FINAL DECISION
SA Power Networks determination 2015−16 to 2019−20

Attachment 11 − Service target performance incentive scheme

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AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on SA Power Networks' 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

Attachment 18 – Connection policy

Contents

Note 11-2

Contents 11-3

Shortened forms 11-4

11 Service target performance incentive scheme 11-6

AER's service target performance incentive scheme 11-6

11.1 Final decision 11-6

11.2 SA Power Networks' revised proposal 11-8

11.3 AER's assessment approach 11-8

11.3.1 Interrelationships 11-8

11.4 Reasons for final decision 11-9

11.5 Applying the STPIS 11-9

11.5.1 Revenue at risk 11-10

11.5.2 Reliability of supply component 11-10

11.5.3 Customer service component 11-10

11.5.4 Performance targets 11-11

11.5.5 Incentive rates 11-11

11.6 Other issues in applying the STPIS 11-12

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 SA Power Networks 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 SA Power Networks for the 2015–20 regulatory control period. In applying the STPIS, we will:

- set revenue at risk for SA Power Networks at the range ± 5.0 per cent
- segment SA Power Networks' network according to feeder categories CBD, urban, short and long 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 SA Power Networks' 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 (using the natural log method to calculate the major event day for exclusion)
- apply the methodology and value of customer reliability (VCR) values to the calculation of incentive rates
- not apply the GSL component as SA Power Networks is subject to a jurisdictional GSL scheme.

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

In making our final decision on the STPIS, we have taken into account our framework and approach (F&A) paper, SA Power Networks' initial and revised regulatory proposals, our information requests to SA Power Networks and submissions raised by stakeholders. Our responses to the matters raised by SA Power Networks and stakeholders 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 SA Power Networks' 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 SA Power Networks for the 2015–20 regulatory control period

	CBD	Urban	Rural short	Rural long
SAIDI	0.0030	0.0365	0.0070	0.0072
SAIFI	0.2557	3.3786	0.9122	1.2094

Source: AER Analysis.

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

	value
CBD	
SAIDI	12.48
SAIFI	0.132
Urban	
SAIDI	121.50
SAIFI	1.353
Rural short	
SAIDI	231.06
SAIFI	1.930
Rural long	
SAIDI	311.70
SAIFI	2.027

Telephone answering

Percentage of calls will be answered within 30 seconds	67.8

Source: AER analysis.

11.2 SA Power Networks' revised proposal

SA Power Networks' revised regulatory proposal accepted our preliminary decision on its STPIS.[2] SA Power Networks also recommended that we revise our STPIS to accommodate the definitional change for momentary interruption so that it aligns with the recent changes in the National Reliability Reporting Framework.[3]

11.3 AER's assessment approach

We are required to make a decision on how the STPIS is to apply to SA Power Networks.[4] 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.[5]

We outlined our proposed approach to, and justification for, the application of the STPIS in our F&A paper for SA Power Networks. [6] 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 SA Power Networks, including its proposal to vary the scheme. In each instance, we considered the relative merits of the alternative against the objectives of the STPIS.[7]

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.[8] 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).[9]

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2 SA Power Networks, *Revised Regulatory Proposal 2015-2020*, July 2015, p. 314.

3 SA Power Networks, *Revised Regulatory Proposal 2015-2020*, July 2015, pp. 314–15.

4 NER, cl. 6.12.1(9).

5 AER, STPIS, cl. 2.1(d).

6 AER, *Final framework and approach for SA Power Networks Regulatory control period commencing 1 July 2015*, April 2014, p. 54.

7 AER, *STPIS*, November 2009, cl. 1.8(f).

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

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

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 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 SA Power Networks for the 2015–20 regulatory control period
- transitional matters in the applying the STPIS between regulatory control periods
- proposed definitional changes to momentary interruptions parameters in the STPIS
- how we will apply the STPIS to SA Power Networks.

11.5 Applying the STPIS

We will apply the STPIS in accordance with our preliminary decision to SA Power Networks. This will account for the transition in the calculation of the major event days exclusions methods in setting SA Power Networks performance targets for the 2015–20 regulatory control period.[10]

We have also updated SA Power Networks incentive rates to reflect the expected revenue (smoothed) in this final decision.

[10] AER, *Final framework and approach for the Victorian Electricity Distributors, regulatory control period commencing 1 January 2016*, 24 October 2014, pp. 96–97.

11.5.1 Revenue at risk

SA Power Networks' revenue at risk for each regulatory year of the 2015–20 regulatory control period will be capped at ± 5.0 per cent as per the scheme standard.

Revenue at risk caps the potential rewards and penalties for SA Power Networks under the STPIS. We consider an incentive of ± 5.0 per cent of the annual allowable revenue would balance the risk to both consumers and SA Power Networks' and thus better meet the objectives of the STPIS.

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 SA Power Networks' CBD, Urban, Short and Long 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 SA Power Networks, 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 SA Power Networks' STPIS performance.

SA Power Networks proposed to calculate the major event day (MED) threshold using the 2.5 beta method in accordance the STPIS.[11] Since we have not received any submissions that we should depart from our F&A, we accept SA Power Network's proposal to transition from the box cox method to the STPIS method to calculate the MED.

11.5.3 Customer service component

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[11] SA Power Networks, *Regulatory Proposal 2015-20*, October 2014, pp. 291–292.

The national STPIS customer service target applicable to SA Power Networks 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 SA Power Networks' 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.[12]

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:[13]

- 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.

SA Power Networks accepted our preliminary decision on the performance targets.[14] As indicated in that decision, we adjusted to SA Power Networks' historical 5-year average target levels to take into account the differences in data normalisation methods. Consistent with our preliminary decision, the calculated performance targets for SA Power Networks are presented in table 11.2 above.

11.5.5 Incentive rates

The incentive rates applicable to SA Power Networks 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.

SA Power Networks accepted our preliminary decision on the VCR for setting the incentive rates.[15] Consequently, this final decision adopted the VCR outlined in the preliminary decision in setting SA Power Networks' incentive rates for the 2015–20 regulatory control period. The final incentive rates based on the VCR and annual revenue requirement 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.

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12 AER, *STPIS*, November 2009, cl. 5.3.1(a).

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

14 SA Power Networks, *Revised Regulatory Proposal 2015-20*, October 2014, p. 314.

15 SA Power Networks, *Revised Regulatory Proposal 2015-20*, October 2014, p. 314.

Table 11.3 AER final decision on STPIS incentive rates for SA Power Networks for the 2015–20 regulatory period

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SAIFI	0.2557	3.3786	0.9122	1.2094

Source: AER Analysis.

11.6 Other issues in applying the STPIS

Definitional change of momentary interruption

SA Power Networks submitted in its revised proposal that we should amend our STPIS to define momentary interruption as being from one to three minutes. This allows the definition to be consistent with the AEMC's recent reliability measures review.[16]

It also submitted that its customers may miss out on improvements in reliability due to the reduced incentives arising from both the lower VCR rate and from the current definition of momentary interruption.[17]

We consider that SA Power Networks' proposed definitional change to momentary interruption relates to the design of the STPIS and should be considered when we review the scheme. Changes of such magnitude should be the subject of comprehensive consultation with all stakeholders, including whether such a change would require an associated change to how the incentive rates should be calculated.

Accounting for step change 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 will affect its revenues in the second regulatory year of the next regulatory control period (that is from 1 July 2014).[18]

The STPIS provides a mechanism to account for any step change in revenues (or prices), via X_0, from one regulatory control period to the next. For SA Power Networks, the 'raw' s-factor calculated for the last and second last regulatory years of the

16 SA Power Networks, *Revised Regulatory Proposal 2015-2020*, July 2015, pp. 314–15.
17 SA Power Networks, *Revised Regulatory Proposal 2015-2020*, July 2015, pp. 314–15.
18 AER, *STPIS*, November 2009, appendix C.

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:[19]

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

Where:

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

Submissions

We received a submission from the Energy Consumers Coalition of South Australia (ECCSA) recommending that:

> …STPIS targets should be set on a moving average of the most recent 4-5 year performance rather than on static numbers set at the start of a regulatory period. This would modify the STPIS targets to include the outcomes of the opex and capex used each year.[20]

We consider that ECCSA's submission regarding the STPIS targets relates to the design of the STPIS and should be considered when we review the scheme.

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

20 Energy Consumers Coalition of South Australia, *Submission on SAPN's regulatory proposal*, June 2015, pp. 36.