DRAFT DECISION

Energex
Distribution Determination
2020 to 2025

Attachment 10
Service target performance incentive scheme

October 2019

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 Energex for the 2020–25 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

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Attachment 10 – Service target performance incentive scheme

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Contents

Shortened forms

Shortened form	Extended form
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
F&A	framework and approach
GSL	guaranteed service level
NER or the rules	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	value of customer reliability

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 Energex for the 2020–25 regulatory control period.

AER's service target performance incentive scheme

We published the current version (version 2.0) of our national STPIS in October November 2018.[1] 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.

AER framework and approach to the application of STPIS

In the final Framework and Approach (F&A), we stated that we will continue to apply the distribution STPIS to Energex in the next regulatory control period. We proposed to:

- set revenue at risk at ± 2 per cent
- segment the network according to the CD, urban and short and long rural feeder categories
- apply the system average interruption duration index or SAIDI, system average interruption frequency index or SAIFI and customer service (telephone answering) parameters
- set performance targets based on Energex's average performance over the past five regulatory years
- apply the method in the STPIS for excluding specific events from the calculation of annual performance and performance targets
- apply the method and value of customer reliability (VCR) values as indicated in AEMO's 2014 Value of Customer Reliability Review final report.[2]

Our F&A also stated that the:

- Guaranteed service level (GSL) component will not apply to Energex if it remains subject to a jurisdictional GSL scheme.[3]

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

[2] AER, *Framework and approach for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020*, July 2018, p. 61.

- revised STPIS may apply to Energex in the next regulatory period if the review of the STPIS is completed on time.[4]

10.1 Draft decision

Our draft decision is to apply the STPIS version 2.0 as is to Energex for the 2020–25 regulatory control period. This is consistent with our F&A on the application of the STPIS in our 2020–25 determinations for Energy Queensland.

We have taken into account Energex's revenue proposal, submissions raised by stakeholders and the F&A in reaching our draft decision.[5] Our response to the matters raised by Energex 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 targets that will apply to Energex for the 2020–25 regulatory period. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.[6]

Table 10.1 Draft decision—STPIS incentive rates for Energex for the 2020–25 regulatory period

	CBD	Urban	Short rural
SAIDI	0.00474	0.07571	0.01802
SAIFI	0.21641	4.52346	1.22917

Source: AER analysis.

3 AER, *Framework and approach for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020*, July 2018, p. 61.

4 AER, *Framework and approach for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020*, July 2018, p. 61.

5 Energex, *Regulatory proposal, Application of Incentive Schemes 2020-25*, January 2019, pp. 14–15; .AER, *Framework and approach for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020*, July 2018, pp. 59–65.

6 AER, *STPIS*, November 2009, cl. 5.3.2(a).

Table 10.2 Draft decision—STPIS reliability targets for Energex for the 2020–25 regulatory period

	Value
CBD	
SAIDI	3.609
SAIFI	0.053
Urban	
SAIDI	56.620
SAIFI	0.632
Short rural	
SAIDI	127.944
SAIFI	1.251
Telephone answering	
Percentage of calls will be answered within 30 seconds	87.10

Source: AER analysis.

10.2 Energex's proposal

Energex's revenue proposal accepted our F&A on how STPIS will apply with the exception that the revenue at risk adjustment to reliability targets where the revenue at risk cap is breached. Energex proposed to apply a different methodology in to calculate the adjustment because it stated that the method under STPIS 2.0 is unclear. Our response to this issue is at section 10.5 of this draft decision.[7]

10.3 AER's assessment approach

We are required to make a decision on how the STPIS is to apply to Energex.[8] 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.[9]

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7 Energex, *Regulatory proposal, Application of Incentive Schemes 2020-25*, January 2019, pp. 14–15.

8 NER, cl. 6.12.1(a).

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

10.4 Interrelationships

In implementing the STPIS we must take into account any other incentives available to the distributor under the NER or relevant distribution determination.[10] 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 2020–25 regulatory 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 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.

10.5 Reasons for draft decision

We will apply the STPIS to Energex in accordance with our F&A.[11] The following section sets out our detailed consideration on applying the STPIS to Energex for the 2020–25 regulatory period.

10 NER, cl. 6.6.2(b)(3)(iv).

11 AER, *Framework and approach for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020,* July 2018, pp. 59–65.

10.5.1 Revenue at risk

Revenue at risk, caps the potential reward and penalty for Energex under the STPIS. As stated in the F&A, we consider an incentive of ± 2.0 per cent of the annual allowable revenue is appropriate for Energex because it has demonstrated strong reliability performance; hence, a ± 2.0 per cent limit is a good balance between the incentives to maintain reliability versus consumer price impact.

10.5.2 Reliability of supply component

Applicable components and parameters

We will apply unplanned SAIDI and unplanned SAIFI parameters under the reliability of supply component to Energex's feeders for the 2020–25. 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 Energex's underlying STPIS performance.

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

For the next regulatory period, this draft decision includes $22.6 million capex to improve the reliability of worst performing feeders.[13] Energex explained that:[14]

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

13 Energex, *Regulatory proposal Strategic Proposal Worst Performing Feeder 2020-25,* January 2019, p. ii.

14 Energex, *Regulatory proposal Strategic Proposal Worst Performing Feeder 2020-25*, January 2019, p. 2.

- The purpose of this expenditure is to improve the customer experience; but does not specifically aim to correct the feeder performance to become favourable against the applicable Minimum Service Standards limit.
- The improvement program does not aim to and will provide negligible performance improvement at the average system SAIDI and SAIFI index level.

We consider that the impact on reliability outcomes of these activities is small as this expenditure represents is less than 0.2 per cent of Energex's regulatory asset base. Further, the impact of this investment is essentially not material compared to the weather impact on historical performance and to meet a regulatory obligation. Since the STPIS only requires the performance targets to be modified by any reliability improvement planned for the next regulatory period where it is expected to result in a material improvement in supply reliability, we propose to set Energex's performance targets based on average performance over the past five regulatory years without modification.

We received no submissions from stakeholders regarding the application of Energex's performance targets.

Our calculated performance targets for Energex for the 2020–25 regulatory control period are presented in Table 10.2.

Adjusting the performance targets where past STPIS reward/penalty is capped by revenue at risk limit of the previous distribution determination

Under the STPIS, distributors can adjust their performance targets where the past performance exceeded the revenue at risk thresholds. Energex's regulatory proposal submitted that the method to calculate this adjustment under STPIS version 2.0 is unclear. Therefore, it proposed to depart from the STPIS formula and apply the approach used in our 2015–20 distribution determination.

We consider that the STPIS scheme document provides sufficient details to perform the calculations and must be adhered to. We applied the method outlined in our national STPIS to make the adjustments accordingly.

10.5.3 Customer service component

The STPIS customer service target applicable to Energex 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). The revenue at risk for the customer service component is capped at ± 0.2 per cent.

We received no submissions from stakeholders regarding the application of Energex's customer service performance target.

Our calculated performance targets for Energex for the 2020–25 regulatory control period are presented in Table 10.2.

Value of customer reliability to calculate the incentive rates

Our F&A stated that we will apply the latest value for VCR through the distribution determination in calculating Energex's incentive rates.[15] Energex provided energy usage information based on AEMO's load classification of residential, commercial, industry and agriculture. Hence, for this draft decision, we have calculated Energex's VCR for the incentive rates by deriving it from its consumption data and AEMO's published segment VCR.

The AER is currently conducting a review to determine the VCR values under rule 8.2 of the NER. We will be publishing the latest VCR values in December 2019. We consider that the latest VCR values should be used to set the incentive rates once available. Hence, we intend to use the latest VCR to be published by us in December 2019 in the final decision.

The VCR for network segments is outlined in Table 10.3. We have applied this VCR to calculate Energex's incentives rates for 2020–25.

Table 10.3 Value of customer reliability ($/MWh), as a place holder until the latest VCR value is published in December 2019

	CBD	Urban	Short rural
VCR	44,720.00	39,710.00	39,710.00

Source: AER analysis, and AEMO, *Value of customer reliability review, final report*, September 2014, p. 30. VCR values have been escalated to the June 2018 quarter and will be updated for the final decision.

10.5.4 Incentive rates

Based on the place holder VCR values above, the incentive rates applicable to Energex 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 at appendix B of the National STPIS v2.0. Our draft decision on Energex's incentive rates are at Table 10.1. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.[16]

[15] AER, *Framework and approach for Energex and Ergon Energy for the regulatory control period commencing 1 July 2020*, July 2018, p. 64.

[16] AER, *STPIS v2.0*, November 2018, cl. 5.3.2(a).