Explanatory statement

Proposed amendment

Service target performance incentive scheme

Electricity distribution network service providers

September 2009

AUSTRALIAN ENERGY REGULATOR

Request for submissions

Interested parties are invited to make written submissions to the Australian Energy Regulator (AER) on the amendments proposed in this paper by the close of business 30 October 2009. **Submissions received after this date will not be considered.**

Submissions can be sent electronically to: aerinquiry@aer.gov.au

Alternatively, submissions can be sent to:

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General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on the AER's website at www.aer.gov.au. For further information regarding the AER's use and disclosure of information provided to it, see the *ACCC/AER Information Policy*, October 2008 also available on the AER's website.

Enquiries about this paper, or about lodging submissions, should be directed to the Network Regulation South Branch of the AER on (03) 9290 1436.

Contents

1 Introduction

The Australian Energy Regulator (AER) is responsible for the economic regulation of distribution network service providers (DNSPs) in the National Electricity Market (NEM), in accordance with the National Electricity Rules (NER).

Under chapter 6 of the NER, the AER is required to develop and publish a service target performance incentive scheme (STPIS/scheme) for DNSPs. On 26 June 2008, the AER published the first version (version 1.0) of the STPIS for DNSPs. On 8 May 2009, the AER amended the STPIS (version 1.1) to address material issues regarding the interaction between the cap on revenue at risk and the equation for the calculation of the s-factor, and to improve the clarity of the operation of the scheme.

Since releasing version 1.1 of the STPIS, the AER has undertaken subsequent analysis of the scheme giving further consideration to issues raised by DNSPs regarding the application of the scheme in forthcoming regulatory determinations for South Australia and Victoria. The AER has also received requests for amendments to the scheme from SP AusNet (21 August 2009) and from ETSA Utilities (ETSA) as part of its regulatory proposal for the 2010–15 regulatory control period. A copy of SP AusNet's request and ETSA's regulatory proposal are available on the AER's website.

Following consideration of these issues, the AER seeks to amend the scheme to:

- improve the clarity, effectiveness and operation of the scheme
- provide greater flexibility with respect to the statistical approach that can be used when determining if an event can be excluded from the scheme
- address a timing issue associated with the operation of the scheme in Victoria.

This explanatory statement sets out these amendments to version 1.1 of the STPIS and satisfies the AER's obligations under clause 6.16(b)(2) of the NER. A copy of the proposed amended STPIS is available on the AER's website at www.aer.gov.au.

The key proposed amendments to the scheme are as follows:

Proposed amendments to the approach to determining the major event boundary

- Currently, outlier performance (e.g. due to extreme weather / events) is excluded using the 2.5 beta method described in the US Institute of Electrical and Electronics Engineers (IEEE) Standard 1366-2003. The AER proposes to allow consideration of other statistical approaches in utilising the data sets applied under the scheme, in cases where that data does not exhibit a log normal distribution — this concern was raised by ETSA.
- The AER also proposes to allow a DNSP to propose a major event day boundary that is greater than the 2.5 beta that is currently permitted. The AER considers that this increased flexibility will allow a DNSP to propose a major event day boundary that more accurately reflects the service performance characteristics of its network. This proposed amendment is in response to the request from SP AusNet for the

scheme to allow discretion for the AER to consider an alternative exclusion threshold proposed by a DNSP.

Proposed amendments to improve the application of the scheme in Victoria

- Currently, the scheme specifies the dates over which a DNSP's performance will be measured over (i.e. 1 July until 30 June inclusive). The AER proposes to alter the scheme to include references to regulatory years. This amendment eliminates the scope for gaps in performance measurement to occur, as under the current scheme DNSPs that start their regulatory control period on 1 January (the Victorian DNSPs) must measure their performance on a financial year basis.

- A number of consequential amendments associated with the amendment discussed above have also been proposed.

The AER has also made other amendments to further clarify the operation of the scheme.

The proposed amendments and clarifications are discussed in more detail at section 5 of this explanatory statement.

When developing and amending the STPIS the AER had regard to the NER requirements as set out in the accompanying Final Decision to version 1.0 and 1.1.[1] The AER has also had regard to these requirements when developing the proposed amendments set out in this explanatory statement. Further, the AER considers that the proposed amendments are consistent with the AER's stated objectives for the scheme, as set out at clause 1.5 of the scheme.

The AER notes that the Queensland and South Australian DNSPs have lodged their regulatory proposals for the 2010–15 regulatory control period and that the Victorian DNSPs have commenced work on their proposals for the next regulatory determination process (2011–15). The AER intends that the amendments to the STPIS outlined in this explanatory statement will be finalised by November 2009 and that the AER will be in a position to take the amendments into account for distribution determinations for South Australia, Queensland and Victoria.

Pursuant to clause 6.6.2(b)(1) of the NER the AER will consult on these amendments with the authorities responsible for the administration of relevant jurisdictional electricity legislation.

While the proposed amendments do not fundamentally alter the operation of the STPIS, the changes will improve the transparency and effectiveness of the scheme and provide greater flexibility where appropriate. Interested parties are invited to make written submissions on the specific areas of the scheme proposed for amendment — issues raised by submissions which are outside the scope of the proposed amendments will not be considered as part of this amendment process.

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[1] AER, *Electricity distribution network service providers Service target performance incentive scheme*, Final decision, June 2008, appendix B. AER, *Electricity distribution network service providers Service target performance incentive scheme*, Final decision, May 2009, appendix B.

2 Background

In June 2008, the AER published version 1.0 of the STPIS for DNSPs. This followed public consultation, which began in November 2007 with the release of an issues paper. A proposed scheme was published in April 2008 and finalised in June 2008.

In May 2009, the AER published version 1.1 of the STPIS. This followed public consultation, which began in February 2009 with the release of a proposed amendment to the scheme and an explanatory statement.

Each version of the scheme was developed following consultation with jurisdictional regulators and industry stakeholders in accordance with clause 6.6.2(b)(1) and rule 6.16 of the NER.

Consistent with the Council of Australian Governments' objectives, this scheme is part of the suite of regulatory requirements designed to:

- streamline and improve the quality of economic regulation of energy networks
- reduce regulatory costs
- enhance regulatory certainty.

While the regulatory regime as a whole encourages a business to improve its operating and capital efficiency, the STPIS is designed to ensure that this increase in efficiency is not at the expense of a deterioration in service performance for customers. Further, the STPIS is designed to encourage a business to improve its service performance where customers are willing to pay for these improvements. The AER considers that in doing so, the STPIS plays an important part in balancing the incentives on regulated businesses to ensure outcomes are consistent with the national electricity objective in section 7 of the NEL, in terms of efficient price and non-price outcomes for the long-term benefit of users.

3 Rule requirements

Clause 6.6.2 of the NER requires the AER to develop and publish a STPIS and sets out the requirements the AER must comply with in doing so.

When amending the STPIS, the distribution consultation procedures, as set out in rule 6.16 of the NER, require the AER to publish:

- a proposed STPIS
- an explanatory statement
- an invitation for submissions.

Stakeholders must be allowed at least 30 business days to make submissions to the AER. Within 80 business days of publishing the proposed STPIS, the AER must publish its final decision and STPIS. As already noted, the AER is required by the NER to consult on the proposed STPIS amendments with authorities responsible for the administration of relevant jurisdictional electricity legislation.

In addition to the specific rules for the scheme set out at clause 6.6.2 of the NER, the scheme has been designed to be consistent with the building block proposal requirements as set out in clause S6.1.3 of schedule 6.1 to chapter 6 the NER.

4 Scheme requirements

Clause 1.8 of the scheme indicates that the AER may amend or replace the scheme from time to time in accordance with clause 6.6.2(c) of the NER and the distribution consultation procedures.

Clause 1.8 of the scheme also provides that a DNSP or other person proposing an amendment to the scheme must submit the proposed amendment in writing to the AER. A proposal to amend the scheme must demonstrate how the proposed amendment is consistent with the objectives in clause 1.5 of the scheme.

As noted above, the AER has received requests from SP AusNet and ETSA to amend the scheme for forthcoming regulatory determinations for DNSPs in South Australia and Victoria. SP AusNet's request and ESTSA's regulatory proposal for the 2010–15 regulatory control period are available on the AER's website.

The proposed amendments to the scheme discussed in this explanatory statement respond to those proposals, address consequential amendments raised by the proposals and other matters to improve the clarity, effectiveness and operation of the scheme.

5 Proposed amendments

This section sets out the AER's proposed amendments to version 1.1 of the STPIS. The amendments seek to improve the clarity, effectiveness and operation of the scheme . The majority of the amendments are contained within the body of the scheme, although the AER has also made changes in appendix C and D.

5.1 Amendment of the s-bank mechanism

The AER notes that ETSA, as part of its regulatory proposal, submitted that the AER amend the operation of the s-bank mechanism to allow either[2]:

- DNSPs to defer incurring any rewards or penalties under the STPIS for more than one year; or

- DNSPs to bank rewards or penalties up to a maximum percentage of a DNSP's revenue, i.e. the s-bank could hold a maximum percentage of a DNSP's revenue.

Under the STPIS, a DNSP receives a financial reward (penalty) for service performance that is better (worse) than the performance target. The s-bank is a revenue smoothing mechanism that currently allows a DNSP to delay the revenue increment or decrement (that is, the reward or penalty), or a portion of the revenue increment or decrement, for one regulatory year. The AER notes that this mechanism provides for less volatility in prices to customers as it enables a DNSP to smooth the impact of the s-factor on customer prices.[3]

The AER notes that allowing rewards or penalties to be banked for more than one regulatory year would lead to a weaker nexus between actual service performance and outturn financial reward or penalties applied to a DNSP via the s-factor. Under ETSA's proposal a DNSP may not incur the resulting financial reward or penalty attributable to its actual service performance until at least three years after the end of the performance measurement period. This is contrary to the objective of the scheme as it potentially reduces the incentive for DNSPs to maintain and improve service performance, given the long lag between service performance levels and rewards / penalties. Such a lag would also diminish transparency for customers with respect to how the scheme's incentives operate.

The AER therefore considers that banking rewards or penalties over more than one regulatory year separates the reward or penalty from the year of service performance, thereby reducing the relationship between performance and the incentive for DNSPs, and as perceived by customers.

The AER notes that the amendment proposed by ETSA would also add complexity to the scheme.

ETSA stated in its proposal that its amendment may reduce volatility. The AER notes that the ESCV has applied a s-bank mechanism to its service incentive (or s-factor)

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2 ETSA Utilities, *Regulatory Proposal 2010–2015*, July 2009, p. 217.
3 AER, *Service target performance incentive scheme*, June 2008, p. 10.

scheme. In applying the s-bank the ESCV also considered whether to allow DNSPs to defer part or all of the s-factor from one year to the next for the purpose of reducing volatility in revenues. The ESCV found that volatility was substantially reduced when the s-factor was averaged over two years compared to one year. However, the ESCV found that volatility is not significantly reduced when the s-factor is smoothed over three years compared to two years and hence did not adopt an s-bank mechanism that operated over multiple years.[4]

Regarding ETSA's alternative proposal on the s-bank mechanism, the AER considers that allowing DNSPs to bank rewards or penalties up to a maximum percentage of a DNSP's revenue could increase the risk of price volatility because once that threshold is reached the entire amount would then be applied to a DNSP's revenue via the s-factor. Further, the incentive for DNSPs to maintain and improve service performance would be reduced when the amount accumulated in the s-bank approaches either threshold.

The AER considers that the current application of the s-bank mechanism allows DNSPs to manage volatility that may arise from the application of the s-factor. The AER is concerned that any further averaging will reduce the power of the incentive. Accordingly, the AER does not propose to amend the operation of the s-bank mechanism.

5.2 Appendix D: Major event days

In version 1.1 of the STPIS the AER further clarified how it would apply the IEEE standard's exclusion framework. The AER adopted the IEEE standard 1366–2003 in the STPIS as the quantitative approach for excluding an unplanned system outage which exceeds a particular boundary (currently 2.5 beta[5] in the scheme).

Appendix D of the scheme provides that if the unplanned SAIDI exceeds the calculated boundary, the period is deemed a major event day and is excluded from the calculation of the revenue increment or decrement (i.e. the s-factor) under the scheme.

On 21 August 2009, SP AusNet wrote to the AER seeking for the scheme to allow discretion for the AER to consider an alternative exclusion threshold proposed by a DNSP. Specifically, SP AusNet sought to allow change to the 2.5 beta major event day boundary to be applied under the scheme.[6]

ETSA has submitted, as part of its regulatory proposal for the 2010–15 regulatory control period, that there should be scope for the Box-Cox transformation methodology to be used to find the average and the standard deviation of service performance data, instead of the natural logarithm approach currently used in the scheme.

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4 ESCV, *Electricity Distribution Price Review 2006-10 (as amended)*, October 2005 pp. 92–93.
5 Beta is defined as the standard deviation of the logarithms of the data set.
6 SP AusNet, *RE: The STPIS Exclusion Regime*, 21 August 2009.

Having considered ETSA's and SP Ausnet's proposals, the AER proposes two amendments in appendix D of the scheme. Each of these proposed amendments are discussed below.

5.2.1 Transformation of data that is not normally distributed

The STPIS currently assumes that all SAIDI data collected under the scheme exhibits a log normal distribution (i.e. after step 3 in appendix D of the scheme). Furthermore, the scheme is silent on how a DNSP should use any data that is obtained under the scheme that is not log normal.

The AER considers that there is merit in addressing this issue and notes that this type of flexibility was envisaged by it in the AER's Final Decision on version 1.0 of the scheme, where it stated:

> Where long run, reliable data sets available from DNSPs do not provide statistical results that are considered by the AER to be acceptable under the IEEE Standard 1366-2003, the AER will consider whether applying an alternative statistical method proposed by a DNSP would better meet the objectives of the STPIS.[7]

This aspect, however, was not explicit in the scheme. Under the revised scheme, the AER proposes to explicitly allow a DNSP to propose an alternative transformation method where a data set is not normally distributed. The AER considers that this amendment improves the operation and clarity of the scheme in instances where step 3 in appendix D does not produce a normally distributed data set.

Any DNSP proposing to use a transformation technique to transform data to a normal distribution will, however, be required to demonstrate to the AER that its approach will lead to an outcome that is consistent with the objectives of the scheme and provide supporting information, as required by appendix D and clause 2.2 of the scheme. For example, the AER would, as part of its consideration process, take into account the outcome of applying the proposed transformation technique in terms of the number of days likely to be excluded from incentive payments under the scheme.

5.2.2 Application of a greater beta threshold

The AER notes SP AusNet's concerns regarding the need to provide greater flexibility in the scheme regarding its exclusion threshold. The AER recognises that circumstances may occur where a DNSP would consider that the use of 2.5 beta from the mean in setting the exclusion boundary is inappropriate and may wish to propose a greater beta threshold — that is, to decrease the number of days that may be excluded — to better reflect the service performance characteristics of its network and to provide sufficient incentive for a DNSP to maintain or improve service performance.

The AER notes that under the current ESCV service performance incentive scheme, Victorian DNSPs are subject to a different exclusion boundary to that under the AER's STPIS. The ESCV's exclusion boundary is based on a SAIFI measure and allows for exclusions on a one-in-five year basis (for DNSPs that had not experienced an outlier

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7 AER, *Final Decision, Electricity distribution network service providers, Service target performance incentive scheme*, June 2008, p. 20.

event during 2000–04[8]). The AER's national approach under the STPIS is based on a SAIDI measure consistent with the IEEE standard, which is based on allowing for, on average, exclusions of around 2.3 days per year.[9]

The AER considers that the application of a threshold greater than 2.5 beta from the mean, as proposed by SP AusNet[10], may in particular circumstances result in more efficient outcomes than application of the 2.5 beta threshold. For example, where such an approach results in service outage events *within* a DNSP's control not being excluded for the purposes of calculating the s-factor under the scheme. Such an approach would be consistent with both the NEL and the objectives of the STPIS, particularly as it is consistent with providing an incentive for a DNSP to maintain and improve its service performance.

The AER recognises that allowing a business to propose a threshold greater than 2.5 beta from the mean may also raise the prospect that a business should also be able to put forward a beta threshold lower than 2.5. The AER, however, considers that 2.5 beta from the mean provides a reasonable 'safe harbour' standard, which has been adopted by the IEEE, and does not consider a lower threshold would be appropriate.

On balance, the AER considers that it is not unreasonable to require DNSPs to use the IEEE standard (a 2.5 beta threshold) as the minimum beta boundary while providing some flexibility by allowing a greater beta threshold to be used where appropriate. Any DNSP seeking to apply a greater beta threshold would, however, be required to demonstrate to the AER that its approach is consistent with the objectives of the scheme and provide supporting information, as required by clause 2.2 of the scheme. The information to be provided by a DNSP to demonstrate consistency with the objectives of the scheme would need to address each of the objectives, which are listed at clause 1.5 of the scheme.

Under the amendments proposed by the AER, a DNSP subject to a beta boundary greater than 2.5 during a regulatory control period and seeking to reduce its beta threshold (e.g. to the minimum 2.5 or to a threshold lower than in previous regulatory control periods but greater than 2.5 beta) in subsequent regulatory control periods would be required to demonstrate to the AER that its approach is consistent with the objectives of the scheme and provide supporting information, as required by clause 2.2 of the scheme. Similarly, a DNSP seeking to apply a threshold that is greater than 2.5 beta, where in previous distribution determinations it had applied a threshold that was greater than 2.5 beta, would be required to demonstrate to the AER that its approach is consistent with the objectives of the scheme and provide supporting information, as required by clause 2.2 of the scheme.

This is proposed to address the potential for a reduction in a DNSP's exclusion threshold to reduce its incentive to maintain and improve service performance.

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8 ESCV, *Electricity distribution price Review 2006–10, Final decision volume 1, Statement of purpose and reasons*, pp. 124–125.

9 Further information about the AER's decision to adopt the IEEE standard under the STPIS is available in the AER's final decisions for the STPIS versions 1.0 and 1.1.

10 SP AusNet, *RE: The STPIS Exclusion Regime*, 21 August 2009.

5.2.3 Proposed amendments

To address the issues raised in sections 5.2.1 and 5.2.2 (above), the AER has added a new paragraph into appendix D in addition to a number of new steps in the process to calculate the major event day boundary.

The AER proposes the following text be inserted at the second paragraph of appendix D:

> Any day where *unplanned SAIDI* exceeds the *major event day* boundary may be excluded when calculating the values of the *parameters* for the purpose of calculating the revenue increment or decrement resulting from this *scheme*.
>
> 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*.
>
> A DNSP may propose in accordance with clause 2.2 of this *scheme* a *major event day* boundary that is greater than 2.5 standard deviations from the mean. A DNSP subject to a beta threshold greater than 2.5 during a *regulatory control period* and seeking to reduce its beta threshold to 2.5 in the subsequent *regulatory control period* must demonstrate to the AER that its proposal is consistent with the objectives of the *scheme* and provide supporting information, as required by clause 2.2 of the *scheme.*

The AER also proposes the following text for use in appendix D:

> The *major event day* boundary is calculated at the end of each reporting period (typically one *regulatory year*) for use during the next reporting period using the 2.5 beta method as follows:
>
> 1. Collect values of daily *unplanned SAIDI* over five sequential regulatory years ending on the last day of the last complete reporting period. If fewer than five regulatory years of historical data are available, the most recent data should be used.
>
> 2. Only those days where an *unplanned SAIDI*/day value > 0 are considered (do not include days that did not have any *interruptions*).
>
> 3. Calculate the natural logarithm (ln) of each daily *unplanned SAIDI* value in the data set.
>
> Apply a commonly accepted statistical test for normality to the data set, and where the data set is normally distributed:
>
> 4. Find α (alpha), the average of the logarithms of the data set.
>
> 5. Find β (beta), the standard deviation of the logarithms of the data set.
>
> 6. The boundary for an extreme event or *major event day* (T_{MED}) is then calculated as follows:
>
> $$T_{MED} = e^{(\alpha + 2.5\beta)}$$

(where the value of 2.5B is adjusted to reflect any alternative amount permitted to be used in accordance with this *scheme*.)

7. Any day in the new reporting period where the total *unplanned SAIDI* exceeds this value of T_{MED} is classified as a *major event day*.

Where application of the statistical test to the data set referred to in step 3 above indicates the data set is not normally distributed:

1. Propose an alternative data transformation method which results in a more normally distributed data set in accordance with clause 2.2 of this *scheme*.

2. Apply the proposed alternative data transformation to calculate each *daily unplanned SAIDI* value in the data set.

3. Find α (alpha) as the average of each daily *unplanned SAIDI* value to which the proposed alternative data transformation method has been applied.

4. Find β (beta) as the standard deviation of each daily *unplanned SAIDI* value to which the proposed alternative data transformation method has been applied.

5. The boundary for an extreme event or *major event day* (T_{MED}) is then calculated such that the transformed value is as follows:

$$T_{MED} = \alpha + 2.5\beta$$

(where the value of 2.5B is adjusted to reflect any alternative amount permitted to be used in accordance with this *scheme*.)

6. Any day in the new reporting period where the total *unplanned SAIDI* exceeds this value of T_{MED} is classified as a *major event day*.

7. In addition to the requirements of clause 2.2 of this *scheme*:

   a. Demonstrate that the natural logarithm of the data set of each *unplanned SAIDI* value is not normally distributed.

   b. Explain the proposed alternative data transformation method.

   c. Provide the calculations that demonstrate the application of the alternative data transformation method to the *unplanned SAIDI* values.

   d. Provide the data set resulting from applying the proposed alternative transformation method.

   e. Demonstrate that the resulting data set is normally distributed or that the normality of the data set is improved.

5.3 Timing of performance measurement

The AER has amended the timing of performance measurement to better align the scheme with the Victorian DNSPs' current approach to reporting performance. As the Victorian DNSPs report on a calendar year basis, and the scheme currently requires performance to be reported on a financial year basis, the amendment seeks to allow performance to be measured on a continuous basis for all DNSPs through the use of regulatory years.

The amendment eliminates the 6 month break in performance measurement data for Victorian DNSPs that would have occurred under a 'financial year only' based scheme. The amendment simplifies the operation of the scheme as it removes the need for the AER to establish a specific transitional arrangement at the beginning of a regulatory control period for those businesses that report on a calendar year basis. The amendment necessitates that all sub-sections of clause 2.4 be amended.

The AER proposes the following text for clause 2.4 of the scheme:

> (a) A DNSP must measure its performance in accordance with this *scheme*:
>
> (1) from the first day to the last day inclusive of each *regulatory year* of the *regulatory control period* to which this scheme applies, or
>
> (2) as otherwise determined by the AER.
>
> (3) [**Deleted**]
>
> (b) Where a DNSP's *regulatory control period* ceases before a full multiple of *regulatory years* has transpired from the start of the *regulatory control period*, the DNSP must measure its performance in the final *regulatory year* until the end of the *regulatory control period* as determined by the AER.
>
> (c) Where clause 2.4(a)(2) applies, the measured performance may be adjusted to represent annualised performance.

5.4 Clarifications and other amendments

5.4.1 Clarifications

5.4.1.1 General application of the scheme

The AER has amended the general application of the scheme to improve its transparency. The amendment involves the insertion of a new clause that clarifies what aspects of the scheme the AER will determine for a DNSP in its distribution determination.

The AER proposes to insert the following clause as clause 2.1(d):

> The AER will, in the distribution determination to which this *scheme* applies, determine the following in accordance with this *scheme*:
>
> (1) each applicable component and *parameter* to apply to a DNSP including the method of network segmentation for the reliability of supply component
>
> (2) the *revenue at risk* to apply to each applicable component and *parameter*
>
> (3) the *incentive rate* to apply to each applicable *parameter* including the value of customer reliability (VCR) to be applied in accordance with clause 3.2.2(d) and appendix B
>
> (4) the *performance target* to apply to each applicable *parameter* in each *regulatory year* of the *regulatory control period*
>
> (5) any decision with respect to the transitional arrangements set out in clause 2.6
>
> (6) the threshold to apply to each applicable GSL *parameter*

(7) the payment amount to apply to the applicable GSL *parameter*

(8) the major event day boundary to apply to a DNSP:

(i) where the DNSP has proposed a *major event day* boundary that is greater than 2.5 standard deviations from the mean; or

(ii) where the *major event day* boundary that applied to the DNSP in previous distribution determinations was greater than 2.5 standard deviations from the mean; or

(iii) where the DNSP has proposed a *major event day boundary* that is greater than 2.5 standard deviations from the mean and where in previous distribution determinations the *major event day boundary* that has applied to the DNSP was greater than 2.5 standard deviations from the mean.

This proposed amendment formalises and clarifies (and lists in the one place) the aspects of the scheme where the AER:

- currently has flexibility to deal with matters in a distribution determination (as highlighted by issues 1–7 above)
- is proposing, as part of this amendment process, additional areas of flexibility (as highlighted by issue 8 above).

5.4.1.2 Proposals to vary the application of the scheme

The AER has amended this clause by clarifying when a DNSP can make a proposal to vary the scheme. The amendment seeks to address the scope for any misunderstanding as to when a DNSP can make a proposal to vary the application of the scheme.

The AER proposes the following text for clause 2.2(a):

> Where the *scheme* indicates that a DNSP can make a proposal to vary the application of this *scheme*, that proposal should be made in the *regulatory proposal* in accordance with and subject to clause 6.8.2 of the NER.

5.4.2 Consequential amendments

5.4.2.1 Process for revision

The AER considers that clause 1.8(f)(1) of the scheme should be amended to better align the scheme with the Victorian DNSPs' current calendar year approach to measuring and reporting performance. The amendment involves the replacement of financial years with regulatory years to expand the type of information that a DNSP may provide to the AER when it seeks to add or vary a parameter.

Clause 1.8(f)(1) and all other proposed amendments can be viewed in the proposed scheme released with this explanatory statement.

5.4.2.2 Values for parameters — Reliability of supply

Performance targets

The AER considers that the process by which performance targets can be set should be amended to permit calendar year data to be the basis for the setting of performance

targets — this has been achieved through reference to regulatory years. The AER has also introduced amendments to clarify that:

- performance targets are set so as not to decline across the regulatory years
- historical performance data that is used to set the performance targets reflects the exclusion boundary adopted under appendix D of the scheme (as well as the exclusions listed in clauses 3.3 and 3.4). This is to ensure that the performance targets, which are based on historical average performance, are set consistent with the exclusion boundary that will be applied under the scheme.

The AER considers that these amendments improve the clarity and operation of the scheme.

The proposed amendments can be found in clause 3.2.1(a), the newly inserted clause 3.2.1(a)(1), and clause 3.2.1(c) of the scheme. The insertion of a new clause has also resulted in some numbering changes in clause 3.2.1.

Incentive rates

The AER has also proposed a consequential amendment regarding how the incentive rates for unplanned SAIDI and SAIFI parameters are calculated to take into account leap years. Put simply, the term 'average' has been included in the third step of the process to clarify that the average number of minutes in a regulatory year is to be used to calculate the incentive rates for unplanned SAIDI and SAIFI parameters.

The proposed amendments can be found in clause 3.2.2(h)(3) and clause 3.2.2(i)(3) of the scheme. The 'worked example' in appendix B has also been amended to reflect this change.

5.4.2.3 Value of parameters — Customer service

Performance targets

In the revised STPIS the AER has also proposed an amendment to the basis on which the performance targets must be set, again as a consequence of the regulatory year based amendments discussed above. The AER has amended the scheme to allow the use of five year's worth of *regulatory year* data to determine the value of the performance targets — to better align the scheme with the Victorian DNSPs' approach to defining the parameters used for performance reporting. The AER has also proposed a new clause to clarify the operation of the scheme.

The proposed text can be found in clause 5.3.1(a), the newly inserted clause 5.3.1(b)(1) and clause 5.3.1(d) of the scheme. The insertion of a new clause has also resulted in some numbering changes in clause 5.3. 1.

5.4.2.4 Appendix C: Adjustments to allowed revenue

The AER has amended a number of examples contained in appendix C to reflect the amendments made in clauses 2.4, 3.2 and 5.3 of the scheme (as detailed above). In general, the amendments involve the replacement of 'years' with 'regulatory years'.

The sub-headings below mirror the headings in appendix C where amendments have been made:

- calculating allowed revenue
- applying the s-factor to the control mechanism
- the operation of the s-bank mechanism
- the service standards s-factor
- overlap between regulatory control periods.

5.4.3 Minor amendments

5.4.3.1 Exclusions (clauses 3.3 and 6.4)

The AER has proposed two minor amendments to reflect the recent (2009) establishment of the Australian Energy Market Operator (AEMO). The amendments replace reference to NEMMCO with AEMO in clause 3.3(a)(4) and 6.4(a)(4).

5.4.3.2 Appendix A: Performance incentive scheme parameters — standard definitions

The AER has amended two definitions contained in appendix A to reflect the amendments made in clauses 2.4, 3.2 and 5.3 of the scheme. The proposed amendments can be found in the definitions for 'Frequency of interruption' and 'Total duration of interruption'. Both amendments involve reference to 'regulatory year' rather than 'year'.

Shortened forms

AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
DNSP	distribution network service provider
ESCV	Essential Services Commission Victoria
IEEE	Institute of Electrical and Electronics Engineers (USA)
NEMMCO	National Electricity Market Management Company
NEL	National Electricity Law
NER	National Electricity Rules
s-factor	service standards factor
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
STPIS	service target performance incentive scheme