# DRAFT DECISION

## SA Power Networks
## Distribution Determination
## 2020 to 2025

## Attachment 10
## Service target performance incentive scheme

October 2019

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165
Email: SAPN2020@aer.gov.au

AER reference: 62729

# Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to SA Power Networks for the 2020–2025 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

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Attachment 12 – Classification of services

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# 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 |
| NER or the rules | national electricity rules |
| NSP | network service provider |
| opex | operating expenditure |
| RBA | Reserve Bank of Australia |
| SAIDI | system average interruption duration index |
| SAIFI | system average interruption frequency index |
| STPIS | service target performance incentive scheme |

# 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 SA Power Networks 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 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 (F&A) to the application of STPIS

In the final F&A, we stated that we will continue to apply the distribution STPIS to SA Power Networks 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 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 SA Power Networks' 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 SA Power Networks if it remains subject to a jurisdictional GSL scheme.[3]

[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 SA Power Networks for the regulatory control period commencing 1 July 2020*, July 2018, pp. 61-64.

The F&A also indicated that the revised STPIS may apply to SA Power Networks 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 to SA Power Networks for the 2020–25 regulatory control period. This is consistent with our F&A position on the application of the STPIS in our 2020–25 determinations for SA Power Networks.

We have taken into account SA Power Networks' revenue proposal, submissions raised by stakeholders and the F&A in reaching our draft decision.[5] Our responses to the matters raised by SA Power Networks and stakeholders about the application of the STPIS are discussed below.

Table 10.1and Table 10.2 present our draft decision on the applicable incentive rates and targets that will apply to SA Power Networks 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 SA Power Networks for the 2020–25 regulatory period

| | CBD | Urban | Short rural | Long rural |
|---|---|---|---|---|
| SAIDI | 0.0035 | 0.0434 | 0.0081 | 0.0081 |
| SAIFI | 0.4293 | 2.8058 | 0.6646 | 1.0070 |

Source: AER analysis.

### Table 10.2 Draft decision—STPIS reliability targets for SA Power Networks for the 2020–25 regulatory period

| | Value |
|---|---|
| **CBD** | |
| SAIDI | 22.730 |
| SAIFI | 0.122 |

3 AER, *Framework and approach for SA Power Networks for the regulatory control period commencing 1 July 2020*, July 2018, pp. 61-64.

4 AER, *Framework and approach for SA Power Networks for the regulatory control period commencing 1 July 2020*, July 2018, pp. 61-64.

5 SA Power Networks, *2020-25 Regulatory proposal, Attachment 10 - Service target performance incentive scheme*, January 2019; AER, *Framework and approach for SA Power Networks for the regulatory control period commencing 1 July 2020*, July 2018, pp. 61-64.

6 AER, *STPIS*, November 2018, cl. 5.3.2(a).

| | Value |
|---|---|
| **Urban** | |
| SAIDI | 105.132 |
| SAIFI | 1.084 |
| **Short rural** | |
| SAIDI | 182.347 |
| SAIFI | 1.481 |
| **Long rural** | |
| SAIDI | 284.393 |
| SAIFI | 1.524 |
| **Telephone answering** | |
| Percentage of calls will be answered within 30 seconds | 78.2% |

Source: AER analysis.

## 10.2 SA Power Networks' proposal

SA Power Networks' revenue proposal accepted our F&A on how the STPIS will apply with the exception of the application of the performance targets adjustment.

As specified in the STPIS, SA Power Networks proposed to apply adjustments to the performance targets because the actual performance outcome of the 2014–15 regulatory year exceeded the Revenue at Risk cap of 3 per cent for that year under the previous distribution determination.[7] [8] It also proposed adjustments to the performance targets relating to the proposed expenditure for reliability improvement.[9]

## 10.3 Assessment approach

We are required to make a decision on how the STPIS is to apply to SA Power Networks.[10] When making a distribution determination, the STPIS requires us to

7 SA Power Networks, *2020-25 Regulatory proposal, Attachment 10 - Service target performance incentive scheme*, January 2019, p. 8.

8 The actual performance of 2014-15 is one of the inputs for setting the new performance targets, being the historical average of the previous five year and subject to other relevant adjustments.

9 SA Power Networks, *2020-25 Regulatory proposal, Attachment 10 - Service target performance incentive scheme*, January 2019, p. 8.

10 NER, cl. 6.12.1(a).

determine all performance targets, incentive rates, revenue at risk and other parameters under the scheme.[11]

We outlined our proposed approach to, and reasons for, the application of the STPIS in our F&A for SA Power Networks. Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by SA Power Networks and 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.[12] 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 control 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
- reductions in capex and opex are achieved efficiently, rather than at the expense of service levels to customers.

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

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

## 10.4 Reasons for draft decision

We will apply the STPIS to SA Power Networks in accordance with our F&A. The following section sets out our detailed consideration on applying the STPIS to SA Power Networks for the 2020–25 regulatory control period.

### 10.4.1 Revenue at risk

SA Power Networks' revenue at risk for each regulatory year of the 2020–25 regulatory control period will be capped at ± 5.0 per cent as per the scheme standard.

Revenue at risk caps the potential reward and penalty for SA Power Networks 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 SA Power Networks' feeders for the 2020–25 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 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 SA Power Networks' underlying STPIS performance.

SA Power Networks 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 SA Power Networks' 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 expected to result in a material improvement in supply reliability;[13] and

- where the actual performance outcome exceeds the revenue at risk cap.[14]

As our draft decision has not included capex for improving reliability, we made no adjustments to SA Power Networks' reliability targets. Please refer to the capex attachment for further details.

We received no submissions from stakeholders regarding the application of SA Power Networks' performance targets.

Our calculated performance targets for SA Power Networks for the 2020–25 regulatory control period are presented in the 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. SA Power Networks' regulatory proposal submitted that it has adopted the method specified by STPIS version 2.0 to calculate this adjustment.

We received no submissions from stakeholders regarding the application of SA Power Networks' performance targets.

We note that—in calculating the adjustments for performance targets to account for the exceedance about the revenue cap for 2014–15— SA Power Networks used the incentive rate for the 2020–25 regulatory period, instead of the incentive rate for the regulatory period when the exceedance occurred.

We have applied the method outlined in our national STPIS to make the adjustments accordingly. Specifically, we have calculated the appropriate adjustments using the relevant incentive rate of 2014–15.

### 10.4.3 Customer service component

The 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). The revenue at risk for the customer service component is ± 0.5 per cent.

We received no submissions from stakeholders regarding the application of SA Power Networks' customer service performance target.

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

14 AER, *STPIS v2.0*, November 2018, cl. 3.2.1(a)(1B).

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

### 10.4.4 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 SA Power Networks' incentive rates.[15] SA Power Networks provided forecast energy usage information. Hence, for this draft decision, we have calculated SA Power Networks' 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 clause 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 apply the latest VCR to be published by us in December 2019 in the final decision for setting the incentive rates.

The VCR for network segments is outlined in Table 10.3. We have applied this VCR to calculate SA Power Networks' 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 | Long rural |
|---|---|---|---|---|
| VCR | 47,956 | 40,847 | 40,847 | 40,847 |

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.

### 10.4.5 Incentive rates

Based on the placeholder VCR values above, 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 at appendix B of the National STPIS v2.0. Our draft decision on SA Power Networks' incentive rates are at **Error! Reference source not found.**. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.[16]

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15 AER, *Framework and approach for SA Power Networks for the regulatory control period commencing 1 July 2020*, July 2018, pp. 61-64.

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