Energy Market Commission (AEMC) and adopted in our Distribution Reliability Measures Guidelines and STPIS 2.0.[15]

Submissions

The submission from the Victorian Community Organisations commented that:[16]

> - As the STPIS targets are set each regulatory control period based on performance in the current period. Effectively, this means there is a significant time period between when the reliability measure was achieved and when the measure is used to generate the reliability targets in the next period. This allows the impacts of the opex and capex programs to generate the improved reliability in the next period, enhancing the likelihood that a STPIS bonus will be generated.
> - To overcome this shortcoming, the sponsors consider that the STPIS targets should be refined on an annual basis (just like the EBSS operates) so that the targets are set on a continuing basis. This can be readily achieved so that the STPIS targets in any one year are based on the average of the previous 3- or 4-year actual outcomes on a rolling basis.
> - As with the CESS, constraining the STPIS to a single regulatory control period is generating a bias in the distributors gaining a benefit under the STPIS at expense of consumers.

Under the NER, our capex and opex allowances are intended to enable a prudent and efficient distributor to maintain the existing supply reliability; but not for the improvement of reliability. The mechanics of our capex and opex forecasts are detailed in the Attachment 5 – Capital expenditure and Attachment 6 – Operating expenditure of this draft decision.

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12 AER, *STPIS v2.0*, November 2018, cl. 3.2.1(a)(1A).

13 AusNet Services, *Electricity Distribution Price Review 2022–26 Part III*, January 2020, p. 239.

14 AusNet Services, *Electricity Distribution Price Review 2022–26 Part III*, January 2020, p. 239.

15 AEMC*, Review of Distribution Reliability Measures, Final Report*, September 2014.

16 Victorian Community Organisation, *2021–26 Victorian EDPR Joint submission from Victorian community organisations – summary document*, May 2020, p. 71.

The purpose of STPIS is to ensure that distributors' cost reduction attempts are effective and not at the expense of decreasing the reliability of supply to customers. A distributor can only keep its reward under STPIS if the reliability improvement is retained in subsequent regulatory control periods. If the improvement is not maintained, the distributor will need to return the earlier reward to the customers.

Hence, a distributor can only earn a reward for reliability improvement results once. Customers however, receive on going benefits from the earlier reliability improvement because the performance targets are increased to that level in the next regulatory control period—for the next five years in the new the regulatory control period.

We believe that changing the current method to a moving average method to determine the performance target would not materially affect the outcome. This is because it will take ten years to account for all the outcomes of a regulatory control period for both methods—in other words, the performance outcome of the last year of one period will be included in the performance target of the last year of the ensuring period.

To implement the proposed changes, a complete redesign of the scheme will be required, including altering the methodology to calculate the incentive rates—in order to achieve a balanced incentive to take into account of the effect on EBSS and CESS. We also note the description of EBSS does not reflect how the EBSS actually operates.

Further, we are unable to modify the application of the scheme nor make fundamental changes to the scheme design in a distribution determination. We will welcome submissions on the scheme's design when we next review the STPIS.

The Victorian Community Organisation's submission also outlined that the scheme should also take into account the customer's willingness to pay to maintain/improve reliability. As stated above, the STPIS accounts for customer's appetite to pay for energy reliability by using latest VCR. For this draft decision, we have applied the latest VCR that were published in our December 2019 study.[17]

Adjusting the performance targets for one-off transitional events – Victorian bushfire event 2019–20

In 2019–20 catastrophic bushfires caused substantial damage to electricity infrastructure including power lines and other assets in parts of Victoria. A significant number of customers lost power supply for lengthy time periods due to damages to electricity infrastructure, limitation of access for repair works or load shedding under the direction of fire authorities.

[17] AER, *Values of Customer Reliability Final report on VCR values,* December 2019.

Under STPIS 1.0, the two peak days of the event in Victoria (30 and 31 December 2019) were classified as MED for exclusions. However, there were other days where the state and federal emergency services ordered AusNet Services to load shed. Therefore supply was not restored to customers as quickly as would have otherwise been the case.

Under STPIS 1.0 load shedding or curtailment directed by state and emergency services cannot be excluded from the STPIS calculation. However, these supply interruptions are excluded from the scheme under STPIS 2.0 in recognition that these events are outside the control of the distributors and recommended by the AEMC.[18]

One of the options to address this issue is for AusNet Services to apply to suspend the scheme. Alternately, this matter could be addressed under Clause 2.6 of STPIS 2.0, where the we can decide on the appropriateness of the arrangement to address a transitional issue on the basis of the:

1. materiality of the issue, and
2. reasonableness and fairness to the DNSP and customers.[19]

We consider that suspending the scheme is not in the best interest of consumers and is administratively complex. A suspension of the scheme would mean that—depending on the context of a suspension—potentially all outages during the suspension dates are not counted for STPIS purposes. This will be unfair to consumers.

A pragmatic approach is to include those supply interruptions due to directions from fire authorities when setting AusNet Services' targets for the 2021–26 regulatory control period under the STPIS 2.0 transitional provision. That is, AusNet Services' targets for the next regulatory control period will be set higher than it should be because the above events were not excluded.

The effects of the above one-off event will result in a one-off financial penalty to AusNet Services in the current regulatory control period and also a relevant adjustment to the performance targets for the next regulatory control period. When conditions return to normal in the next regulatory control period, AusNet Services will receive an opposite cash flow to reverse the earlier one-off penalty. The net effect is that AusNet Services only suffers the financing cost for the initial penalty. We and AusNet Services have agreed that applying this method is in the best interest of consumers.[20]

10.4.3 Customer service component

The STPIS customer service target parameter will not apply to AusNet Services in the next regulatory control period because the distributor has opted to apply our CSIS.

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[18] AEMC, *Review of Distribution Reliability Measures, Final Report*, 5 September 2014.

[19] Under clause 2.7 of version 1.0 of the STPIS for those supply interruptions due to the directions of fire authorities.

[20] AER, Information request #11 re: AusNet Services' STPIS adjustments for recent bush fire event, 24 April 2020; AusNet Services, Response to AER Information request #11, 12 May 2020.

A submission from the AER's Consumer Challenge Panel (CCP17) outlined the importance of telephone answering as a crucial service for many consumers. As such, we consider that AusNet Services should continue to report on the telephone answering parameter in the next regulatory control period for transparency purposes.[21]

CCP17's submission commented that both the STPIS and the proposed CSIS appear to focus on unplanned outages. Therefore, it advises us to examine the correlation between unplanned outage duration and customer satisfaction with unplanned outages when these schemes are combined. We note this submission and will explore this issue when we next review the scheme.[22]

10.4.4 Incentive rates

The incentive rates applicable to AusNet Services for the reliability of supply performance parameters have been calculated in accordance STPIS 2.0 and our VCR published in December 2019.

Our draft decision on AusNet Services' incentive rates are at Table 10.1.[23]

10.4.5 Value of customer reliability to calculate the incentive rates

Our F&A stated that we will apply the latest VCR in the distribution determination to calculate AusNet Services' incentive rates. For this draft decision, we have calculated AusNet Services' incentive rates using our Values of Customer Reliability Review published in December 2019.[24]

The VCR for network segments outlined in Table 10.3 were applied to calculate AusNet Services' incentives rates for the 2021–26 regulatory control period.

Table 10.3 Value of customer reliability ($/MWh)

	Urban	Short rural	Long rural
VCR	41,210	41,210	41,210

Source: AER, *Value of customer reliability review, final report*, December 2019, p. 17 and 71.

Note: VCR has been escalated to the December 2019 quarter.

21 AER Consumer Challenge Panel, *CCP17 Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*, 10 June 2020, p. 36.

22 AER Consumer Challenge Panel, *CCP17 Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*, 10 June 2020, p. 36.

23 AER, *STPIS*, November 2009, cl 5.3.2(a) and 3.2.2 and using the formulae provided as appendix B of the STPIS 2.0.

24 AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 76.

10.5 Transitional arrangements for the STPIS

The STPIS operates as part of the building block determination and is applied via the control mechanism. Through the S-factor component of the STPIS, distributors are penalised or rewarded for diminished or improved service performance compared to predetermined targets. Distributors are either rewarded or penalised via network charges two years after the end of each regulatory year as audited performance data is only available after the regulatory year is completed—hence, the earliest time the S-factor can apply is the year following audited performance data availability.

Consequently, the S-factor outcomes of 2019 and 2020 will apply to prices in the 2021 and 2022 regulatory control years respectively.

A key amendment under STPIS 2.0 was to simplify the scheme by specifying STPIS outcomes as a fixed monetary amount, rather than as a percentage adjustment to the maximum allowable revenue as set out in STPIS 2.0 Appendix C.[25]

To transition to STPIS 2.0, the S-factor outcomes for 2019, 2020 and the extension period will be converted to a dollar value before being applied in the price control formula in the next regulatory control period. Please refer to Attachment 14 – Control mechanisms of the draft decision for details

We consulted with Victorian distributors and received no submissions on our proposed transition to STPIS 2.0.[26] We consider as a principle, any STPIS outcome reward or penalty should be revenue neutral under either STPIS 1.0 or STPIS 2.0. Nonetheless, an earlier transition to STPIS 2.0 will likely provide more clarity and certainty to Victorian distributors.

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[25] Adjustments to allowed revenue, of STPIS 2.0; Appendix C also sets out the S-factor calculation formula and the operation of the S-bank mechanism under this approach.

[26] AER, *Email to regulatory managers - Communication with Victorian distributors regarding the application of 2019 STPIS outcomes to the 2021–22 pricing proposals, 17, 29 June, 2020.*

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
AEMC	Australian Energy Market Commission
capex	capital expenditure
CCP17	AER's Consumer Challenge Panel
CESS	Capital Expenditure Sharing Scheme
CSIS	Customer Service Incentive Scheme
distributor	distribution network service provider
EBSS	Efficiency Benefit Sharing Scheme
F&A	framework and approach
GSL	guaranteed service level
MAIFI	Momentary Average Interruption Frequency Index
MED	major day events
NER	national electricity rules
opex	operating expenditure
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
STPIS	Service Target Performance Incentive Scheme
VCR	values of customer reliability