PRELIMINARY DECISION
United Energy distribution determination
2016 to 2020

Attachment 18 – f-factor scheme

October 2015

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's preliminary decision on United Energy's revenue proposal 2016–20. It should be read with all other parts of the preliminary decision.

The preliminary 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 - f-factor scheme

Contents

Note 18-2

Contents 18-3

Shortened forms 18-4

18 f-factor scheme 18-6

18.1 Preliminary decision 18-6

18.2 United Energy's proposal 18-6

18.3 AER’s assessment approach 18-7

18.4 Reasons for preliminary decision 18-7

18.5 Transitional arrangement 18-7

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced metering infrastructure
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

18 f-factor scheme

The f-factor scheme is prescribed by *f-factor scheme order 2011* (the Order) issued under the National Electricity (Victoria) Act 2005. The Order confers functions and powers on the AER to implement the f-factor. The objective of the f-factor scheme is to provide incentives for Victorian distributors to:[1]

- Reduce the risk of fire starts due to electricity infrastructure
- Reduce the risk of loss or damage caused by fire starts.

In its submission to our F&A paper, Department of State Development Business and Innovation stated that it intend to review the f-factor scheme in 2014-15 to determine how the incentive has performed in delivering efficient improvements to power line bushfire safety.[2]

Because of the above advice, our F&A paper proposed to retain the current incentive framework—to set the target based on a 5 years historical average and an incentive rate of $25,000 per fire starts.[3] We will apply this scheme in its amended form once the relevant legislation is complete after the review.

We will also apply to incentive mechanism in a manner similar to the other incentive schemes, such as the STPIS. As stated in our F&A paper, we will include an adjustment amount as an "I-factor" component in the annual revenue calculation formula to give effect to the reward of penalty outcomes of actual fire starts from the year commencing on 1 January 2016.[4]

18.1 Preliminary decision

We approve United Energy’s proposed f-factor scheme target at 134.9 fires per year—based on the average of the past 5 regulatory years—because it is consistent with our F&A method.[5]

18.2 United Energy's proposal

United Energy accepts the AER’s position in the F&A paper to apply the f-factor scheme for the 2016–20 regulatory control period.[6]

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1 Energy and Resources Legislation Amendment Bill 2010, Explanatory Memorandum, p. 10.

2 Department of State Development Business and Innovation, Submission: Preliminary positions on replacement framework and approach (for consultation), 30 August 2014, p. 8.

3 AER, *Final Framework and approach for the Victorian Electricity Distributors*, October 2014, p. 127.

4 AER, *Final Framework and approach for the Victorian Electricity Distributors*, October 2014, p. 87.

5 Calculation was based on (1) the fire starts data for 2012–2014 from the f-factor RIN; and (2) because audited fire start information was not available for 2010 and 2011, we adopted the fire starts target under the previous scheme as the fire start numbers for 2010 and 2011, in accordance with information provided by United Energy on 13 October 2015 in response to AER's information request (United Energy - IR#037).

6 United Energy, *Regulatory Proposal*, April 2015, p. 135.

18.3 AER’s assessment approach

We examined the proposed f-factor scheme against the requirements of F&A as stated above—whether it:

- set the target based on a 5 years historical average
- maintain the incentive rate of $25,000 per fire start.

18.4 Reasons for preliminary decision

We approve United Energy’s f factor scheme because we found that it is consistent with the F&A approach to:

- set the target based on a 5 years historical average
- maintain the incentive rate of $25,000 per fire start.

18.5 Transitional arrangement

Under the Oder, the outcome of the current f-factor scheme for the last two years of the current period (2014 and 2015) will apply to the first two regulatory years of the forthcoming regulatory control period—2016 and 2017.

The rewards and penalties under the f-factor scheme for the forthcoming regulatory control period and, specifically for the regulatory year commencing 1 January 2018, will be implemented as an adjustment amount of the "I-factor" component in the annual revenue calculation formula.