



**DRAFT DECISION**  
**TasNetworks distribution**  
**determination**  
**2017–18 to 2018–19**

**Attachment 11 – Service target**  
**performance incentive scheme**

September 2016

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## Note

This attachment forms part of the AER's draft decision on TasNetworks' distribution determination for 2017–19. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

Attachment 13 – Classification of services

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Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for Electricity Distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

# 11 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 how we will apply the STPIS to TasNetworks for the 2017–19 regulatory control period.

## AER's service target performance incentive scheme

We published the current version of our national STPIS in November 2009.<sup>1</sup> The STPIS is intended to balance incentives to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to distributors to maintain and improve service performance where customers are willing to pay for these improvements.

### 11.1 Draft decision

In accordance with our framework and approach (F&A) position on STPIS,<sup>2</sup> our draft decision is to apply the STPIS to TasNetworks for the 2017–19 in the following manner:

- set revenue at risk for TasNetworks at the range  $\pm 5.0$  per cent
- segment TasNetworks' network according to feeder categories:
  - critical infrastructure
  - high density commercial
  - urban
  - high density rural
  - low density rural
- apply reliability of supply parameters of:
  - system average interruption duration index (SAIDI)
  - system average interruption frequency index (SAIFI)
  - customer service (telephone answering)
- set performance targets based on TasNetworks' average performance over the past five regulatory years

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<sup>1</sup> AER, *Electricity distribution network service providers—service target performance incentive scheme*, November 2009. (AER, *STPIS*, November 2009).

<sup>2</sup> AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2017*, July 2015, p. 15.

- apply the methodology indicated in the national STPIS for excluding specific events from the calculation of annual performance targets
- apply the methodology and value of customer reliability (VCR) values to the calculation of incentive rates using the latest VCR for Tasmania.

In making our draft decision on the STPIS, we have taken into account our F&A, TasNetworks' regulatory proposal, our information requests to TasNetworks and submissions raised by stakeholders.<sup>3</sup> Our responses to the matters raised by TasNetworks and stakeholders about the application of the STPIS are discussed in this draft decision.

Table 11-1 and Table 11-2 present our draft decision on the applicable incentive rates and targets that will be applied to TasNetworks' STPIS for the 2017–19 regulatory period. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.<sup>4</sup>

**Table 11-1 Draft decision—STPIS incentive rates for TasNetworks for the 2017–19 regulatory period**

	Critical Infrastructure	High Density Commercial	Urban	High Density Rural	Low Density Rural
SAIDI	0.0031	0.0034	0.0362	0.0092	0.0125
SAIFI	0.2258	0.2586	3.0036	0.9495	1.7290

Source: AER analysis.

**Table 11-2 Draft decision—STPIS reliability targets for TasNetworks for the 2017–19 regulatory period**

	value
<b>Critical Infrastructure</b>	
SAIDI	23.900
SAIFI	0.293
<b>High Density Commercial</b>	
SAIDI	26.068

<sup>3</sup> TasNetworks, *Tasmanian Distribution Regulatory Proposal, Regulatory Control Period 1 July 2017 to 30 June 2019*, 29 January 2016, pp. 125–126; TasNetworks, *TN Response AER Request IR004-STPIS*, 17 May 2016; TasNetworks, *TN Response AER Request IR004-STPIS*, 17 June 2016; TasNetworks, *TN Response AER Request IR004-STPIS*, 15 July 2016.

<sup>4</sup> AER, *STPIS*, November 2009, cl. 5.3.2(a).

SAIFI	0.303
<b>Urban</b>	
SAIDI	82.589
SAIFI	1.027
<b>High Density Rural</b>	
SAIDI	242.015
SAIFI	2.548
<b>Low Density Rural</b>	
SAIDI	430.087
SAIFI	3.378
<i>Telephone answering</i>	
<b>Percentage of calls will be answered within 30 seconds</b>	78.70

Source: AER analysis.

## 11.2 Our framework and approach paper

We are required to set out our likely approach on how to apply our STPIS in our F&A.<sup>5</sup> Our final F&A for TasNetworks proposed to apply our national STPIS but not apply the guarantee service level (GSL) component.<sup>6</sup> It also proposed to apply the latest values for VCR in the distribution determination.<sup>7</sup>

## 11.3 TasNetworks' proposal

TasNetworks proposed to adopt the approach specified in the F&A, except for the level of revenue at risk.<sup>8</sup> TasNetworks proposed to lower the revenue at risk to  $\pm 2.5$  percent rather than the standard scheme design of  $\pm 5.0$  per cent, on the basis of:<sup>9</sup>

- customers do not want to pay for improvements in reliability

<sup>5</sup> NER, cl 6.8.1(b)(2)(iii), .

<sup>6</sup> AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2017*, July 2015, p. 15.

<sup>7</sup> Values determined from the most recent Australian Energy Market Operator (AEMO) review of VCR values.

<sup>8</sup> TasNetworks, *Tasmanian Distribution Regulatory Proposal, Regulatory Control Period 1 July 2017 to 30 June 2019*, 29 January 2016, p. 125.

<sup>9</sup> TasNetworks, *Tasmanian Distribution Regulatory Proposal, Regulatory Control Period 1 July 2017 to 30 June 2019*, 29 January 2016, pp. 125–126.

- customers support measures to reduce annual price volatility
- the AER's proposed rate of revenue at risk in relation to distribution service performance is five times greater than those under the transmission STPIS. As TasNetworks is an integrated transmission and distribution business, the interaction between the two schemes needs to be reconsidered
- the regulatory period is only two years in duration
- the AER recently accepted Energex's and Ergon Energy's proposal to cap revenue at risk under the STPIS at  $\pm 2.0$  per cent.<sup>10</sup>

Section 11.7 below sets out our consideration of these matters.

## 11.4 Assessment approach

We are required to make a decision on how the STPIS is to apply to TasNetworks.<sup>11</sup> When making a distribution determination, the STPIS requires us to determine all performance targets, incentive rates, revenue at risk and other parameters under the scheme.<sup>12</sup>

We outlined our proposed approach to, and reasons for, the application of the STPIS in our F&A for TasNetworks. Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by TasNetworks and by stakeholders.

### 11.4.1 Interrelationships

In implementing the STPIS we must take into account any other incentives available to the distributor under the NER or relevant distribution determination.<sup>13</sup> 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 2017–19 regulatory control period, the STPIS will interact with the Capital Expenditure Sharing Scheme (CESS) and the opex Expenditure Benefit Sharing Scheme (EBSS).<sup>14</sup>

The reward and penalty mechanism, under 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.

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<sup>10</sup> AER, *Final decision Ergon Energy distribution determination 2015–16 to 2019–20*, October 2015; AER, *Final decision Energex distribution determination 2015–16 to 2019–20*, October 2015.

<sup>11</sup> NER, cl. 6.12.1(a).

<sup>12</sup> AER, *STPIS*, November 2009, cl. 2.1(d).

<sup>13</sup> NER, cl. 6.6.2(b)(3)(iv).

<sup>14</sup> AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2017*, July 2015, p. 15.

Our 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 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
- reductions in capex and opex are achieved efficiently, rather than at the expense of service levels to customers.

## 11.5 Reasons for draft decision

The following section sets out our detailed consideration on:

- applying the STPIS to TasNetworks for the 2017–19 regulatory control period
- transitional matters in applying the STPIS between regulatory control periods.

## 11.6 Applying the STPIS

We will apply the STPIS in accordance with our F&A paper to TasNetworks.<sup>15</sup> We have not accepted TasNetworks' proposal to depart from our F&A in applying the STPIS via adopting a lower revenue at risk.

### 11.6.1 Revenue at risk

TasNetworks' revenue at risk for each regulatory year of the 2017–19 regulatory control period will be capped at  $\pm 5.0$  per cent as per the scheme standard. This was also the revenue at risk applied to TasNetworks in the current regulatory period.

For the reasons outlined in section 11.7, we have not accepted TasNetworks' proposal to depart from our F&A position on the STPIS by modifying the revenue at risk.<sup>16</sup>

Revenue at risk, caps the potential reward and penalty for TasNetworks under the STPIS. We consider an incentive of  $\pm 5.0$  per cent of the annual allowable revenue would result in the right balance with the operation of the EBSS and CESS to ensure

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<sup>15</sup> AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2017*, July 2015, p. 15.

<sup>16</sup> TasNetworks, *Tasmanian Distribution Regulatory Proposal, Regulatory Control Period 1 July 2017 to 30 June 2019*, 29 January 2016, pp. 125–126.

that the incentives to reduce costs will not be delivered at the expense of service levels to customers—hence meeting the long term interest of consumers.

## 11.6.2 Reliability of supply component

### Applicable components and parameters

We will apply unplanned SAIDI and unplanned SAIFI parameters under the reliability of supply component to TasNetworks' feeders for the 2017–19. 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.

### 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 TasNetworks' underlying STPIS performance.

TasNetworks proposed to calculate the major event day (MED) threshold using the 2.5 beta method in accordance our F&A. Since we have not received any submissions that we should depart from our F&A, we accept TasNetworks' proposal.

### Performance targets

The STPIS specifies that the performance targets should be based on the average performance over the past five regulatory 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 expected to result in a material improvement in supply reliability.<sup>17</sup>

Subsequent to its regulatory proposal, TasNetworks advised that it has since identified data accuracy issues with the historical performance data previously provided to the AER in the relevant regulatory information notices (RINs).<sup>18</sup> However, TasNetworks have not provided any specific information in this regard. We consider that any attempt to modify historical RIN data must be subject to the same level of scrutiny as the standard RIN reporting process and must be independently verified. Hence, for the purpose of this draft decision, we applied TasNetworks' originally reported historical

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<sup>17</sup> AER, *STPIS*, November 2009, cl. 3.2.1.

<sup>18</sup> TasNetworks, Supplementary information to *AER information request – TasNetworks Distribution – IR#010 – STPIS*, 15 July 2016.

performance to set the performance targets as a placeholder. We consider that TasNetworks should clarify this matter in its revised proposal. This will provide transparency to the process as well as enabling TasNetworks adequate time to submit properly verified data to us.

Since TasNetworks' capex for the current and next regulatory control period do not contain reliability improvement expenditure, we have not made adjustments to the targets, which are based on the relevant historical average levels.

We received no submissions from stakeholders regarding the application of TasNetworks performance targets.

Our calculated performance targets for TasNetworks for the 2017–19 regulatory control period are presented in the table below.

**Table 11-3 Draft decision—STPIS reliability targets for TasNetworks for the 2017–19 regulatory period**

	value
<b>Critical Infrastructure</b>	
SAIDI	23.900
SAIFI	0.293
<b>High Density Commercial</b>	
SAIDI	26.068
SAIFI	0.303
<b>Urban</b>	
SAIDI	82.589
SAIFI	1.027
<b>High Density Rural</b>	
SAIDI	242.015
SAIFI	2.548
<b>Low Density Rural</b>	
SAIDI	430.087
SAIFI	3.378
<i>Telephone answering</i>	
<b>Percentage of calls will be answered within 30 seconds</b>	78.70

Source: AER analysis.

### 11.6.3 Customer service component

The STPIS customer service target applicable to TasNetworks is telephone response measured as the number of telephone calls answered within 30 seconds. This measure is referred to as the telephone Grade of Service (GOS).

We accept TasNetworks' customer service targets as it has applied a 5 year's historical average to derived them for the next regulatory control period. This is consistent with our national STPIS.<sup>19</sup>

We received no submissions from stakeholders regarding the application of TasNetworks customer service performance target.

### 11.6.4 Incentive rates

The incentive rates applicable to TasNetworks for the reliability of supply performance parameters of the STPIS have been calculated in accordance with clause 3.2.2 and using the formulae provided as appendix B of the National STPIS. Our draft decision of TasNetworks' incentive rates are at Table 11-4. The incentive rate for the customer service component will be  $-0.040$  per cent per unit of the telephone answering parameter.<sup>20</sup>

**Table 11-4 Draft decision—STPIS incentive rates for TasNetworks for the 2017–19 regulatory period**

	Critical Infrastructure	High Density Commercial	Urban	High Density Rural	Low Density Rural
SAIDI	0.0031	0.0034	0.0362	0.0092	0.0125
SAIFI	0.2258	0.2586	3.0036	0.9495	1.7290

Source: AER analysis

## 11.7 Reasons for not departing from our F&A on revenue at risk

### 11.7.1 Level of revenue at risk

Revenue at risk, caps the potential reward and penalty for TasNetworks under the STPIS. TasNetworks proposed to lower the revenue at risk to  $\pm 2.5$  per cent rather than the standard scheme design of  $\pm 5.0$  per cent on the basis of:

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<sup>19</sup> AER, *STPIS*, November 2009, cl. 5.3.1(a).

<sup>20</sup> AER, *STPIS*, November 2009, cl. 5.3.2(a).

- customers do not want to pay for improvements in reliability
- customers support measures to reduce annual price volatility
- the AER's proposed rate of revenue at risk in relation to distribution service performance is five times greater than the incentive for transmission services. As TasNetworks is an integrated transmission and distribution business, the interaction between the two schemes needs to be reconsidered.
- the regulatory period is only two years in duration
- the AER has recently accepted Energex's and Ergon Energy's proposal to cap revenue at risk under the STPIS at  $\pm 2.0$  per cent.<sup>21</sup>

Clause 2.5(b) of the STPIS provides that a DNSP may propose a different level of revenue at risk where this would satisfy the objectives of the scheme. We determine that the revenue at risk should remain  $\pm 5.0$  per cent of annual allowable revenue because:

- Due to the two year lag nature of the STPIS between the actual service performance and the s-factor adjustment of annual revenue, the network tariffs of the forthcoming 2017–19 regulatory years will be subject to SPTIS adjustments based on TasNetworks' actual performance of the 2015/16 and 2016/17 regulatory years of the current regulatory control period—which is subject to the scheme standard  $\pm 5.0$  per cent cap. A change to the revenue cap for the forthcoming two year regulatory control period will have no impact on the network tariff for the period.
- TasNetworks is currently subject to the standard  $\pm 5.0$  per cent revenue at risk cap of the distribution STPIS. Our expenditure incentive schemes encourage a business to pursue efficiency improvements in opex and capex.<sup>22</sup> The STPIS incentivises a business to maintain or improve the quality of its services. Our expenditure incentives are balanced with STPIS incentives so a business does not make expenditure savings at the expense of service quality. A reduction in the revenue at risk may off-set this balance and may result in outcomes not in the interest of consumers.
- We recognise that TasNetworks' customers may not want to pay for improvements in reliability but they still want reliability to be maintained. The incentive rates under the scheme for the forthcoming regulatory control period are based on the latest VCR survey findings. Hence, we consider that the scheme incentive mechanism is reflective of customers' value in terms of reliability outcomes. Further, we consider that the potential for deterioration in service performance will increase if revenue at risk is reduced under the STPIS, given that the incentive to reduce expenditure

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<sup>21</sup> AER, *Final decision Ergon Energy distribution determination 2015–16 to 2019–20*, October 2015; AER, *Final decision Energex distribution determination 2015–16 to 2019–20*, October 2015.

<sup>22</sup> These are the capital expenditure sharing scheme (CESS) for capex, and the efficiency benefit sharing scheme (EBSS) for opex.

under EBSS and CESS could outweigh the incentive to maintain service performance under STPIS.

- Regarding the price volatility issue raised by TasNetworks, our national STPIS includes a banking mechanism to minimise price shocks. Under this mechanism, TasNetworks may delay a portion of the revenue increment or decrement arising from the STPIS to limit price volatility for customers.<sup>23</sup> To date, applying revenue at risk of  $\pm 5.0$  per cent resulted in an average net impact to the revenue due to STPIS of around 1 per cent. Given that distribution network charges accounts around 40 per cent of the final bill, this translates less than 0.5 per cent of the total final electricity bill for an average typical customer.
- The latest AEMO VCR values, which is about 40 per cent less than the historical value under the standard scheme values, also minimises the effects of a price shock to customers. The lower VCR will flow across to TasNetworks' incentive rates thereby lowering reward/penalty rates per each event and each minute of supply interruptions.
- Regarding the interaction between the transmission STPIS and the distribution STPIS schemes, we do not consider that these two schemes should be linked together; because the two schemes have different purpose and focus in both design and operation. The distribution STPIS focuses on direct customer impacts in terms of availability of supply; whereas the transmission STPIS focuses on the impact on the wholesales market. For example, 90 per cent of the distribution scheme's incentive mechanism is on the availability of supply and is measured based upon the impact on each customer irrespective of each customer's size.<sup>24</sup> By comparison, only eight per cent of the incentive mechanism under the transmission scheme relates to loss of supply events; which is measured based on the impact on the total energy sales of the TNSP (rather than the number of end users—in other words a one minute outage at the Bell Bay Aluminium smelter (when operating at full capacity) is equivalent to one minute outages of about 70,000 average Tasmanian retail customers).<sup>25</sup>

AusNet Services in Victoria also has an integrated distribution and transmission services and is subject to both the transmission and distribution SPTIS. AusNet Services currently has a scheme standard  $\pm 5.0$  per cent revenue at risk cap under the distribution STPIS. It has not raised concerns about different revenue caps under the different STPIS schemes for distribution and transmission.

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<sup>23</sup> AER, *Electricity distribution network service providers – service target performance incentive scheme*, 1 November 2009, clauses 2.5(d) and (e).

<sup>24</sup> Telephone service has  $\pm 0.5$  per cent cap of revenue at risk, among the  $\pm 5$  per cent cap of the total revenue at risk.

<sup>25</sup> Based on the statement contained in *Bell Bay Aluminium - Submission on TasNetworks' revised proposal - 6 February 2015*, that "as Tasmania's largest electricity consumer, the Bell Bay Smelter consumes more than 25% of the State's electricity demand."

- Our decision to apply lower revenue at risk for Queensland DNSPs was due to the NER that imposed 1 and 2 per cent of revenue at risk.<sup>26</sup> This was the first time we applied the scheme. We continued to apply  $\pm 2$  per cent of revenue at risk for the 2016–21 regulatory period given that no issue was raised against it.
- For TasNetworks, we determined that the revenue at risk should be  $\pm 5.0$  per cent for the 2012–17 regulatory period because it mitigated the risk of the scheme to TasNetworks. It also provided a stronger incentive for TasNetworks to at least maintain network reliability performance.<sup>27</sup>

We specifically consulted in the Issues Paper on TasNetworks' proposal to depart from the F&A position, for lowering the revenue at risk to  $\pm 2.5$  per cent.<sup>28</sup> Three submissions were received from the stakeholders, none of which supported TasNetworks' proposal on the basis that:<sup>29</sup>

- a revenue at risk of  $\pm 5.0$  per cent, together with the jurisdictional GSL, provides significant incentive to maintain and improve levels of reliability.<sup>30</sup>
- a reduction on the revenue at risk will change the balance of the suite of incentive schemes ( such as EBSS and CESS).<sup>31</sup>
- there should not be a lesser penalty for reduced reliability as consumers do not want to see cost savings achieved at the expense of service provision<sup>32</sup>
- the argument for greater price stability achieved through a lower revenue at risk does not hold because the implementation of other changes in the regulatory regime will have more significant volatility in pricing (such as a revenue cap and annual update of cost of debt).<sup>33</sup>

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<sup>26</sup> AER, *Final framework and approach paper Application of schemes, Energex and Ergon Energy 2010–15*, November 2008, PP. 17–18.

<sup>27</sup> AER, *Draft Distribution Determination Aurora Energy Pty Ltd 2012–13 to 2016–17*, November 2011, p. 274.

<sup>28</sup> AER, *TasNetworks electricity distribution regulatory proposal 2017–19, Issues Paper*, March 2016, p. 26.

<sup>29</sup> Tasmanian Council of Social Service, *Submission to the TasNetworks issues paper*, 28 April 2016, p. 2. CCP (David Headberry), *Submission to the AER, Response to the proposal from Tasmania's electricity distribution network service provider (TasNetworks - TND) for a revenue reset for the 2017–19 regulatory period*, 4 May 2016, p. 41. Tasmanian Small Business Council, *Submission to the TasNetworks issues paper*, May 2016, p. 37.

<sup>30</sup> Tasmanian Council of Social Service, *Submission to the TasNetworks issues paper*, 28 April 2016, p. 2.

<sup>31</sup> CCP (David Headberry), *Submission to the AER, Response to the proposal from Tasmania's electricity distribution network service provider (TasNetworks - TND) for a revenue reset for the 2017–19 regulatory period*, 4 May 2016, p. 41.

<sup>32</sup> Tasmanian Council of Social Service, *Submission to the TasNetworks issues paper*, 28 April 2016, p. 2; CCP (David Headberry), *Submission to the AER, Response to the proposal from Tasmania's electricity distribution network service provider (TasNetworks - TND) for a revenue reset for the 2017–19 regulatory period*, 4 May 2016, p. 41. Tasmanian Small Business Council, *Submission to the TasNetworks issues paper*, May 2016, p. 37.

<sup>33</sup> CCP (David Headberry), *Submission to the AER, Response to the proposal from Tasmania's electricity distribution network service provider (TasNetworks - TND) for a revenue reset for the 2017–19 regulatory period*, 4 May 2016, p. 41.

- further investigation is required to support the claim that revenue at risk could skew the application of the scheme between the transmission and distribution networks.<sup>34</sup>

We also note that Tasmanian Small Business Council submitted that the scheme should operate on a penalty only basis.<sup>35</sup> We are unable to depart from the standard scheme design and the F&A without a full review of the STPIS and its interaction with other incentive schemes.

## 11.8 Other considerations in applying the STPIS

### 11.8.1 Value of customer reliability to calculate the incentive rates

Our F&A paper stated that we will apply a latest value for VCR through the distribution determination in calculating TasNetworks' incentive rates.<sup>36</sup> TasNetworks provided energy usage information based on AEMO's load classification of residential, commercial, industry and agriculture. Hence, for this draft decision, we have calculated TasNetworks' VCR for the incentive rates by deriving it from its consumption data and AEMO's published segment VCR.

The VCR for network segments is outlined in Table 11-5. We have applied this VCR to calculate its incentives rates for 2017–19.

**Table 11-5 Value of customer reliability (\$/MWh)**

	Critical Infrastructure	High Density Commercial	Urban	High Density Rural	Low Density Rural
VCR	44,399.05	43,785.62	35,659.75	38,146.86	40,342.75

Source: AER analysis, and AEMO, *Value of customer reliability review, final report*, September 2014, p. 30. VCR values have been escalated to the June 2016 quarter and will be updated for the final decision.

## 11.9 Arrangements for the overlap between regulatory control periods

This section addresses the following transitional issues relating the STPIS:

- how we intend to adjust the S-factor between regulatory control periods
- how we intend to account for revenue increments or decrements resulting from the STPIS outcomes between regulatory control periods.

<sup>34</sup> Tasmanian Small Business Council, *Submission to the TasNetworks issues paper*, May 2016, p. 37.

<sup>35</sup> Tasmanian Small Business Council, *Submission to the TasNetworks issues paper*, May 2016, p. 37.

<sup>36</sup> AER, *STPIS*, November 2009.

### 11.9.1 Adjusting the S-factor between regulatory control periods

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 because audited performance data would only be 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 2015–16 and 2016–17 will apply to prices in the 2017–18 and 2018–19 regulatory years respectively.

The revenue at risk caps the risk of the STPIS to TasNetworks at  $\pm 5.0$  per cent of the annual allowable revenue. However, distributors may exceed this cap where there are increases or decreases to the amount of the annual allowable revenue that they can recover between regulatory control periods. The STPIS scheme accounts for the differences to the allowable revenue recoverable between regulatory control periods by making an adjustment to the "raw"<sup>37</sup> S-factor for the last and second last regulatory years of the current regulatory control period (which is applied in the first and second regulatory years of the next regulatory control period) by adjusting the raw S-factor value based on:

...the percentage change between the annual revenue requirement in the last regulatory year of the previous regulatory control period and the annual revenue requirement for first regulatory year of the next regulatory control period taken from the post-tax revenue model.<sup>38</sup>

Hence, the revenue at risk cap for the first two years of the next regulatory control period will be adjusted based on the approved revenue at risk cap of the previous regulatory control period.

### 11.9.2 Accounting for revenue increments decrements between regulatory periods

A distributor's performance in the last regulatory year of its regulatory control period will affect its revenue in the second regulatory year in the next regulatory control period.

For example, if a distributor has a regulatory control period of 5 regulatory years between 1 July 2007 and 30 June 2012, its performance in the 2011–12 financial year

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<sup>37</sup> "Raw" refers to the S-factor prior to any adjustments.

<sup>38</sup> AER, *STPIS*, November 2009, Appendix C, pp. 33–34.

will affect its revenues in the second regulatory year of the next regulatory control period (that is from 1 July 2014).<sup>39</sup>

The STPIS provides a mechanism to account for any step change in revenues (or prices), via  $X_0$ ,<sup>40</sup> from one regulatory control period to the next. For TasNetworks, the 'raw' S-factor calculated for the last and second last regulatory years of the regulatory control period (which is applied in the first and second regulatory years of the next regulatory control period) is adjusted in accordance with the following formula:<sup>41</sup>

$$S_t''' = \frac{S_t'}{1-X_0}$$

Where:

- $X_0 = \frac{AR_{2017-18} - AR_{2018-19}}{AR_{2017-18}}$
- $S_t'$  is the sum of the S-factors for all parameters, after application of the s-bank, as determined in equation (3) in the STPIS
- $AR_{2017-18}$  is TasNetworks' approved revenue in the 2017–18 pricing proposal
- $AR_{2018-19}$  is TasNetworks' allowable revenue in the final determination 2018–19.

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<sup>39</sup> AER, *STPIS*, November 2009, appendix C.

<sup>40</sup> Defined as the percentage change between the annual revenue requirement in the last regulatory year of the previous regulatory control period and the annual revenue requirement for first regulatory year of the next regulatory control period taken from the post-tax revenue model, AER, *STPIS*, November 2009, Appendix C, pp. 33–34.

<sup>41</sup> AER, *STPIS*, November 2009, Appendix C, pp. 33–34.