



DRAFT DECISION

Essential Energy Distribution Determination 2019 to 2024

Attachment 10 Service target performance incentive scheme

November 2018

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Essential Energy for the 2019–2024 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

Attachment 11 – Demand management incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

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Shortened forms

Shortened form	Extended form
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
capex	capital expenditure
CCP10	Consumer Challenge Panel (subpanel 10)
CESS	capital expenditure sharing scheme
EBSS	efficiency benefit sharing scheme
F&A	framework and approach
GSL	guaranteed service level
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	value of customer reliability

10 Service target performance incentive scheme

Under clauses 6.3.2(3) 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 Essential Energy (Essential) for the 2019–24 regulatory control period.

AER's service target performance incentive scheme

We published the current version of our national STPIS in November 2009.¹ 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 (F&A) to the application of STPIS

In the final F&A, we stated that we will continue to apply the distribution STPIS to Essential in the next regulatory control period. We proposed to:

- set revenue at risk at ± 5 per cent
- segment the network according to the CBD, urban, short rural and long rural feeder categories as applicable
- 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 Essential'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:

- GSL component will not apply to Essential if it remains subject to a jurisdictional GSL scheme.³

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

² AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59–65.

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

Given that the revised STPIS is not yet complete in time for this draft decision, we will apply the current version of the distribution STPIS (November 2009)⁵ to Essential for the 2019–24 regulatory period.

10.1 Draft decision

We will apply the STPIS to Essential for the 2019–24 regulatory control period. This is consistent with our F&A position on STPIS and determinations for NSW distributors.

We have taken into account Essential's revenue proposal, submissions raised by stakeholders and the F&A in reaching our draft decision.⁶ Our responses to the matters raised by Essential and stakeholders about the application of the 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 Essential for the 2019–24 regulatory period. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.⁷

Table 10-1 Draft decision—STPIS incentive rates for Essential Energy for the 2019–24 regulatory period

	Urban	Short rural	Long rural
SAIDI	0.0097	0.0297	0.0072
SAIFI	0.8198	3.5061	1.1602

Source: AER analysis.

³ AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59-65.

⁴ AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019 to 30 June 2024*, July 2017, p. 60.

⁵ AER, *Electricity distribution network service providers—service target performance incentive scheme*, November 2009. (AER, *STPIS*, November 2009).

⁶ Essential Energy, *Revenue Proposal Attachment 8.2: STPIS Approach Paper 2019-24 Regulatory Period*, April 2018, pp. 10–19; Consumer Challenge Panel (CCP10), *Submission on Essential Energy 2019-24 regulatory proposal*, 8 August 2018, pp. 1-7; AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59-65.

⁷ AER, *STPIS*, November 2009, cl. 5.3.2(a).

Table 10-2 Draft decision—STPIS reliability targets for Essential Energy for the 2019–24 regulatory period

	value
Urban	
SAIDI	69.098
SAIFI	0.844
Short rural	
SAIDI	204.015
SAIFI	1.876
Long rural	
SAIDI	449.593
SAIFI	3.021
Telephone answering	
Percentage of calls will be answered within 30 seconds	67.9%

Source: AER analysis.

10.2 Essential Energy’s proposal

Essential's revenue proposal accepted our F&A position on how the STPIS will apply with the following exceptions.⁸

Essential proposed that one of the AEMC’s recommended exclusion criteria for current STPIS review, "the load interruptions caused or extended by a direction from state or federal emergency services, provided that a fault in, or the operation of, the network did not cause, in whole or part, the event giving rise to the direction", should be adopted for Essential for the 2019-24 regulatory period.⁹

Essential also proposed a sustained outage definition of greater than three minutes should be adopted.¹⁰

⁸ Essential Energy, *Revenue Proposal Attachment 8.2: STPIS Approach Paper 2019-24 Regulatory Period*, April 2018, pp. 6–7.

⁹ Essential Energy, *Revenue Proposal Attachment 8.2: STPIS Approach Paper 2019-24 Regulatory Period*, April 2018, p. 6.

¹⁰ Essential Energy, *Revenue Proposal Attachment 8.2: STPIS Approach Paper 2019-24 Regulatory Period*, April 2018, p. 7.

In addition, Essential proposed that, for the calculation of customer service telephony parameter, it will remove calls from the 'next day' after a major event day, noting that it is often the days following the date the interruption begins that have the greatest impact on customer service telephony.¹¹

10.3 AER's assessment approach

We are required to make a decision on how the STPIS is to apply to Essential.¹² 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.¹³

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

10.3.1 Interrelationships

In implementing the STPIS we must take into account any other incentives available to the distributor under the NER or relevant distribution determination.¹⁴ 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 2019–24 regulatory control period, the STPIS will interact with the Capital Expenditure Sharing Scheme (CESS) and the 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 and operating 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.

¹¹ Essential Energy, *Revenue Proposal Attachment 8.2: STPIS Approach Paper 2019-24 Regulatory Period*, April 2018, p. 6.

¹² NER, cl. 6.12.1(9).

¹³ AER, *STPIS*, November 2009, cl. 2.1(d).

¹⁴ NER, cl. 6.6.2(b)(3)(iv).

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.

10.4 Reasons for draft decision

We will apply the STPIS in accordance with our F&A paper to Essential.¹⁵ The following section sets out our detailed consideration on applying the STPIS to Essential for the 2019–24 regulatory control period.

10.4.1 Revenue at risk

Essential's revenue at risk for each regulatory year of the 2019–24 regulatory control period will be capped at ± 5.0 per cent as per the scheme standard.

CCP10 supports a stronger STPIS option that is a 'strength' of 5 per cent being applied.¹⁶

Revenue at risk caps the potential reward and penalty for Essential under the STPIS. We consider an incentive of ± 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 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.

10.4.2 Reliability of supply component

Applicable components and parameters

We will apply unplanned SAIDI and unplanned SAIFI parameters under the reliability of supply component to Essential's feeders for the 2019–24 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.

¹⁵ AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59-65.

¹⁶ Consumer Challenge Panel (CCP10), *Submission on Essential Energy 2019-24 regulatory proposal*, 8 August 2018, p. 34.

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 Essential's underlying STPIS performance.

Essential 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 Essential's proposal.

We are required to apply the current version of the distribution STPIS (November 2009) to Essential for the 2019–24 regulatory period. Therefore, we will not include Essential's proposed additional exclusion criteria where the load interruptions are caused or extended by a direction from state or federal emergency services.

Definition of sustained outage

Similarly, we will not adopt Essential proposed definition of sustained outage for this draft decision. The definition of sustained outage is specified in the current STPIS.

Customer service telephony parameter

Under the current STPIS, in calculating daily unplanned SAIDI, any interruption that spans multiple days is accrued to the day on which the interruption begins. Where an interruption on a major event day spans multiple days, the entire length of the interruption is excluded when calculating the values of the parameters for the purpose of calculating the revenue increment or decrement resulting from this scheme.

While we appreciate Essential's reasons for the proposed changes to exclude calls on the day following a major event day, we cannot accept this proposal without a proper review of the incentive framework, followed by amendment of the scheme.

Further, we note that Essential has 4 or 5 MEDs per year for the last two regulatory control periods.¹⁷ The performance target for this measure is reflective of its historical performance level. Hence, Essential would not be disadvantaged in this regard.

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

¹⁷ AER, *Proposed amendment Service Target Performance Incentive Scheme (STPIS)*, December 2017, p. 11.

by the network service provider and expected to result in a material improvement in supply reliability.¹⁸

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

For this draft decision, we have calculated Essential's performance targets to be based on actual performance over the last four regulatory years of 2013–14 to 2016–17. For the final decision, the performance target will be updated to include the last five regulatory years, following the end of the 2017-18 regulatory year.

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

Our calculated performance targets for Essential for the 2019–24 regulatory control period are presented in the table below.

Table 10-3 Draft decision—STPIS reliability targets for Essential Energy for the 2019–24 regulatory period

	value
Urban	
SAIDI	69.098
SAIFI	0.844
Short rural	
SAIDI	204.015
SAIFI	1.876
Long rural	
SAIDI	449.593
SAIFI	3.021
Telephone answering	
Percentage of calls will be answered within 30 seconds	67.9%

Source: AER analysis.

¹⁸ AER, *STPIS*, November 2009, cl. 3.2.1.

10.4.3 Customer service component

The STPIS customer service target applicable to Essential 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 received no submissions from stakeholders regarding the application of Essential's customer service performance target.

Our calculated telephone answering performance targets for Essential for the 2019–24 regulatory control period are presented in Table 10-2.

10.4.4 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 Essential's incentive rates.¹⁹ Essential accepted our position. Essential provided forecast energy usage information. Hence, for this draft decision, we have calculated Essential's incentive rates by deriving it from its consumption data and AEMO's published aggregate VCR value for NSW.

The VCR for network segments is outlined in the table below. We have applied this VCR to calculate its incentives rates for 2019–24.

Table 10-4 Draft decision—Value of customer reliability (\$/MWh)

	Urban	Short rural	Long rural
VCR ^a	38,350	38,350	38,350

Source: AER analysis, and AEMO, *Value of customer reliability review, final report*, September 2014, p. 30.

^a The VCR values shown are at 2014 dollar value. They will be escalated to the June 2019 dollar value in the final decision

10.4.5 Incentive rates

The incentive rates applicable to Essential 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 decisions on Essential's incentive rates are in the table below. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.²⁰

¹⁹ AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59–65.

²⁰ AER, *STPIS*, November 2009, cl. 5.3.2(a).

Table 10-5 Draft decision—STPIS incentive rates for Essential Energy for the 2019–24 regulatory period

	Urban	Short rural	Long rural
SAIDI	0.0097	0.0297	0.0072
SAIFI	0.8198	3.5061	1.1602

Source: AER analysis.