Final decision

Electricity distribution network service providers

Service target performance incentive scheme

June 2008

AUSTRALIAN ENERGY REGULATOR

Contents

Shortened forms

AER	Australian Energy Regulator
AEMC	Australian Energy Market Commission
ANZEWON	Australia and New Zealand Energy and Water Ombudsman Network
Capex	capital expenditure
COAG	Council of Australian Governments
CRA	Charles River Associates
DNSP	distribution network service provider
EDSD	electricity distribution and service delivery review
EBSS	Efficiency benefit sharing scheme
ENA	Electricity Networks Association
ESCV	Essential Service Commission (Victoria)
GSL	guaranteed service level
IEEE	Institute of Electrical and Electronics Engineers
MAIFI	momentary average interruption frequency index
NEMMCO	National Electricity Market Management Company
NEL	National Electricity Law
NER or rules	National Electricity Rules

Opex	operating expenditure
s-factor	service standards factor
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SCNRRR	Steering Committee of National Regulatory Reporting Requirements
STPIS or scheme	service target performance incentive scheme
VCR	value of consumer reliability
VoLL	value of lost load

1 Introduction

Following amendments to chapter 6 of the National Electricity Rules (NER) in 2008, the Australian Energy Regulator (AER) is responsible for the economic regulation of distribution network service providers (DNSPs) in the National Electricity Market.

Under the NER, the AER is required to develop and publish certain models, guidelines and schemes. On 1 April 2008, the AER released and invited submissions on the following proposed guidelines, schemes and models that are required to be published under chapter 6 of the NER:

- post-tax revenue model (PTRM)
- roll forward model (RFM)
- cost allocation guidelines
- efficiency benefit sharing scheme (EBSS)
- service target performance incentive scheme (STPIS).

In addition, the AER held a public forum in Melbourne on 23 April 2008 relating to its proposed guidelines, schemes and models and to receive comments from stakeholders.

The AER received 16 written submissions on its proposed guidelines package. This final decision sets out the AER's consideration of the issues raised in these submissions as part of finalising the STPIS. Stakeholders that provided submissions in relation to the proposed STPIS are listed at Appendix A of this final decision. In some instances stakeholders raised issues that are more appropriately addressed in the framework and approach papers that the AER will publish and in the AER's consideration of a DNSP's regulatory proposal (e.g. revenue reset proposal). These issues are noted throughout this decision.

This final decision and the finalised STPIS have been prepared in accordance with the AER's obligations under clause 6.16(e) of the NER.

2 Background

In developing the STPIS, the AER has considered the objectives for reform of economic regulation set out by the Council of Australian Governments (COAG) and endorsed by the Ministerial Council on Energy (MCE) in December 2003, the National Electricity Law (NEL) objective as well as the requirements of chapter 6 of the NER which are outlined in section 3 of this paper.

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 and enhance regulatory certainty, consistent with COAG's objectives. 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 intended to encourage a business to improve its service performance where customers are willing to pay for these improvements. The AER considers that in so doing the STPIS plays a part in balancing the incentives on regulated businesses to ensure outcomes are consistent with the NEL objective in terms of efficient price and non-price outcomes for the long-term benefit of users.

In developing the STPIS, the AER has also had regard to the significant experience of service performance incentive schemes in Australia. Service incentive schemes operate currently or have operated previously in South Australia, Tasmania and Victoria. A paper trial of a scheme has also operated in New South Wales. The schemes in South Australia and Victoria have been applied in two regulatory control periods and are regarded as mature schemes. The AER acknowledges that significant research and thought has already been applied to the design of service performance incentive schemes by various jurisdictions, including enhancements over time as these schemes are applied in practice and their operation is reviewed. The AER has drawn on this experience to develop the STPIS.

In developing this national scheme and in considering its future application, the AER has also had regard to a number of underlying principles which include:

- The scheme should be applied on a consistent basis nationally where this is practical.
- The scheme should provide clarity and certainty to a DNSP regarding how the scheme would be applied.
- The opportunities and risks to DNSPs that arise from operating under the scheme should be transparent, and the onus placed on DNSPs to manage these opportunities and risks.
- The scheme should reflect customer preferences regarding service performance and willingness to pay for service improvements.

The AER has also been mindful to ensure that the design and operation of the scheme would not put at risk a DNSP's ability to comply with relevant service standards and service targets (including guaranteed service levels) specified in jurisdictional electricity legislation, as required by clause 6.6.2 of the NER. The AER notes that

such service standards and targets are currently set by jurisdictional governments and regulators.

By basing the STPIS on existing jurisdictional schemes, the scheme has been developed with regard to past and current industry and community expectations. The scheme has also been designed to provide a degree of flexibility that may be exercised in application to take account of transitional issues and the circumstances of DNSPs given their particular operating environments.

However, the AER notes that the scheme will need to evolve over time as expectations and circumstances change and to reflect changes in the economy, energy industry technology, land use, electricity supply arrangements, climate change policies and other issues affecting customer expectations on service performance and the operating environments of DNSPs. For this reason the STPIS at Appendix C should be seen as a first generation national scheme.

3 Rule requirements

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

6.6.2 Service target performance incentive scheme

(a) The *AER* must, in accordance with the distribution consultation procedures, develop and publish an incentive scheme or incentive schemes (service target performance incentive scheme) to provide incentives (which may include targets) for *Distribution Network Service Providers* to maintain and improve performance.

(b) In developing and implementing a service target performance incentive scheme, the AER:

(1) must consult with the authorities responsible for the administration of relevant jurisdictional electricity legislation; and

(2) must ensure that service standards and service targets (including guaranteed service levels) set by the scheme do not put at risk the Distribution Network Service Provider's ability to comply with relevant service standards and service targets (including guaranteed service levels) as specified in jurisdictional electricity legislation; and

Note:

A service target performance incentive scheme operates concurrently with any average or minimum service standards and guaranteed service level schemes that apply to the Distribution Network Service Provider under jurisdictional electricity legislation.

(3) must take into account:

(i) the need to ensure that benefits to consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme for Distribution Network Service Providers; and

(ii) any regulatory obligation or requirement to which the Distribution Network Service Provider is subject; and

(iii) the past performance of the distribution network; and

(iv) any other incentives available to the Distribution Network Service Provider under the Rules or a relevant distribution determination; and

(v) the need to ensure that the incentives are sufficient to offset any financial incentives the service provider may have to reduce costs at the expense of service levels; and

(vi) the willingness of the customer or end user to pay for improved performance in the delivery of services; and

(vii) the possible effects of the scheme on incentives for the implementation of non-network alternatives.

(c) The *AER* may, from time to time and in accordance with the *distribution consultation procedures*, amend or replace any scheme that is developed and published under this clause.

Note:

A Distribution Network Service Provider is not precluded from entering into a contract with a third party (such as a network support service provider) under which the benefits of a service target performance incentive scheme are passed on to the third party, or the third party is required to indemnify the provider for penalties to which the provider becomes liable under the scheme.

The distribution consultation procedures in clause 6.16 of the NER require the AER to publish a proposed STPIS, explanatory statement and 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 noted above, the AER is required by the NER to consult on the proposed STPIS with authorities responsible for the administration of relevant jurisdictional electricity legislation. The AER contacted these authorities to facilitate this consultation process and a number of the authorities provided submissions on the proposed STPIS and met with AER staff to discuss the proposed scheme.

This final decision and STPIS have been prepared to satisfy the AER's obligations under clause 6.16(e) of the NER.

In developing the STPIS, the AER has also had regard to the following transitional arrangements for Queensland DNSPs provided for under the NER.[1]

11.16.5 Service Target Performance Incentive Scheme

In formulating a *service target performance incentive scheme* to apply to ENERGEX and Ergon Energy for *the regulatory control period*, the AER, in addition to the requirements in clause 6.6.2(b), must also:

(1) take into account the continuing obligations on ENERGEX and Ergon Energy throughout the regulatory control period to implement the recommendations from the EDSD Review adopted by the Queensland Government;

(2) take into account the impact of severe weather events on service performance; and

(3) consider whether the scheme should be applied by way of a paper trial or whether a lower powered incentive is appropriate.

The AER has set out in Appendix B how it has complied with the rule requirements.

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 the NER.

[1] In formulating the STPIS, the AER must also have regard to the transitional arrangements for Queensland DNSPs provided for under the NER that are applicable to the STPIS.

4 Reasons and basis for scheme

The regulatory framework under the NER applying to the revenue that can be recovered by DNSPs provides an incentive for DNSPs to become more cost efficient. A DNSP may seek to reduce its costs in two ways:

- realising productive efficiencies
- deferring expenditure on forecast programs leading to a reduction in service performance.

Cost reductions from genuine efficiency gains are generally accepted as being beneficial for both the DNSP and its customers as long as service performance is maintained or improved. However, savings realised from inefficient levels or deferrals of operating and capital expenditure are not desirable as they can result in reduced service performance to customers.

The rationale for a STPIS is to balance the incentive to reduce expenditure with the need to maintain and improve service performance for customers. This can be achieved through the provision of non-financial incentives such as monitoring and publicly reporting against specified service standards,[2] or through financial incentives such as rewards and penalties based on the service outcomes delivered. As noted previously, DNSP service standards are currently set by jurisdictional governments and regulators through jurisdictional electricity legislation.

The STPIS (through its s-factor component) provides a financial incentive for DNSPs to maintain and improve service performance on average by assigning rewards or penalties to a DNSP where performance is either better or worse than the past average performance level respectively.

The rate at which rewards and penalties are assigned is based on customer willingness to pay, which has been derived from customer surveys and previous economic studies. The rationale for this approach is based on the economic notion that the schedule of rewards and penalties should mimic customers' marginal willingness to pay for improved service performance. This allows a DNSP to change its service performance up to the point where the optimal level of service performance is attained, that is, the marginal cost of improving performance equals the reward for doing so.

In practice this means that where a DNSP's actual cost of undertaking works to improve service performance is less than the reward provided through the scheme the DNSP has an incentive to carry out the works and achieve the desired performance level. In this way the scheme can act as an additional cost-recovery mechanism for service performance improvements, where these improvements are over and above those being funded through the revenue allowed in a distribution determination. As the scheme is symmetrical, that is penalties are accrued at the same rate as rewards, there is also an incentive under the scheme for a DNSP to maintain its service performance.

[2] The AER will publicly report on the service performance of DNSPs in the future. The AER will consult with DNSPs and other stakeholders on the reporting measures through consultation on the AER's future annual reporting arrangements for DNSPs.

The guaranteed service levels (GSL) component of the STPIS has a role in both improving service to customers receiving poor performance and providing recognition, through an appropriate payment, to customers that have received poor performance.

5 Outline of scheme operation

The STPIS is in the form of a framework within which appropriate performance parameters and parameter values are selected and applied through the framework and approach and distribution determination processes applicable to a DNSP under the NER.

The STPIS includes four aspects of service performance:

- reliability of supply
- quality of supply
- customer service
- GSLs.

One or more of these components of the STPIS may apply to a DNSP. Each component of the scheme comprises defined parameters for measuring service performance.

The 'reliability of supply', 'quality of supply' and 'customer service' components of the scheme are known as the s-factor components. These s-factor components determine whether a DNSP's revenue is increased (or decreased) based on changes in service performance between years relative to its historical average performance in previous years, as assessed by the AER in accordance with the scheme. The scheme operates so that a DNSP that meets a performance target across a forthcoming regulatory control period is neither rewarded or penalised overall under the scheme.

Under the GSL component, payments are made directly to customers where the service performance received by those customers does not meet the thresholds specified in the STPIS. These payments are estimated using current performance and are reflected in a DNSP's annual revenue requirement as set out in the relevant distribution determination.

The AER also notes that the GSL component of the STPIS will not apply to a DNSP where jurisdictional electricity legislation imposes an obligation on a DNSP to operate a GSL scheme.

Values for the parameters that may be applied to a DNSP include:

- performance targets, typically based on historical performance; and
- incentive rates, typically based on how customers value the service.

In addition, the STPIS specifies caps on the revenue at risk for a component of the scheme and exclusions for defined events.

A cap on the overall revenue change in any one year (the revenue at risk) is also specified to limit the financial impact of the scheme for a DNSP.

5.1 Application of the scheme

As outlined above, the STPIS is in the form of a framework which will be applied as part of the AER's framework and approach and distribution determination processes applicable to a DNSP.

The framework and approach paper for each DNSP will set out the AER's likely approach to how the STPIS will be applied when assessing a particular DNSP's regulatory proposal. For these purposes, a DNSP's regulatory proposal must contain at least:

- as part of the building block proposal, a description, including relevant explanatory material, of how the DNSP proposes the STPIS should apply for the relevant regulatory control period (in accordance with clause S6.1.3(4) of the NER) and

- such information as is required under any relevant regulatory information instrument issued by the AER.

Following this, the AER will make a decision on how the STPIS is to apply to a DNSP in each distribution determination.

Through the design of the STPIS and the operation of the framework and approach and distribution determination processes in the NER, the STPIS and its supporting regulatory arrangements provide for some flexibility in the application of the scheme. This is to accommodate, as appropriate, the individual circumstances of a DNSP, for example, where the DNSP has previously operated under an equivalent jurisdictional scheme and where there are differences between DNSP operating environments (e.g. specific service performance issues that may arise in a jurisdiction or DNSP service area).

Notwithstanding this, where a DNSP proposes that the AER adopt a flexible approach to the application of the STPIS, as provided for in the scheme (e.g. by adopting a different overall cap on the revenue at risk to that specified in the scheme), then it will need to satisfy the AER that such modifications satisfy the objectives of the scheme.

5.2 S-factor component

As outlined above, the reliability of supply, quality of supply and customer service components of the scheme make up the s-factor component of the scheme. This section sets out the key design features of the s-factor component.

- The s-factor component is symmetrical as penalties are incurred at the same rate as rewards. This symmetry provides the incentive for a DNSP to maintain and improve service performance.

- The s-factor is determined by calculating the gap between targeted performance and actual performance in a year less the same gap in the previous year. By acting on the cumulative difference between actual and targeted performance, the scheme only rewards (or penalises) long term systemic changes in performance rather than year on year (absolute) variations.

- The reward or penalty incurred by the DNSP is maintained for five years from when it is incurred. This approach aligns the scheme with the incentive and carryover arrangements under the AER's EBSS.[3]

- There is a 6 month or 12 month delay from the year in which performance was measured to when the s-factor is applied depending on whether the regulatory control period begins on 1 January or 1 July.

- Performance targets are to be based on the average performance over the past five years adjusted for any planned reliability improvements.

- Incentive rates are based on a customer's willingness to pay for service improvements.

- There is an overall cap on the revenue at risk in the scheme of 3 per cent. There is a 1 per cent cap on the customer service component of the scheme and a 0.5 per cent cap on any individual customer service parameter to ensure that the focus of the scheme is on reliability.

- Outlier performance (e.g. due to extreme weather / events) will be excluded by using the 2.5 beta method described in the US Institute of Electrical and Electronics Engineers (IEEE) Standard 1366-2003. In addition, the scheme identifies a list of events outside the control of the DNSP that may be excluded from the scheme.

- Application of the s-factor or a portion of the s-factor can be delayed in any one year to smooth the impact on customer prices (s-bank).

- How the s-factor will be incorporated into the form of control will be outlined for each business through the framework and approach process for a distribution determination, as this process determines the form of control that will be applied to the DNSP for the applicable regulatory control period.

5.3 GSL component

- The GSL component has a role in both improving service to customers receiving poor performance and providing recognition to customers, though an appropriate payment, that have received poor performance.

- The expected volume of GSL payments is estimated using current performance and is included in the annual revenue requirement set in the distribution determination made by the AER.

- GSL parameters, thresholds and payment amounts in the STPIS have been based on existing jurisdictional arrangements.

[3] See AER, June 2008, *Electricity distribution network service providers: Efficiency benefit sharing scheme*, available at www.aer.gov.au.

- Payments are required to be made to customers automatically as opposed to on application from the customer.

- The GSL component applies different thresholds of performance to different parts of the network for the frequency and duration of interruptions parameters.

- The GSL component uses the same exclusion criteria that apply to the s-factor component.

- The GSL component of the AER's STPIS will not be applied where a DNSP is already subject to a jurisdictional GSL scheme.

6 Issues raised in submissions and AER response

This section outlines the main issues raised in submissions from stakeholders in relation to the AER's proposed STPIS, which was accompanied by an explanatory statement and a discussion paper, released on 1 April 2007. It provides a summary of each issue raised and the AER's response.

6.1 Clarity of the proposed scheme

In the explanatory statement and discussion paper on the proposed scheme, the AER sought comment from stakeholders on whether there was sufficient clarity in the proposed scheme so that DNSPs can plan the actions they need to take to be able to comply with the scheme when it is implemented.

6.1.1 Stakeholder comments

A few stakeholders considered the proposed scheme was not sufficiently clear and suggested it should specify the information that a DNSP will be required to include in its building block proposal and the nature of the matters that the AER intends to address in its framework and approach paper.[4]

6.1.2 AER response

The AER considers the STPIS does provide sufficient clarity on how it will operate. In terms of the specific performance parameters and other parameter values that are relevant, it is more appropriate for the framework and approach and distribution determination processes to detail more specific requirements relevant to each DNSP, including information requirements. The specific matters to be addressed in the framework and approach process for each DNSP will be determined by the AER at the time of undertaking this process. The framework and approach papers that the AER will publish in relation to ETSA Utilities, Ergon Energy and Energex will be representative of the matters the AER will address in the framework and approach papers for future regulatory determinations.

Details on the information DNSPs will be required to provide as part of their regulatory proposals will be specified by the AER in regulatory information instruments. The AER will consult fully with interested parties when developing those instruments but considers that the STPIS and this decision document provide sufficient clarity for DNSPs to plan and implement the actions they need to take to be in a position to comply with the scheme when it is implemented.

6.2 Planned interruptions

In the explanatory statement and discussion paper that accompanied the proposed scheme, the AER sought comment from stakeholders on the inclusion of planned interruptions in the reliability measures.

[4] Ergon Energy, 14 May 2008, *Response to AER proposed STPIS*, p.7; Aurora Energy, 15 May 2008, *Response to AER proposed STPIS*, p.6.

6.2.1 Stakeholder comments

Most stakeholders opposed this inclusion, specifically in the s-factor component of the proposed scheme. For example, the Energy Networks Association (ENA) commented:

> Including planned interruptions is inconsistent with maximising incentives to maintain the network and there are potential negative incentives concerning the safety of network operation that are unnecessarily introduced though taking this approach…This approach is also economically unsound as it presumes that customers are indifferent between planned and unplanned outages (fixed time interruptions commonly occurring in business hours with several weeks or days notice) and unplanned outages, which are by the nature episodic and of varying durations. The ENA is unaware of evidence to support this presumption which is at odds with customers capacity to avoid or shift at least elements of their electricity usage.[5]

A number of stakeholders commented that it was incorrect for the AER to assume that planned interruptions only made up a small percentage of interruptions. For example, ActewAGL noted that planned interruptions make up 50 per cent of its total interruptions.[6]

A few stakeholders suggested that if planned interruptions were to be included then it should have a lower incentive rate than unplanned interruptions reflecting the lower impact of these interruptions to customers evident from some DNSP customer surveys.[7]

6.2.2 AER response

The AER recognises planned interruptions are necessary to carry out required works on the network such as maintenance and new connections. The reason for including planned interruptions in the s-factor component of the proposed scheme was to provide incentives to improve the efficiency of undertaking planned works.

However, the AER acknowledges that there are already cost efficiency incentives available in the regulatory framework applicable to DNSPs (through the CPI-X form of regulation and the operation of the EBSS) which are designed to improve the efficiency of a DNSP's performance, including planned works. Given that this suite of operational efficiency incentives will be in place for the national regulation of DNSPs the AER has decided not to include planned interruptions in the scheme at this time. The AER intends to report publicly on the level of planned interruptions in the future to ensure that this aspect of service performance can be monitored.

6.3 Customer service component

A number of stakeholders raised issues about the customer service component of the scheme. The customer service component may include telephone answering, streetlight repair, new connections and response time to written enquiries. However, at this time the AER has only mandated telephone answering in the STPIS.

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5 ENA, 1 February 2008, *Response to AER proposed STPIS*, p.5.

6 ActewAGL, 14 May 2008, *Response to AER proposed STPIS*, p.3.

7 Citipower and Powercor, 14 May 2008, *Response to AER proposed STPIS*, p. 6; ActewAGL, 14 May 2008, *Response to AER proposed STPIS*, p.3

6.3.1 Stakeholder comments

Aurora Energy did not support the inclusion of any of the parameters. It stated:

> Aurora does not support the inclusion of customer service measures proposed under sections 5.1(a) – (c) of the Guidelines in the Scheme. Aurora considers that measures such as telephone answering are a relatively minor component of a DNSP's activities and are not indicative of the level or quality of service that a customer receives. Aurora suggests that the inclusion of such measures in the Scheme be optional and up to the discretion of an individual DNSP.[8]

Ergon Energy did not support the customer service component. It suggested that the telephone answering parameter was too narrow and that optional parameters were covered by GSLs. Rather, Ergon Energy proposed that the AER consider a more holistic measure of 'customer satisfaction'.[9]

CitiPower and Powercor considered that the 'response to written enquiries' parameter should not be included in the scheme. They stated:

> The businesses receive relatively few written enquiries. The vast majority of enquiries are received though the call centre which is already included as part of the Service Incentive Scheme.[10]

CitiPower and Powercor also commented on the inclusion of 'notice of planned interruptions'. They stated:

> The 'notice of planned interruptions' is a regulatory obligation to be complied with at all times and there is simply no headroom for improvement above the regulatory floor.[11]

In regard to the streetlight repair parameter, Energex noted that streetlight repair is not currently a standard control service in Queensland and therefore should not be in the scheme.[12]

6.3.2 AER response

The AER has included a customer service component in the STPIS as this aspect of performance has been demonstrated to be important to customers, as reported in distribution determinations undertaken by jurisdictional regulators. Also, customer service components have generally been applied in mature service performance incentive schemes operating in Australia and in Great Britain.

However, the AER has maintained reliability as the main focus of the s-factor aspect of the final STPIS and has capped the revenue at risk on the customer service component at 1 per cent to reflect this. Additionally, the AER has capped the revenue at risk on any individual customer service parameter at 0.5 per cent.

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8 Aurora Energy, 15 May 2008, *Response to AER Proposed STPIS*, p. 6.

9 Ergon Energy, 14 May 2008, *Response to AER Proposed STPIS*, p.4.

10 CitiPower and Powercor, 14 May 2008, *Response to AER proposed STPIS*, p. 7.

11 Ibid.

12 Energex, 14 May 2008, *Response to AER proposed STPIS*, p. 18.

The AER has included telephone answering in the customer service component of the final scheme as:

- there is evidence from customer surveys that customers value this parameter
- the data on which the parameter is based is readily available and accurate
- it is used in mature service performance incentive schemes operating in South Australia, Victoria and Great Britain.

In addition to the telephone answering parameter, there are a number of other customer service parameters that a DNSP may seek to incorporate, or that the AER may determine, in the s-factor through the application of the scheme. The AER generally considers that these aspects are best addressed through the GSL component of the scheme. However, should a particular aspect of service be of concern to stakeholders or a DNSP, it may be included in the customer service component of the STPIS and be measured as part of the s-factor. This is intended to provide a further incentive to improve performance for these parameters and can act as a cost recovery mechanism for such improved service performance.

In relation to the 'response to written enquiries' parameter, the AER recognises that a DNSP may only receive a small amount of written enquiries. However, the AER considers that a customer who has taken the time to write to a DNSP deserves to receive a timely response. The AER has maintained this as an optional parameter in the STPIS.

The AER agrees with CitiPower and Powercor that the 'notice of planned interruptions' parameter is not suitable for inclusion in the customer service component of the STPIS and has accordingly removed this parameter in the final scheme.

In relation to Energex's comment on the 'streetlight repair' parameter and its exclusion on the grounds that it is not currently a standard control service in Queensland, the AER acknowledges that a parameter should not apply where the service it relates to is subject to effective competition. Clauses 5.1(e) and 6.2(c)(4) have been added to the STPIS to reflect this.

6.4 The overall cap on the s-factor component

In the explanatory statement and discussion paper on the proposed scheme, the AER sought comment on its proposal to cap the revenue at risk for the s-factor component at 3 per cent. Comment was also sought on the proposed revenue at risk for the customer service component and an individual parameter within the customer service component, proposed as being at 1 per cent and 0.5 per cent respectively.

6.4.1 Stakeholder comments

Most stakeholders supported the proposed 3 per cent cap. However, ETSA Utilities considered that the cap was too high noting that it could expose DNSPs and customers to significant financial risks.[13]

SP AusNet submitted that the scheme should be uncapped and stated:

> the introduction of a cap will unnecessarily conflict with the working of the s-factor scheme.[14]

The ENA stated it:

> supports the concept of a distributor being able to nominate 3% revenue at risk as a 'safe harbour' provision, but considers that distributors should also have the flexibility to propose schemes that are either:
>
> low powered, particularly as a transitionary measure; or
>
> high powered and which do not feature maximum caps, reflecting the policy choice of governments to not impose a maximum threshold through the recently finalised National Electricity Distribution Rules[15]

ETSA Utilities and SP AusNet both queried whether under and over performance outside of the cap was subject to being carried forward under the scheme.[16]

6.4.2 AER response

The AER considers that imposing a notional 3 per cent cap maintains a sufficient enough incentive for a DNSP to improve service performance without imposing undue risk. The STPIS also provides for this cap to be increased or decreased where this would satisfy the objectives of the scheme. However, a DNSP must provide good reasons to the AER to move away from this notional cap. The AER notes that it has discretion over the level of revenue at risk that is applied under the STPIS.

In forming its view on the level of revenue at risk the AER considered that:

- a consistent national approach would be fair
- an uncapped scheme may introduce an unreasonable level of risk for DNSPs that have not previously operated under a service performance incentive scheme
- to date, the greatest change in annual revenue under a jurisdictional s-factor scheme has been 2.6 per cent.[17]

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13 ETSA Utilities, May 2008, *Response to the AER proposed STPIS*, p. 4.

14 SP AusNet, 14 May 2008, *Response to AER proposed STPIS*, p.3.

15 ENA, 1 February 2008, *Response to AER proposed STPIS*, p. 4.

16 SP AusNet, 14 May 2008, *Response to AER proposed STPIS*, p.3; ETSA, Utilities, May 2008, *Response to AER proposed STPIS*, p.4.

17 The greatest change in revenue to date under a jurisdictional s-factor scheme has been a 2.6 per cent penalty for SP AusNet in 2002 and again in 2004 (although there were offsetting rewards in other years) under the ESCV's service performance incentive scheme in Victoria.

The AER notes submissions did not raise any concerns on the proposed caps for the customer service component and the individual customer service parameters. Accordingly the AER has not made any changes to these caps in the STPIS. The AER also notes that any under or over performance (penalties and rewards) outside the cap is not subject to being carried forward under the scheme.

6.5 Incentive rates

In the explanatory statement and discussion paper on the proposed scheme, the AER sought comment on the proposed approaches for setting incentive rates for the reliability and customer service components of the STPIS.

6.5.1 Stakeholder comments

Some stakeholders were concerned that the methodology proposed may not reflect individual characteristics of a DNSP's customer base. For example Aurora Energy stated:

> The application of Victorian and South Australian "Willingness to Pay" may not reflect the characteristics of an individual DNSPs customer base including variations with respect to customer demographics, growth rates and willingness to pay.[18]

Energex was concerned that the incentive rates may not adequately represent the current economic climate and its impact on customers since 2002.[19]

Aurora Energy suggested that a DNSP be allowed to propose alternative values where it can be demonstrated that these more appropriately reflect the DNSP's individual circumstances.[20]

6.5.2 AER response

The AER notes that the Charles River Associates (CRA) study and Essential Services Commission Victoria (ESCV) analysis is the most recent documented and robust work on reliability incentive rates.[21] The AER has based the incentive rate for the reliability component of the scheme on this work.

This work uses the value of consumer reliability (VCR) to set the overall incentive rate, and willingness to pay information to set the weighting of the incentive rate between the various reliability parameters. In response to the comments from Aurora Energy and Energex, the AER notes that the STPIS allows for an incentive rate based on an alternative VCR. The STPIS also provides that where a DNSP proposes an alternative VCR it must provide the AER with the methodology used to calculate the value and the research that supports the calculation. The AER would expect a DNSP to demonstrate why the VCR in the scheme is not appropriate and how an alternative VCR is consistent with the objectives of the scheme. The AER considers that any

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18 Aurora Energy, 15 May 2008, *Response to AER proposed STPIS*, p.8.

19 Energex, 14 May 2008, *Response to AER proposed STPIS*, p.12.

20 Aurora Energy, 15 May 2008, *Response to AER proposed STPIS*, p. 8.

21 Charles River Associates, 2002, *Assessment of the Value of Consumer Reliability (VCR) - report prepared for VENCorp*, Melbourne; Essential Services Commission, 2006, *Electricity Distribution Price Determination 2006-2010 Volume 1*.

future assessments of the VCR would need to be objective and consider input from relevant stakeholders.

6.6 Non-network alternatives to augmentation

In the proposed scheme the AER proposed that performance targets for reliability be adjusted to account for the effect of any non-network alternatives to augmentation of the distribution system. This provision was included so that the scheme would not have the effect of undermining incentives for DNSPs to undertake non-network alternatives, having regard to the incentive arrangements for efficient non-network alternatives that are provided for under the NER. The AER considered that a DNSP may have an incentive to undertake capital expenditure for its distribution network instead of enabling non-network alternatives, if non-network alternatives are less reliable and could affect the DNSP's service performance under the scheme.

In the explanatory statement and discussion paper the AER sought comment on whether this mechanism was sufficient to perform this task and whether there were any other mechanisms that the AER should consider.

6.6.1 Stakeholder comments

Stakeholders expressed some uncertainty about how this mechanism would operate in practice. For example, Energex stated:

> Energex is unclear how the balance between network and non-network solutions will be achieved under the proposed scheme. The availability of non-network solutions is currently limited and the lead time to implement DSM solutions can be lengthy. Given the lower reliability of non-network solutions which will adversely impact on SAIDI there may be a disincentive to adopt non-network solutions if the scheme does not include any appropriate recognition.[22]

Aurora Energy stated:

> It is not clear how a mechanism to balance non-network augmentation with non-network alternatives would work in practice. Aurora request that the AER include details of the proposed operation in the Guidelines.[23]

Similarly, ETSA Utilities stated:

> A DNSP would not be able to forecast the impact of non-network alternative to augmentation until the decision is made to implement a non-network alternative as it provides a financial benefit to customers and passes the regulatory test. We consider that an improved option would be to exclude the contribution to reliability that results from failure of a non-network alternative. This may mean that all or part of an interruption is excluded from the determination of the reward or penalty under the STPIS.[24]

6.6.2 AER response

The AER agrees that the approach to accounting for non-network alternatives in the proposed scheme raised issues of practical application. For this reason, references to

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22 Energex, 14 May 2008, *Response to AER proposed STPIS*, p. 12.

23 Aurora, 15 May 2008, *Response to AER proposed STPIS*, p.7

24 ETSA Utilities, May 2008, *Response to AER proposed STPIS*, p. 4.

non-network alternatives have been removed from the section of the scheme that deals with the setting of performance targets (i.e. clause 3.2.1 of the STPIS).

The AER notes ETSA Utilities' proposal that the contribution of reliability that results from the failure of a non-network alternative could be excluded from a DNSP's service performance after the event. The AER considers that while such an exclusion can have the effect of not unduly discouraging non-network alternatives to augmentation, it is also the case that providing such an exclusion for non-network alternatives may place an undue level of risk on customers. This could take the form of less reliable service performance arising from unsuccessful non-network alternatives, that is not acceptable to customers not directly party to the establishment of non-network alternatives (e.g. demand management arrangements). The AER considers that such an adjustment to the STPIS, which is fundamentally intended to maintain or improve service performance, would be inappropriate as customers should not be worse off in terms of the level of service performance they receive due to the implementation of non-network alternatives. The AER has therefore not included an exclusion for non-network alternatives as it intends that the STPIS be as neutral as possible regarding the level of reliability provided by network solutions vis-à-vis non network alternatives (i.e. DNSP service performance is not distinguished on this basis in the STPIS).

The AER considers that the risks associated with the reliability of a non-network alternative should be managed by a DNSP as it is the party best able to manage that risk through the commercial arrangements it establishes in relation to non-network alternatives. The AER recognises the complexity associated with a DNSP's decision on whether to invest in non-network alternatives as compared to investment in network augmentation. The AER intends to further consider the issues associated with providing incentives for non-network alternatives when it consults on a future national demand management incentive scheme for DNSPs.

6.7 Exclusions

The proposed STPIS provided that the 2.5 beta method described in the IEEE Standard 1366-2003 would be used to determine exclusions under the scheme.[25] In addition the proposed STPIS identified specific events, the impact of which would be excluded under the STPIS. Stakeholders made a number of comments on both these matters.

6.7.1 Stakeholder comments on the 2.5 beta method in the IEEE 1366-2003 standard

Most stakeholders were concerned with the midnight to midnight timeframe for calculating daily SAIDI under the 2.5 beta method. In particular it was noted that extreme events which occurred over more than one calendar day may not be excluded under this method.[26] Some stakeholders proposed a rolling 24 hour timeframe in

[25] IEEE Power Engineering Society, 2004, *IEEE Guide for Electric Power Distribution Reliability Indices*, New York, USA.

[26] ETSA Utilities, May 2008, *Response to AER proposed STPIS*, p.9; Aurora Energy, 15 May 2008, *Response to AER proposed STPIS*, p.9; Ergon Energy, 14 May 2008, *Response to AER proposed STPIS*, p.16.

response to this issue. There were also other comments in relation to the 2.5 beta method including a proposal to amend the IEEE standard.

In relation to the application of the 2.5 beta method to its SAIDI data, ETSA Utilities noted that:

> the natural log distribution of daily unplanned SAIDI is skewed (i.e. not "normal /Gaussian") and therefore the statistical manipulation undertaken in determining "major event days" in accordance with the IEEE standard is not valid.[27]

ETSA Utilities preferred the Steering Committee on National Regulatory Reporting Requirements (SCNRRR) method for calculating exclusions. The SCNRRR method excludes an event where the DNSP wide weather related SAIDI exceeds 3 minutes for a single event. Alternatively ETSA Utilities suggested using 2 day average SAIDI to determine a major event day using the 2.5 beta method.

CitiPower and Powercor suggested that separate SAIDI and SAIFI thresholds should be applied to address widespread events affecting a large number of customers for relatively short durations.

6.7.2 AER response

The AER notes that the intention of allowing exclusions in the STPIS is to remove outlier performance (i.e. due to extreme weather or other events) that may distort the incentive properties of the scheme. For the purposes of the STPIS, the AER considers the IEEE standard to be a robust method for determining exclusions and notes its adoption by a number of Australian jurisdictions to measure the service reliability of DNSPs. The IEEE standard recognises the midnight to midnight timeframe limitation but accepts this in exchange for the simplicity and ease of calculation of the method.[28] The AER notes that the IEEE standard measures outages using a defined period (i.e. midnight to midnight) and legitimately provides for exclusions to be calculated on the same basis.

The AER further notes that while the data referred to by ETSA Utilities in its submission appears to demonstrate that the natural log of daily SAIDI is skewed, the second data set referred to by ETSA Utilities suggested better statistical results (i.e. closer to a log normal distribution), albeit in relation to a shorter time period.[29] This is important because ETSA Utilities recently altered its process of recording reliability performance and it is the more recent data that shows the higher correlation. However, the AER is of the view that insufficient historical data is available to determine the actual degree of correlation.

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.

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27 ETSA Utilities, May 2008, *Response to AER proposed STPIS*, p.9..

28 IEEE Power Engineering Society, 2004, *IEEE Guide for Electric Power Distribution Reliability Indices*, New York, USA, p.26.

29 ETSA Utilities, May 2008, *Response to AER proposed STPIS*, p.9.

In relation to the issue raised by CitiPower and Powercor regarding separate SAIDI and SAIFI thresholds, the AER notes the statement in the IEEE Standard 1366-2003 that SAIDI has been adopted to set the threshold for major event days instead of SAIFI because SAIDI is a better measure of the total cost of reliability events, including utility repair costs and customers losses.[30]

The AER has decided to maintain the 2.5 beta method described in the IEEE Standard 1366-2003 to determine exclusions in the STPIS.

6.7.3 Stakeholder comments on specific excluded events

A number of stakeholders proposed that the list of excluded events be expanded to include existing jurisdictional exclusions such as:

- directions from police and other authorised emergency service personnel
- directions from NEMMCO or a system operator
- automatic under frequency load shedding
- an interruption caused by a customer's electrical installation or failure of that electrical installation.[31]

6.7.4 AER response

The AER agrees that exclusions for load shedding due to directions from NEMMCO or a system operator and due to under frequency should be recognised. These events are exclusions in the final STPIS.

Exclusions at the direction of police and other authorised emergency personnel have not been specifically included in the final STPIS. The AER considers that such events do not occur often and will generally have a minor impact on performance, which will in any case be reflected in the historical data used to set targets under the reliability parameters in the STPIS. The AER notes that where such directions are associated with a major event (for example, a major storm or bushfire) the event would generally be captured by the 2.5 beta method exclusion criteria.

Exclusions due to a customer's electrical installation have also not been specifically included in the final STPIS on the basis that it is often difficult to determine whether a customer's installation has caused a service interruption or whether the interruption is due to a distribution network protection system not responding appropriately to a customer fault. Also, outages due to a customer's electrical installation are unlikely to be material to the performance measured under the reliability parameters in the STPIS.

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30 IEEE Power Engineering Society, 2004, *IEEE Guide for Electric Power Distribution Reliability Indices*, New York, USA, p.26.

31 Energex, 14 May 2008, *Response to AER proposed STPIS*, p.13; Ergon Energy, 14 May 2008, *Response to AER proposed STPIS*, p.16-17; ENA, 1 February 2008, *Response to AER proposed STPIS*, p.5; SP AusNet, 14 May 2008, *Response to AER proposed STPIS*, p.3; Alinta AE, 16 May 2008, *Response to AER proposed STPIS*; United Energy Distribution, 16 May 2008, *Response to AER proposed STPIS*, p.27..

However, the final STPIS has allowed for exclusions due to load interruptions caused by the exercise of any obligation, right or discretion imposed upon or provided for under jurisdictional electricity legislation applying to a DNSP. Clauses 3.3(8) and 6.4(8) have been added to reflect this change.

6.8 Maintaining the reward or penalty and aligning the scheme with the EBSS

The proposed scheme included a mechanism to maintain the revenue increment (or decrement) for an appropriate period of time (i.e. the $S'_{t-t'}$ term specified at Appendix C of the proposed scheme). The AER proposed that the reward or penalty incurred by a DNSP would be maintained for five years from when it was incurred. This approach aligned the scheme with incentives and carryover arrangements under the AER's EBSS. Aligning the retention periods in this manner minimised the potential for the STPIS and the EBSS to interact in such a way that could reduce the incentives provided. The AER sought comment on this proposed mechanism.

6.8.1 Stakeholder comments

United Energy Distribution considered that the mechanism proposed for maintaining the reward or penalty appeared counterintuitive and queried the purpose of providing a DNSP with a bonus for out performance in the current period, only to apply a 'penalty' six years later.[32]

6.8.2 AER response

The AER considers that maintaining the revenue increment for a set period ensures that customers do not indefinitely pay for service improvements made in the past. The STPIS provides that a DNSP will retain a reward or incur a penalty for a 5 year period. This results in an approximate 70:30 sharing ratio of the reward/penalty between customers and DNSPs respectively and aligns the scheme with the EBSS. The AER considers this approach to be appropriate.

6.9 Timing of the incentive and the measurement of performance

In the explanatory statement and discussion paper on the proposed scheme, the AER recommended that all reporting to the AER be on a calendar year basis to facilitate public reporting and to streamline the administration of annual regulatory processes applicable to DNSPs. This would result in a six month lag between measured performance and the application of the s-factor for DNSPs operating on a financial regulatory year (i.e. DNSPs in all jurisdictions except Victoria) and a 12 month lag for those operating on a calendar regulatory year (i.e. Victorian DNSPs).

6.9.1 Stakeholder comments

Energex and Ergon Energy did not consider 6 months to be a long enough period to collect and report on performance information in order to apply the s-factor.
Ergon Energy stated:

[32] United Energy Distribution, 16 May 2008, *Response to AER proposed STPIS,* p.25.

> It should be recognised that, in reality, the proposed timeframes become compressed by the requirement for network prices to be established and submitted in March each year for publication by 31 May. That is, the proposed 6 month window between the end of the reporting period and the application of the s-factor to customer prices effectively becomes 3 months.[33]

Ergon Energy also noted that the proposed change in the performance reporting period would require it to separate its storm season, which falls between October and February, into two separate reporting periods.[34]

Some stakeholders also noted the costs of moving to calendar year reporting. For example, Aurora Energy stated:

> Aurora is currently required to provide its regulatory reporting on a financial year basis. While it is possible for Aurora to report on a calendar basis, such reporting is likely to entail substantial administrative costs both in terms of modification of the current data capture process and the potential for dual reporting of information to support jurisdictional requirements and the requirements of the AER.[35]

6.9.2 AER response

The AER has reviewed its proposal for performance reporting on a calendar year basis and has decided that it is appropriate for performance reporting to be on a financial year basis for the purposes of the STPIS. This aligns the period for reporting under the STPIS with the current performance reporting period of the majority of jurisdictions and with other instruments and schemes administered by the AER relating to the regulation of DNSPs.

The AER notes that DNSPs are required to submit their annual pricing proposals two months before their pricing arrangements are implemented. Under the STPIS there will be a 12 month period between the end of the performance year for the scheme and the start of the regulatory year for pricing purposes, for the majority of DNSPs. The AER considers this provides ample time to incorporate performance outcomes under the STPIS into the annual pricing arrangements.

The AER notes that there will be a six month period between the end of the performance year for the STPIS and the start of the regulatory year for Victorian DNSPs. The AER considers this provides sufficient time for these DNSPs to incorporate performance outcomes under the STPIS into the annual pricing arrangements.

The AER recognises that although DNSPs moving to reporting performance on a financial year basis may incur a once-off cost in doing so which will be recovered through customer prices, it considers the transition to a consistent national service performance incentive scheme will provide ongoing benefits to consumers.

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33 Ergon Energy, 14 May 2008, *Response to AER proposed STPIS*, p.18.

34 Ibid.

35 Aurora Energy, 15 May 2008, *Response to AER proposed STPIS*, p. 10.

6.10 Transitional issues

In its explanatory statement and discussion paper on the proposed scheme, the AER recognised that there may be transitional issues which arise when applying the STPIS both initially and from one regulatory control period to the next. The AER noted that it would address any transitional issues as they arose.

6.10.1 Stakeholder comments

United Energy Distribution and Alinta claimed that a change to incentive rates between regulatory control periods has led to unintended consequences in Victoria.[36]

United Energy Distribution also noted that a transitional issue arose from resetting the targets at the beginning of each regulatory control period. It stated:

> Changes to performance targets or incentive weightings (i.e. the amount of incentive for the same value of performance) during the life of the scheme can have the effect of producing some significant penalties or rewards that are totally inconsistent with the reliability performances delivered for customers.[37]

6.10.2 AER response

The AER recognises that changing the incentive rate between regulatory control periods can lead to windfall gains and losses for DNSPs in the first year of the regulatory control period. However, the AER considers this only occurs where there is a step change in the incentive rates between regulatory control periods. The magnitude of the incentive rates in the STPIS are the same as that which currently applies in Victoria. The AER therefore does not consider there will be transitional issues of this nature for Victorian DNSPs.

The AER agrees that changes in performance targets between regulatory control periods may lead to rewards or penalties inconsistent with the level of service performance delivered for customers. The s-factor calculation applicable to the first year of the regulatory control period has accordingly been adjusted to address this issue.

The s-factor in the STPIS is of the form:

$$S'_t = \sum_p s_p \times [(Tar_{p,t-1} - Act_{p,t-1}) - (Tar_{p,t-2} - Act_{p,t-2})]$$

To ensure that the rewards or penalties incurred under the STPIS are consistent with the service performance delivered to customers $Tar_{p,t-2}$ is to be set equal to $Tar_{p,t-1}$ in the first year of the regulatory control period.

The AER recognises that there may be other transitional issues which arise in moving to the national scheme and also from one regulatory control period to the next. These transitional issues cannot be foreseen with certainty. Accordingly, the STPIS includes an arrangement that reduces the impact of transitional issues and the AER will address

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36 United Energy Distribution, 16 May 2008, *Response to AER proposed STPIS*, p.23; Alinta AE, 16 May 2008, *Response to AER proposed STPIS.*

37 United Energy Distribution, 16 May 2008, *Response to AER proposed STPIS*, p.20.

such issues as they arise during the framework and approach and distribution determination processes.

6.11 Incorporating the s-factor into the form of control

In the explanatory statement and discussion paper on the proposed scheme, the AER sought comment on how the s-factor should be incorporated into the form of control mechanism.

6.11.1 Stakeholder comments

The AER received a limited response on this issue. CitiPower and Powercor stated that the AER should specify an adjustment to either the P_0 or to the s-factor applied in the subsequent regulatory control period such that the dollar impact of the s-factor remains consistent across regulatory control periods.[38]

6.11.2 AER response

The AER will outline how it will incorporate the s-factor into the form of control mechanism for standard direct control services for each DNSP through the framework and approach process. The general form in which the s-factor will be applied is set out at Appendix C of the STPIS.

The AER agrees that an adjustment is required to reflect the step change in revenues (prices) where there is an overlap between regulatory control periods (i.e. where a resulting s-factor in one regulatory control period is applied to revenues in the next regulatory control period). The AER has set out an appropriate adjustment to effect this at Appendix C of the STPIS.

6.12 Guaranteed Service Level (GSL) component

The AER sought comment on the parameters, threshold levels, payment amounts and exclusion criteria in the GSL component of the proposed scheme. Stakeholders commented on three aspects of the proposed GSL component as set out below.

6.12.1 Stakeholder comments—services covered by parameters

ANZEWON supported the coverage of services covered by the GSL component, the proposed thresholds and the requirement for automatic payments. However, ANZEWON suggested further consideration be given to including a GSL for appointment windows, noting missed appointments are a source of customer complaints to Ombudsman offices.[39]

ANZEWON also stated that it would be helpful if the AER could carefully monitor service to rural customers to ensure that the thresholds for reliability indicators are effective in providing an incentive to improve service standards for rural customers.[40]

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38 CitiPower and Powercor, 14 May 2008, *Response to AER proposed STPIS*, p.6.

39 ANZEWON, 14 May 2008, *Response to the AER STPIS*, p.2.

40 Ibid.

6.12.2 AER response

The AER considers that an 'appointment window' parameter would not be a robust parameter as it is difficult to measure and, for actual performance to be measured, relies on customers lodging complaints. The AER also notes that DNSPs have incentives to maintain appointment times under jurisdictional Ombudsman schemes.

The AER agrees that service to rural customers is important. The STPIS incorporates service reliability parameters that can be applied to rural feeders. Further, the AER envisages that the public reporting regime previously referred to in this decision document could incorporate reporting on worst performing feeders in both urban and rural areas.

6.12.3 Stakeholder comments—written enquiries

CitiPower and Powercor and ETSA Utilities did not agree with the inclusion of a 'response to written enquiries' parameter in the GSL component of the proposed scheme. Both considered that the measure was open to abuse by customers and did not reflect how the majority of customers contact DNSPs (i.e. by telephone).[41]

6.12.4 AER response

The AER agrees that there is potential for abuse by customers of 'response to written enquiries' GSL payments. Accordingly, this parameter has been removed from the GSL component in the STPIS but remains as an optional parameter in the customer service component of the scheme.

6.12.5 Stakeholder comments—exclusions

A number of stakeholders commented on the issue of whether exclusions should apply to the reliability parameters in the GSL component of the proposed scheme.

For example, ETSA Utilities stated:

> ETSA Utilities agrees that it is appropriate to treat the reliability GSL associated with excluded events differently as these events are beyond the effective control of the DNSP. However, it should still be recognised that customer have received poor performance from their perspective. ETSA Utilities considers that customers should receive a reliability GSL payment for excluded events from the DNSP but it should be paid via a pass through.[42]

The Department of Infrastructure, Energy and Resources (Tasmania) also stated that the GSL component needed to have as few exclusions as possible and proposed that the AER develop a means of minimising the financial exposure on DNSPs.[43]

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41 CitiPower and Powercor, 14 May 2008, *Response to AER proposed STPIS*, p.7; ETSA Utilities, May 2008, *Response to the AER proposed STPIS*, p. 12.

42 ETSA Utilities, May 2008, *Response to AER proposed STPIS*; p.12.

43 Department of Infrastructure, Energy and Resources (Tasmania), 15 May 2008, *Response to AER proposed STPIS*, p.1.

Similarly, Aurora Energy commented:

> the proposed GSL component appears to be uncapped. This represents unacceptable liability, especially if GSLs are considered to be an operating cost and therefore subject to the EBSS.[44]

6.12.6 AER response

The AER considers that exclusions should apply to the GSL component to limit the financial risk a DNSP is exposed to operating under the STPIS. The exclusion criteria for GSL payments have been maintained in the STPIS. The AER does not agree with Aurora Energy that GSLs are an unacceptable liability and notes that the scheme's exclusion mechanism limits the financial risk to a DNSP.

[44] Aurora Energy, 15 May 2008, *Response to AER STPIS*, p.10.

7 Other issues raised and AER response

The following table sets out other issues raised in submissions and the AER's response.

Issue	Stakeholder	AER response
Convergence towards a common approach to service target performance should be a 10-15 year medium term objective, minimising duplication during the transition phase.	ENA	The AER considers the development of a national scheme is consistent with the COAG objectives for reform of economic regulation across energy markets, as well as the NEL objective. However, the AER notes national consistency is only desirable where practical, and consistency in the application of the scheme cannot be achieved immediately. The STPIS provides for flexibility in the application of the scheme to account for these differences.
The scheme should explicitly allow for the development of an individual DNSP related objective.	Ergon Energy	The AER considers it inappropriate to include DNSP specific objectives in the STPIS. However, the scheme provides flexibility to accommodate the particular circumstances of a DNSP, provided it is consistent with the objectives set out in the scheme.
All substantive issues should be included in the guidelines, and regulatory information instruments should only be used in circumstances where there are specific issues that are required to be addressed outside of the guidelines.	Ergon Energy	The STPIS is in the form of a framework which would be applied through the AER's framework and approach and distribution determination processes, having regard to the particular circumstances of a DNSP. The AER considers that regulatory information instruments are the appropriate mechanism under the NEL and the NER for setting out information requirements.

Issue	Stakeholder	AER response
Accuracy and audit requirements should be included in the scheme.	Ergon Energy	The AER will set out its assurance requirements in the regulatory information instruments that specify reporting arrangements (whether annually or for building block proposals). This provides a single point of reference for DNSPs to understand all of their obligations regarding the reporting of information and the level of assurance/verification required. The AER considers that incorporating assurance requirements in these information instruments is a better approach given their close relationship with the data and information required.
Clarification about the relationship between the STPIS, minimum service standards imposed under state-based arrangements and targets applied in establishing capex and opex requirements.	Aurora Energy, ENA, Ergon Energy	Targets applied in the STPIS are separate from service standards and targets imposed under jurisdiction-based arrangements. The STPIS provides for targets to be adjusted to take account of any planned reliability improvements (e.g. to reflect minimum jurisdictional standards). This will ensure that the scheme does not put at risk a DNSP's ability to comply with relevant service standards or targets specified in jurisdictional electricity legislation.
Requests the AER develop and provide DNSPs with the model that will be used to perform the year on year calculations for the s-factor.	Ergon Energy	The approach to calculating the s-factor is outlined in the STPIS and in this final decision. As noted, the AER will outline how it will incorporate the s-factor into the form of control for standard direct control services for each DNSP through the framework and approach process.
With respect to the reliability parameters, the AER should specify the range of network segmentation options available to a DNSP.	Ergon Energy	Segmentation options are set out in the STPIS. The appropriate form of segmentation will be foreshadowed through the framework and approach process and decided upon in the distribution determination.

Issue	Stakeholder	AER response
Whether the STPIS will include a separate set of performance targets based on the normalised performance of a DNSP (i.e. separate to any existing jurisdictional performance targets).	Ergon Energy	Under the STPIS, targets are based on the average of the last 5 years performance, adjusted for any planned reliability improvements and normalised in line with the exclusion criteria set out in the scheme.
Whether the STPIS values are intended to be determined once at the beginning of the regulatory control period or determined for each year of the regulatory control period based on the DNSP's rolling average of performance for the previous 5 years.	Ergon Energy	Targets will be set once at the beginning of a regulatory control period.
Clarification on the proposed mechanisms for 'reversing out' performance gains and improvements where these are considered to have been recovered from both the distribution determination and the STPIS.	Ergon Energy	Targets will be adjusted to reflect planned reliability improvements. The AER expects DNSPs to be in a position to confirm the expected impacts of planned reliability improvements.

Issue	Stakeholder	AER response
The manner in which the STPIS will avoid penalising a DNSP for not achieving material ongoing improvement after a period of consistent improvement. That is, the risk that the more reliable the supply network becomes, the larger the 'gap' between target system performance and achievable system performance.	Ergon Energy	Rewards are made for sustained service improvements only. If service performance remains constant, no reward or penalty is accrued.
Aurora Energy suggests the AER comment on the relationship between the VCR and VoLL. In particular, the AER should comment on the significant differential (in dollar terms) between the value of customer reliability identified in the VCR and VoLL.	Aurora Energy	VoLL is the cap on spot market prices and is not a measure of the amount that end use customers might be prepared to pay for reliability. Earlier uses of the term VoLL were derived from customer surveys and the AER has relied on the studies by Khan and Conlon and Charles River Associates (reports prepared for Victoria Power Exchange (VPX) in 1997 and for VENCorp in 2002) to inform its decisions on incentive rates.[45] The AEMC Reliability Panel has recently released its final determination 'Review of VoLL in 2008' in which the use of VoLL in setting a cap on the national electricity market is discussed.[46]
Queried the empirical rational for a 3 per cent cap.	ENA, SP AusNet	The rational for the 3 per cent cap is set out in this final decision.

[45] Khan and Conlon, 1997, *Value of lost load -study for the Victorian Power Exchange;* Charles River Associates, 2002, *Assessment of the Value of Consumer Reliability (VCR) - report prepared for VENCorp*, Melbourne.

[46] AEMC Reliability Panel, April 2008, *Review of VoLL 2008 Final determination.*

Issue	Stakeholder	AER response
Should clarify that the sum of s-factors is a reference to the *S'* term in equation 4 of Appendix C and not the S_t term in equation 1.	CitiPower and Powercor, Ergon Energy	The term 'sum of s-factors' is defined in equation 4. This term is not used in equation 1. No change is required.
Clarify whether a DNSP is able to propose a cap on the customer service component and parameters.	Ergon Energy	Such a proposal is open to a DNSP and would be considered by the AER and assessed against the objectives of the STPIS.
Customer service parameter definitions for Energex are different to the proposed definitions – is there flexibility to propose alternatives?	Energex	The STPIS does not provide for flexibility in customer service parameter definitions because of its objective to achieve national consistency in the measurement and reporting of service performance.
The incentive rate for telephone answering should be expressed as a negative number to provide a positive incentive for improved performance.	CitiPower and Powercor	The AER agrees the incentive rate for telephone answering should be expressed as a negative number to provide a positive incentive for improved performance. The STPIS has been amended accordingly.
Clarification on what the incentive rate for telephone answering is applied to.	Ergon Energy	The incentive rate is applied to the percentage of calls answered within 30 seconds, as set out at Appendix A of the STPIS.
Clarify whether incentive rates are calculated at the start of the regulatory control period or every year.	Energex	The AER has amended the scheme to clarify that incentive rates are calculated at the start of the regulatory control period.
Limiting the s-bank to one year may result in a change in prices that exceeds the side constraint.	Energex	The AER notes clause 6.18.6(d) of the NER provides that the recovery of revenue to accommodate a variation to the distribution determination under the STPIS is to be disregarded when deciding on whether the side constraint has been exceeded in a particular year.

Issue	Stakeholder	AER response
In relation to the reliability measures specified in Appendix A of the Guidelines (SAIDI, SAIFI and MAIFI), Aurora notes that it does not have a customer-to-asset link completed. Aurora therefore uses the analogous, "kVA connected" approach to calculating these indicators. Aurora is concerned that this approach is not permitted under the proposed STPIS. Aurora seeks the AER's guidance on this issue.	Aurora Energy	DNSPs will be expected to undertake works to install the appropriate systems, where such systems are currently not in place for the provision of service performance data required under the STPIS.
Note 3 to the 'Reliability Component' of Appendix A of the proposed STPIS states '[i]nactive accounts are excluded' from the calculation of SAIDI, SAIFI and MAIFI. Unclear what these 'inactive accounts' are referring to. Also concerned that these references seem to imply a retail as opposed to a distribution focus.	Aurora Energy	The AER has adopted the definitions determined by SCNRRR. This excludes inactive accounts which are not further defined. The AER understands that the intent is that a customer's premises that is not taking a supply of electricity, i.e. without an active retailer account (temporary disconnection etc.), can be excluded. A definition for inactive account has been added to the glossary of the STPIS.

Issue	Stakeholder	AER response
Thresholds for GSLs are based upon the classification of feeders to which customers are attached. These definitions are based on feeder load density, according to Appendix A of the STPIS. Unclear as to whether this means that a customer's GSL threshold will vary up and down with load density on the feeder.	Aurora Energy	The feeder category is assigned to the whole of a distribution feeder.
Seeks clarification on when the feeder load density is calculated.	Aurora Energy	The DNSP's annual planning process should be used to determine the feeder load density and hence the classification. Classifications may change through the year as network augmentation or load growth occurs. The classification assigned to a feeder should be the one applied for the majority of the period. However, such issues are not expected to result in material changes to reported performance.
Clarify whether 'applying a credit to the customer's account' refers to the customers account with a retailer.	Aurora Energy	Yes.
Clarify the frequency of GSL payments (i.e. annually or when the trigger event occurs that qualifies a customer for a payment).	Aurora Energy	GSL payments are to be made to a customer when the trigger event occurs that qualifies the customer for a payment.

Appendix A: Submissions received to the proposed STPIS

The following parties provided submissions on the AER's proposed STPIS published on 1 April 2007:

- ACT Planning and Land Authority
- ActewAGL
- Alinta
- Australia and New Zealand Energy and Water Ombudsman Network (ANZEWON)
- Aurora Energy
- CitiPower and Powercor
- Department of Infrastructure, Energy and Resources (Tasmania)
- Energy Networks Association (ENA)
- Energex
- Ergon Energy
- ETSA Utilities
- Independent Competition and Regulatory Commission
- SP AusNet
- SPA Consulting
- United Energy

Copies of these submissions are available on the AER's website at www.aer.gov.au.

Appendix B: Addressing NER requirements

The following table sets out how the AER has met the relevant NER requirements in developing the STPIS. These matters are discussed in more detail in this decision document.

NER requirement	AER response
Clause 6.6.2(a) The AER must develop and publish an incentive scheme or incentive schemes (service target performance incentive scheme) to provide incentives (which may include targets) for DNSPs to maintain and improve performance.	The STPIS is at Appendix C of this final decision.
Clause 6.6.2(b)(1) The AER must consult with the authorities responsible for the administration of relevant jurisdictional electricity legislation.	The AER has consulted with the authorities responsible for the administration of relevant jurisdictional electricity legislation in the development of the STPIS. The AER contacted these authorities to facilitate this consultation process and a number of the authorities provided submissions on the proposed STPIS and met with AER staff to discuss the proposed scheme.
Clause 6.6.2(b)(2) The AER must ensure that service standards and service targets (including guaranteed service levels) set by the scheme do not put at risk the DNSP's ability to comply with relevant service standards and service targets (including guaranteed service levels) as specified in jurisdictional electricity legislation.	Service standards and service targets as specified in jurisdictional legislation will be funded through the capital and operating expenditure requirements of a DNSP. The impact of these improvements will be considered when setting targets under the STPIS. The STPIS does not therefore put at risk a DNSP's ability to comply with relevant service standards and service targets specified in jurisdictional electricity legislation. The GSL component of the scheme will not apply where a jurisdictional GSL scheme is in place. For this reason the STPIS will not impact on a DNSP's ability to comply with GSLs in jurisdictional electricity legislation.

Clause 6.6.2(3)(i) The AER must take into account the need to ensure that benefits to consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme for DNSPs.	The incentive rates in the STPIS are based on customers' willingness to pay for improved service levels. The AER considers that the benefits likely to result from the STPIS are sufficient to warrant any reward or penalty under the scheme.
Clause 6.6.2(3)(ii) The AER must take into account any regulatory obligation or requirement to which the DNSP is subject.	The AER has set out that it will take into account any regulatory obligations or requirements in setting performance targets under the scheme. As noted above the GSL component of the STPIS will not apply where a jurisdictional scheme is in place.
Clause 6.6.2(3)(iii) The AER must take into account the past performance of the distribution network.	Targets under the scheme are to be set at the average of the last 5 years performance, adjusted for any planned reliability improvements. GSL payments and thresholds have been developed and based on existing jurisdictional GSL arrangements and thus are based on the levels of service that DNSPs are currently subject to under these arrangements.
Clause 6.6.2(3)(iv) The AER must take into account any other incentives available to the DNSP under the NER or a relevant distribution determination.	In developing the STPIS, the AER has taken into account incentives provided under the CPI-X regulatory framework and the EBSS as set out in the NER and the relevant schemes promulgated by the AER.

Clause 6.6.2(3)(v) The AER must take into account the need to ensure that the incentives are sufficient to offset any financial incentives the service provider may have to reduce costs at the expense of service levels.	The AER considers that as incentive rates are set at customers' willingness to pay and the scheme is symmetrical, i.e. penalties are incurred at the same rate as rewards, there is a strong incentive for a DNSP not to reduce costs at the expense of service levels. The STPIS is flexible to allow the incentive rate to be increased or decreased as appropriate. This will be decided as part of the framework and approach and distribution determination processes. The AER has placed a financial cap on the STPIS which it considers will provide sufficient rewards to a DNSP for an improvement in service performance and sufficient penalties for a decline in service performance. The rationale for the cap is discussed in this final decision.
Clause 6.6.2(3)(vi) The AER must take into account the willingness of the customer or end user to pay for improved performance in the delivery of services.	As noted above, the incentive rates under the reliability component of the scheme are set at customers' willingness to pay. The GSL component of the scheme is based on existing jurisdictional schemes.
Clause 6.6.2(3)(vii) The AER must take into account the possible effects of the scheme on incentives for the implementation of non-network alternatives.	The AER has taken into account the possible effects of the STPIS on incentives for the implementation of non-network alternatives. The AER intends that the STPIS be as neutral as possible regarding the level of reliability provided by network solutions vis-à-vis non network alternatives. The AER will further consider the issues associated with providing incentives for non-network alternatives when it consults on a future national demand management incentive scheme for DNSPs.

The AER has also had regard to the Queensland transitional arrangements under the NER in developing the STPIS.

Rule requirement	**AER response**
Clause 11.6.5(1) The AER must take into account the continuing obligations on ENERGEX and Ergon Energy throughout the regulatory control period to implement the recommendations from the EDSD Review adopted by the Queensland Government.	The STPIS allows for these obligations to be taken into account.
Clause 11.6.5(2) The AER must take into account the impact of severe weather events on service performance.	The STPIS takes into account the impact of severe weather events on service performance by excluding events using the 2.5 beta method.
Clause 11.6.5(3) The AER must consider whether the STPIS should be applied by way of a paper trial or whether a lower powered incentive is appropriate.	The STPIS provides flexibility to allow for consideration of these options through the framework and approach and distribution determination processes for Queensland DNSPs.

Appendix C: Service target performance incentive scheme

This appendix is provided as an attachment to this final decision document.