Draft Decision

Essential Energy Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 10
Service target performance incentive scheme

September 2023

AUSTRALIAN ENERGY REGULATOR

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10 Service target performance incentive scheme

The National Electricity Rules (NER) sets out that our regulatory determination must specify how any applicable Service target performance incentive scheme (STPIS) is to apply in the 2024–29 period.[1]

This attachment sets out our draft decision on how we will apply the STPIS to Essential Energy for the 2024–29 period.

AER's service target performance incentive scheme

Our distribution STPIS provides electricity distributors with incentives to maintain and improve network reliability performance, to the extent that consumers are willing to pay for such improvements. The STPIS is also intended to ensure that distributors' service levels do not reduce as result of efforts to achieve efficiency gains.

The current version (version 2.0) of our national STPIS was published in November 2018 and will apply to all revenue determination from that date.[2]

Framework and approach to the application of STPIS

Our Framework and Approach (F&A) paper for New South Wales (NSW) distributors stated that we will apply version 2.0 of the STPIS to Essential Energy in the 2024–29 period and we proposed to:[3]

- set revenue at risk at ± 5 per cent,
- segment the network according to the urban, short, and long rural feeder categories,
- apply the system average interruption duration index or SAIDI, system average interruption frequency index or SAIFI and customer service (telephone answering) parameters. However, if NSW distributors proposed a customer service incentive scheme (CSIS) to include similar performance measure, the telephone answering parameter of the STPIS will not be applied,
- set performance targets based on NSW distributors' average performance over the past five regulatory years,
- apply the method in the STPIS for excluding specific events from the calculation of annual performance and performance targets, and
- apply the latest published value of customer reliability (VCR) values by the AER to set the incentive rates for SAIDI and SAIFI.

1 NER, Cl. 6.3.2 and 6.12.1(9).

2 AER, *Electricity distribution network service providers—service target performance incentive scheme version 2.0*, November 2018. (AER, STPIS v2.0, November 2018).

3 AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy (New South Wales) Regulatory control period commencing 1 July 2024*, July 2022, p. 46.

We will not apply the guaranteed service level (GSL) component, which is composed of direct payments to customers experiencing service below a predetermined level, if NSW distributors remain subject to a jurisdictional GSL scheme.

10.1 Draft decision

Our draft decision is to apply STPIS 2.0 to Essential Energy in the 2024–29 period. Specifically:

- Set revenue at risk at ± 4.5 per cent because the CSIS will apply,
- segment the network according to the urban, short, and long rural feeder categories,
- apply the SAIDI and SAIFI parameters,
- set performance targets based on Essential Energy's average performance over the past five regulatory years,
- apply the method in the STPIS for excluding specific events from the calculation of annual performance and performance targets, and
- apply the latest published VCR values by the AER to set the incentive rates.

The STPIS customer service parameter will not apply to Essential Energy in the 2024–29 period because the distributor has opted to apply our CSIS. Please refer to the CSIS attachment of this draft decision for further details.

We will not apply the GSL component as Essential Energy remains subject to a jurisdictional GSL scheme.

Essential Energy is required to submit the 2022–23 STPIS actual performance data in its revised revenue proposal to allow us to set the STPIS targets and incentive rates in our final decision.

We have considered Essential Energy's revenue proposal, submissions raised by stakeholders and the F&A in reaching our draft decision.[4] Our response to the matters raised by Essential Energy and stakeholders about the application of STPIS is discussed below.

Error! Reference source not found. and Table 10.2 present our draft decision on the applicable performance targets and incentive rates that will apply to Essential Energy for the 2024–29 period.

4 Essential Energy, *2024-29 Regulatory Proposal, 8.04 Service Target Performance Incentive Scheme (STPIS) Approach,* January 2023.

Table 10.1 Draft decision – STPIS reliability targets for Essential Energy for the 2024–29 period

	Urban	Short rural	Long rural
SAIDI	70.1168	212.4135	499.0768
SAIFI	0.8492	1.7577	2.8745

Source: AER analysis.

Table 10.2 Draft decision – STPIS incentive rates for Essential Energy for the 2024–29 period

	Urban	Short rural	Long rural
SAIDI	0.0123	0.0388	0.0091
SAIFI	0.6749	3.1260	1.0583

Source: AER analysis

10.2 Essential Energy's revenue proposal

Essential Energy's revenue proposal adopted our F&A position on how STPIS will apply to calculate its targets, incentive rates, and major event day (MED) for exclusion.[5]

10.3 Assessment approach

We are required to decide how the STPIS is to apply to Essential Energy.[6] When making a distribution determination, the STPIS requires us to determine all performance targets, incentive rates, revenue at risk and other parameters under the scheme.[7]

10.3.1 Interrelationships

We must consider any other incentives available to the distributor under the NER or relevant distribution determination in implementing the STPIS.[8] One of the objectives of the STPIS is to ensure that the incentives are sufficient to offset any financial incentives the distributor may have to reduce costs at the expense of service levels.[9] For the 2024–29 period, the STPIS will interact with the Capital Expenditure Sharing Scheme (CESS) and the operating expenditure (opex) Efficiency Benefit Sharing Scheme (EBSS).

The reward and penalty mechanism under the STPIS (the incentive rates) are determined based on the average customer value for the improvement, or otherwise, to supply reliability

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5 Essential Energy, *2024-29 Regulatory Proposal, 8.04 Service Target Performance Incentive Scheme (STPIS) Approach*, January 2023, pp. 3–4.

6 NER, cl. 6.12.1(9).

7 AER, *STPIS v2*.0, November 2018, cl. 2.1(d).

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

9 NER, cl. 6.6.2(b)(3)(v).

(the VCR). This is aimed at ensuring that the distributor's operational and investment strategies are consistent with customers' value for the services that are offered to them.

Our capital expenditure (capex) and opex allowances are set to reflect the expenditures required by a prudent and efficient business to achieve the capex and opex objectives. These include complying with all applicable regulatory obligations and requirements and, in the absence of such obligations, maintaining quality, reliability, and security of supply outcomes.

The STPIS provides an incentive for distributors to invest in further reliability improvements (via additional STPIS rewards) where customers are willing to pay for it. Conversely, the STPIS penalises distributors where they let reliability deteriorate. Importantly, the distributor will only receive a financial reward after actual improvements are delivered to the customers.

In conjunction with CESS and EBSS, the STPIS will ensure that:

- any additional investments to improve reliability are based on prudent economic decisions, and
- any reductions in capex and opex are achieved efficiently, rather than at the expense of service levels to customers.

10.4 Reasons for draft decision

We will apply the STPIS 2.0 to Essential Energy for the 2024–29 period without the customer service parameter. This approach is consistent with our F&A and our recent revenue determination for Victorian DNSPs for the 2021–26 period.[10] The following section sets out our detailed consideration on applying the STPIS to Essential Energy for the 2024–29 period.

No submissions were received related to the STPIS.

10.4.1 Revenue at risk

Revenue at risk caps the potential reward and penalty for Essential Energy under the STPIS. We consider that an incentive of ± 4.5% of the annual forecast revenue is appropriate for Essential Energy because it has demonstrated strong reliability performance; hence a ±4.5% limit is the appropriate balance between the incentives to maintain reliability versus the price impact to customers funding the reliability outcomes.

The total revenue at risk has been reduced from ± 5.0% by 0.50% due to the application of the CSIS in lieu of the STPIS customer service parameter.

10.4.2 Reliability of supply component

Applicable components and parameters

We will apply the unplanned SAIDI and unplanned SAIFI parameters under the reliability of supply component to Essential Energy's feeder segments for the 2024–29 period. Unplanned SAIDI measures the sum of the duration of each unplanned sustained customer interruption

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10 AER, *2021–26 Final distribution determinations for Jemena, Powercor, Citipower, United Energy, and AusNet Services*, 30 April 2021.

(in minutes) divided by the total number of distribution customers. Unplanned SAIFI measures the total number of unplanned sustained customer interruptions divided by the total number of distribution customers.[11]

Exclusions

The STPIS allows certain events to be excluded from the calculation of the s-factor revenue adjustment. These exclusions include the events specified in the STPIS, such as the effects of transmission network outages and other upstream events. They also exclude the effects of extreme weather events that have the potential to significantly affect Essential Energy's underlying STPIS performance.

We accept Essential Energy's proposal to calculate the major event day threshold using the 2.5 beta method in accordance with our F&A and scheme.

Performance targets

The STPIS specifies that the performance targets should be based on the average performance over the past five regulatory control years. It also states that the performance targets must be modified for any reliability improvements completed or planned where:

- the planned reliability improvements are included in the expenditure program proposed by the network service provider, and
- it is expected to result in a material improvement in supply reliability.[12]

Adjusting the performance targets to account for approved resilience capital expenditure

Our draft decision has included a resilience capex allowance for Essential Energy. Essential Energy proposed these capex programs to insulate its network against extreme events. These will involve:

- installing composite (fire resistant) power poles
- undergrounding some high-risk powerlines
- installing standalone power systems, which will supply continuous power even when the rest of the grid is down
- supporting microgrids
- improving communications
- supporting our communities as they recover from natural disasters.[13]

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11 Sustained interruption means supply interruption longer than three minutes. Momentary interruptions are those supply interruptions lasting less than three minutes.

12 AER, *STPIS v2.0*, November 2018, clause 3.2.1(a).

13 Essential Energy, *2024-29 Regulatory Proposal, Planning for the future*, 31 January 2023, p. 70.

Essential Energy has also proposed to adjust its STPIS targets for resilience capex that will improve network reliability.[14]

We have reviewed and are satisfied with Essential Energy's economic analysis on the reliability impact from these projects, including a resultant material improvement in supply reliability. Consequently, we have adjusted Essential Energy's reliability targets in accordance with the scheme. Please refer to the capex attachment 5 of this draft decision for further details about these projects.

Our calculated performance targets for Essential Energy for the 2024–period is presented in **Error! Reference source not found.**.

10.4.3 Customer service component

We will not apply the STPIS telephone answering target and incentive rate to Essential Energy in the 2024–29 period because the distributor has opted to apply the CSIS.

However, we consider that telephone answering is still an important service for many consumers. Therefore, we require Essential Energy to continue to annually report on the telephone answering parameter in the 2024–29 period. This requirement is consistent with our recent decisions for the Victorian distribution network service providers (DNSPs) who opted to apply the CSIS for the 2021–26 period.

10.4.4 Incentive rates

The incentive rates applicable to Essential Energy for the reliability of supply performance parameters of the STPIS were calculated in accordance with clause 3.2.2 STPIS 2.0. We used the formulae provided at Appendix B of STPIS 2.0 and our most recent VCR review.[15]

Our draft decision calculated incentive rates for Essential Energy for the 2024–29 period is presented in Table 10.2.

10.4.5 Value of customer reliability to calculate the incentive rates

Our F&A stated that we will apply the latest VCR to the distribution determination in calculating Essential Energy's incentive rates. Hence, for this draft decision, we have calculated Essential Energy's incentive rates by using our most recent VCR review.[16]

The VCR for network segments outlined in Table 10.3 were applied to calculate Essential Energy's incentives rates for the 2024–29 period.

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14 Essential Energy, *2024-29 Regulatory Proposal, 8.04 Service Target Performance Incentive Scheme (STPIS) Approach*, January 2023, p. 5.

15 AER, *STPIS v2.0*, November 2018; AER, *Value of customer reliability review, final report*, December 2019; AER, *2022 VCR Annual adjustment*, December 2022.

16 AER, *Value of customer reliability review, final report*, December 2019; AER, *2022 VCR Annual adjustment*, December 2022.

Table 10.3 Value of customer reliability ($/MWh)

Feeder types	Urban	Short rural	Long rural
VCR	47,412	47,412	47,412

Source: AER, *2022 VCR Annual adjustment*, December 2022; AER, *Value of customer reliability review, final report*, December 2019, pp. 17 and 71. VCR will be escalated to the June 2024 dollar value in the final decision.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
CSIS	customer service incentive scheme
DNSP	distribution network service provider
EBSS	efficiency benefit sharing scheme
F&A	framework and approach (document)
GSL	guaranteed service level
MED	major event day
NER	national electricity rules
NSW	New South Wales
opex	operating expenditure
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
STPIS	service target performance incentive scheme
VCR	value of customer reliability