



FINAL DECISION
Energex determination 2015–16
to 2019–20

Attachment 11 – Service target
performance incentive scheme

October 2015

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Note

This attachment forms part of the AER's final decision on Energex's 2015–20 distribution determination. It should be read with all other parts of the final decision.

The final 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

Attachment 14 – Control mechanism

Attachment 15 – Pass through events

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

Shortened form	Extended form
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
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 clause 6.3.2 of the NER our regulatory determination must specify how any applicable service target performance incentive (STPIS) is to apply in the 2015–20 regulatory control period.

This attachment sets out how we will apply the STPIS to Energex for the 2015–20 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.

11.1 Final decision

We will apply the STPIS to Energex for the 2015–20 regulatory control period. In applying the STPIS, we will:

- set revenue at risk for Energex at the range ± 2.0 per cent
- segment Energex's network according to feeder categories CBD, urban and rural
- set applicable reliability of supply (system average interruption duration index or SAIDI and system average interruption frequency index or SAIFI) and customer service (telephone answering) parameters
- set performance targets based on the Energex's average performance over the past five regulatory years
- 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 Queensland
- not apply the GSL component as Energex is subject to a jurisdictional GSL scheme.

In making our final decision on the STPIS, we have taken into account our preliminary decision, F&A paper, Energex's initial and revised regulatory proposals, our information requests to Energex and a submission from the Alliance of Electricity Consumers of Queensland. Our responses to the matters raised by Energex and the

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

Alliance of Electricity Consumers of Queensland about the application of the STPIS are also discussed in this final decision.

Tables 11.1 and 11.2 present our final decision on the applicable incentives rates and targets that will be applied to Energex's STPIS for the 2015–20 regulatory control period.

The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.

Table 11.1 AER final decision on STPIS incentive rates for Energex for the 2015–20 regulatory control period

	CBD	Urban	Rural
SAIDI	0.0028	0.0494	0.0116
SAIFI	0.2735	3.3749	0.9693

Source: AER Analysis.

Table 11.2 AER final decision on STPIS reliability targets for Energex for the 2015–20 regulatory control period

	Value
CBD	
SAIDI	3.897
SAIFI	0.0352
Urban	
SAIDI	60.118
SAIFI	0.9081
Rural	
SAIDI	144.475
SAIFI	1.8747
Telephone answering	
Percentage of calls will be answered within 30 seconds	85

Source: AER analysis.

11.2 Energex's revised proposal

Energex's revised regulatory proposal accepted our preliminary decision on its STPIS.²

11.3 AER's assessment approach

We are required to make a decision on how the STPIS is to apply to Energex.³ When making a distribution determination, the STPIS requires us to determine all performance targets, incentive rates, revenue at risk and other parameters required to apply the scheme.⁴

We outlined our proposed approach to, and justification for, the application of the STPIS in our F&A for Energex.⁵ Our preliminary decision and final decision have adopted the same approach, unless new information has become available or new arguments have been put forward which warrant a reconsideration of this position. We have considered material submitted to us by stakeholders and Energex. In each instance, we considered the relative merits of the alternative against the objectives of the STPIS.⁶

11.3.1 Interrelationships

In applying the STPIS we must consider any other incentives available to the distributor under the NER or relevant distribution determination.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 2015–20 regulatory control period, the STPIS will interact with the Capital Expenditure Sharing Scheme (CESS) and the opex Expenditure Benefit Sharing Scheme (EBSS).⁸

The rewards and penalties amounts 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.

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

² Energex, *Revised regulatory proposal*, 3 July 2015, p. 131.

³ NER, cl. 6.12.1(9).

⁴ AER, STPIS, cl. 2.1(d).

⁵ AER, *Final Framework and approach for Energex an Ergon Energy Regulatory control period commencing 1 July 2015*, April 2014, pp. 70–71.

⁶ AER, STPIS, November 2009, cl. 1.8(f).

⁷ NER, cl. 6.6.2(b)(3)(iv).

⁸ AER, STPIS, November 2009, cl. 1.5(b)(5).

include complying with all applicable regulatory obligations and requirements and, in the absence of such obligations, maintaining quality, reliability, and security outcomes.

The STPIS, on the other hand 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/or opex are achieved efficiently, rather than at the expense of service levels to customers.

11.4 Reasons for final decision

The following section sets out our detailed consideration on:

- applying the STPIS to Energex for the 2015–20 regulatory control period
- how we will apply the STPIS between regulatory control periods and our response to submissions
- how we will apply the STPIS to Energex.

11.5 Applying the STPIS

We will apply the STPIS in accordance with our preliminary decision and F&A to Energex.⁹

We have, however, updated Energex's incentive rates to reflect the expected revenue (smoothed) for this final decision.

11.5.1 Revenue at risk

Energex's revenue at risk for each regulatory year of the 2015–20 regulatory control period will be capped at ± 2.0 per cent. Within this there will be a cap of ± 1.9 per cent for the reliability of supply component and ± 0.1 per cent for the customer service component.

Revenue at risk caps the potential rewards and penalties for Energex under the STPIS. We consider an incentive of ± 2.0 per cent of the smoothed annual allowable revenue

⁹ AER, *Final Framework and approach for Energex an Ergon Energy Regulatory control period commencing 1 July 2015*, April 2014, p. 70-71; AER, *Preliminary decision Energex determination 2015–16 to 2019–20 Attachment 11 – Service target performance incentive scheme*, April 2015.

would balance the risk to both consumers and Energex and thus better meet the objectives of the STPIS. This rate is consistent with our F&A.

11.5.2 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 CBD, Urban, and rural feeders for the 2015–20 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.

Exclusions

The STPIS allows certain events to be excluded from the calculation of the service standards component (the s-factor) revenue adjustment. These exclusions include the events that are beyond the control of Energex, 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 STPIS performance.

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

11.5.3 Customer service component

The national 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).

In accordance with our preliminary decision, we accept Energex's customer service targets as it has applied a 5 year historical average to derive them for the 2015–20 regulatory control period. This is consistent with our national STPIS.

11.5.4 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

target must be modified for any reliability improvements completed or planned where the planned reliability improvements are:¹⁰

- included in the expenditure program proposed by the distributor in its regulatory proposal, or
- proposed by the distributor, and the cost of the improvements is allowed by the relevant regulator, in the distributor's previous regulatory proposal or regulatory submission, and
- expected to result in a material improvement in supply reliability.

Energex accepted our preliminary decision on the performance targets in its revised regulatory proposal.¹¹ Consistent with our preliminary decision, our calculated performance targets for Energex are presented in table 11.2 above.

11.5.5 Incentive rates

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.

Energex accepted our preliminary decision on the VCR for setting the incentive rates.¹² Consequently, this final decision adopted the VCR outlined in the preliminary decision in setting Energex's incentive rates for the 2015–20 regulatory control period.

The final incentive rates based on the VCR and smoothed expected revenue are found in table 11.3. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.¹³

Table 11.3 Final decision—STPIS incentive rates for Energex for the 2015–20 regulatory period

	CBD	Urban	Rural
SAIDI	0.0028	0.0494	0.0116
SAIFI	0.2735	3.3749	0.9693

Source: AER Analysis.

11.6 Other issues in applying the STPIS

11.6.1 Accounting for step change between regulatory periods

¹⁰ AER, *STPIS*, November 2009, cl. 3.2.1.

¹¹ Energex, *Energex 2015-20 revised regulatory proposal*, 3 July 2015, p. 131.

¹² Energex, *Energex 2015-20 revised regulatory proposal*, 3 July 2015, p. 131.

¹³ AER, *STPIS*, November 2009, cl. 5.3.2(a).

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 will affect its revenues in the second regulatory year of the next regulatory control period (that is from 1 July 2014).¹⁴

The STPIS provides a mechanism to account for any step change in revenues (or prices), via X_0 ¹⁵, from one regulatory control period to the next. For Energex, 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:¹⁶

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

Where:

- $X_0 = \frac{AR_{2014-15} - AR_{2015-16}}{AR_{2014-15}}$
- $AR_{2014-15}$ is Energex's approved revenue in the 2014–15 pricing proposal
- $AR_{2015-16}$ is Energex's allowable revenue in the final determination for 2015–20.

11.6.2 Submissions

We received a submission from the Alliance of Electricity Consumers of Queensland regarding Energex's STPIS proposal.

The Consumer Challenge Panel did not provide a submission on the STPIS.

The Alliance of Electricity Consumers re-submitted that Energex should not be rewarded for meeting its legislative level of service. As such, we should revoke the STPIS payments Energex is seeking to recover in the 2015–20 regulatory control period.¹⁷

¹⁴ AER, *STPIS*, November 2009, appendix C.

¹⁵ 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.

¹⁶ AER, *STPIS*, November 2009, Appendix C, pp. 33–34.

¹⁷ Alliance of Electricity Consumers, *Submission to the Australian Energy Regulator's preliminary decision (Queensland)*, 3 July 2015, p.30.

The Alliance of Electricity Consumers may be referring to the deterministic "N-1" planning standard for supply security.¹⁸ The deterministic "N-1" planning standard is no longer enforced and has been replaced with cost/benefit trade-off "probabilistic" planning approach. Both deterministic and probabilistic planning standards mainly address capacity shortfalls rather than reliability outcomes.

The STPIS on the other hand has a different purpose. It is an outcome focused mechanism intended to balance incentives to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to electricity distributors maintain and improve service performance where customers are willing to pay for these improvements.

Energex was rewarded under the STPIS in the current regulatory control period because it met its reliability targets or the intended outcome which was set above the reliability standard.

¹⁸ Alliance of Electricity Consumers, *Submission to the Australian Energy Regulator's preliminary decision (Queensland)*, 3 July 2015, p.30.