DRAFT DECISION

Jemena
Distribution Determination
2021 to 2026

Attachment A –
Victorian f-factor incentive scheme

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Jemena for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

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Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

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Attachment A – Victorian f-factor incentive scheme

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A.1 Victorian f-factor Incentive Scheme

On 22 December 2016, the Victorian Government published the 'f-factor scheme order 2016' (the Order).[1] This Order revokes the previous f-factor scheme Order that commenced on 23 June 2011, under which the 2011 f-factor scheme applied, and provides for the establishment of a new f-factor scheme. This new scheme establishes a new incentive mechanism that targets incentives towards fire ignitions that pose the greatest risk of harm through the use of ignition risk units (IRUs).[2] Details of the new scheme, the setting of IRU values and how we will apply the scheme are explained in Appendix A of this attachment.

While the Order specifies the precise methods to determine the incentive payments (or penalties) under the scheme, the AER is required under clause 8 of the Order to make an f-factor scheme determination on how the incentive payments, or penalties, are to be included in each distributor's maximum allowable revenue each year for the 2021–2026 regulatory control period. This is to give effect to the f-factor outcomes in network charges.[3]

Clauses 8(1) and (4) of the Order provide that the AER must make an f-factor scheme determination in respect of each regulatory control period, and that an f-factor scheme determination may be published as part of a distribution determination for the relevant regulatory control period. This attachment is the f-factor scheme determination for Jemena for the 2021–2026 regulatory control period.

AER framework and approach to the application of the f-factor

In the final Framework and Approach (F&A), we stated that we will apply the f-factor to all Victorian distributors in their next regulatory control period.[4]

A.2 Draft decision

In accordance with clause 9(4) of the Order, the annual revenue adjustment for Jemena for the 2021–26 regulatory control period must be determined by the AER as follows:

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1 Victoria Government Gazette, G 51 22 December 2016, p. 3239 - http://www.gazette.vic.gov.au/gazette/Gazettes2016/GG2016G051.pdf.

2 *National Electricity (Victoria) Act 2005*, f-factor scheme Order 2016, clause 1, Victorian Government Gazette, G 51 22 December 2016, p. 883239.

3 Clause 9(5) of the Order specifies that 'An f-factor scheme determination may specify how the revenue adjustment is to occur. For the avoidance of doubt and without limitation, the revenue adjustment may–

(a) be by way of a pass through;

(b) be by way of an annual adjustment to be included in the control mechanism for a distribution determination;

(c) be expressed as a percentage adjustment to revenue;

(d) take effect over more than one regulatory year; and

(e) take effect over more than one regulatory control period'.

4 AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 88.

$$\boldsymbol{Revenue\ adjustment} = \boldsymbol{Incentive\ rate} \times (\boldsymbol{IRU\ target} - \boldsymbol{IRU\ amount})$$

where

(a) *Revenue adjustment* is the adjustment to the revenue for the relevant Distribution Network Service Provider for the regulatory year;

(b) *Incentive rate* is $15,000;

(c) *IRU target* is the IRU target applicable for the relevant financial year for the relevant Distribution Network Service Provider, as published by the Victorian Government in accordance with the Order; and

(d) *IRU amount* is the number of IRUs accrued in relation to the relevant distribution system in the relevant financial year, determined in accordance with clause 11 of the Order.

Revenue adjustment, Incentive rate, IRU target and IRU amount have the same meanings as prescribed by the Order.

Pursuant to clause 9(5) of the Order, this f-factor scheme determination specifies that the *revenue adjustment* for Jemena for the 2021–26 regulatory control period will form a part of the 'I-factor' adjustment to the annual revenue requirement calculation formula. Please refer to attachment 14 – Control mechanisms for details.

IRU targets

As foreshadowed in the F&A,[5] the Victorian Government published the IRU targets for the 2020–21 financial year for Jemena at 4.2 on 30 July 2020.[6]

We understand that the IRU targets for each financial year of the 2021–26 regulatory control period will be set by the Victorian Government prior to the commencement of the relevant year. Hence, the relevant IRU target for each year of the forthcoming regulatory control period will be set by the Victorian Government under section 16C of the *National Electricity (Victoria) Act 2005 (Vic)* and subclause 10(2) of the Order.[7]

A.3 Jemena's proposal

Jemena proposed to apply the f-factor scheme.

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5 AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, p. 88.

6 Victorian Government Gazette No. G 30, Thursday 30 July 2020.

7 This Order is published in the Victoria Government Gazette No. G51 Thursday 22 December 2016 page 3239, made under section 16C of *the National Electricity (Victoria) Act 2005.*

A.4 Submissions

The AER's Consumer Challenge Panel noted that:[8]

> The Victorian DNSPs are subject to and have proposed a combination of efficiency incentive schemes and performance incentive schemes including the f-factor.

Energy Consumers Australia commented that:[9]

> The F-factor scheme applies in Victoria and incentivises networks to reduce the risk of fire starts from network assets. The F-factor scheme, together with other bush fire risk reduction initiatives such as REFCL has been very effective in reducing fire starts with all networks reporting declining rates of fire starts over the past 5 years. We have no objection to this scheme continuing for the 2021–26 period, but will be interested to understand whether the scheme is required once all REFCLs have been installed.

A.5 Assessment approach

We make this draft decision based on the provisions contained in the Order.

A.6 Reasons for draft decision

We will continue to adopt our current approach to make the revenue adjustment as an 'I-factor' component in the annual revenue requirement calculation formula. This is because this method is the simplest and most direct way to give effect to the f-factor results, as well as reflecting that the f-factor is an incentive scheme.

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8 AER's Consumer Challenge Panel, *CCP17 Submission on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*, June 2020, p. 33.

9 Energy Consumers Australia, *Submission on the Victorian Electricity Distribution Regulatory Proposal 2021–26,* June 2020, p. 33.

Appendix A: The 2016 f-factor scheme

The new f-factor scheme seeks to incentivise better alignment between the bushfire risk reduction practices and priorities of the distribution businesses and the bushfire risk exposure of the Victorian Community posed by the distribution network.[10]

Under the new scheme, the revenue adjustment is to be arrived at by applying an incentive rate to the result of the subtraction of an IRU amount from an ignition risk unit (IRU) target. The IRU amount reflects the past year's actual performance.[11] The f-factor scheme requires the AER to determine the IRU amount.[12] The incentive rate and IRU target are prescribed.[13]

To determine the IRU amount, the AER will collect fire start information from distributors (fire start reports) and send it to Energy Safe Victoria (ESV) for verification annually. ESV will provide a validation report on the accuracy of the data. This validation report is subject to an extensive consultation regime.[14] The AER may have regard to the distributor's fire start report and the validation report to determine the number of fire starts for the relevant distributor.[15] The AER will publish the distributors' fire start reports and ESV's validation reports each year.

Each determined fire start will then be weighted by a '*location multiplier*' and a '*danger multiplier*' (fire risk)[16]. These are also prescribed in the Order.[17] By applying these two weighting factors to each fire start, the AER can determine the risk factor of each fire start. On this basis the AER can determine the IRU amount, or it may determine the IRU amount using other methods.[18] The IRU amount based on all fire starts within a financial year will be measured against the benchmark IRU target.

The benchmark targets will be set by the Victorian Government each year under the Order based on the historical performance of the distributors. The Order also specifies the incentive mechanism, the definitions of the locational and danger factor components of the IRU measurement method, and the penalty/reward rate of each IRU unit that is above or below the benchmark target value.[19]

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10 Victorian Department of Environment Land Water and Planning, *f-factor Incentive Scheme: Regulatory Impact Statement*, October 2016, p. 15.

11 Clause 9 of the Order.

12 Clause 11 of the Order.

13 See clause 9(4)(ii) and 9(4)(iii) of the Order.

14 Clause 7 of the Order.

15 Clause 12 of the Order.

16 Clause 11 of the Order.

17 Clause 11(1) of the Order.

18 Clause 11(3) of the Order.

19 Clause 9(4) of the Order.

Revenue adjustment mechanism under the f-factor scheme

Clause 9(1) of the Order specifies that an f-factor scheme determination must establish an f-factor scheme under which there is a revenue adjustment for each Distribution Network Service Provider.

Clause 9(6) of the Order specifies that, for the purposes of a distribution determination, a revenue adjustment under an f-factor scheme is not revenue of, expenditure by, or a cost of a Distribution Network Service Provider, unless the AER determines otherwise.

Clause 9(4) of the Order specifies that a separate revenue adjustment must be made for each Distribution Network Service Provider for the 2019 regulatory year, and for each subsequent regulatory year, in accordance with the following formula:

$$\boldsymbol{Revenue\ adjustment} = \boldsymbol{Incentive\ rate} \times (\boldsymbol{IRU\ target} - \boldsymbol{IRU\ amount})$$

where

(a) *Revenue adjustment* is the adjustment to the revenue for the relevant Distribution Network Service Provider for the regulatory year;

(b) *Incentive rate* is $15,000;

(c) *IRU target* is the IRU target applicable for the relevant financial year for the relevant Distribution Network Service Provider, as specified in clause 10; and

(d) *IRU amount* is the number of IRUs accrued in relation to the relevant distribution system in the relevant financial year, determined in accordance with clause 11.

Notes: See the definition of 'relevant financial year' in clause 4. By reason of that definition, the revenue adjustment for a regulatory year is made on the basis of the IRU target and IRU amount for the relevant financial year, which ends 18 months prior to the commencement of the regulatory year.

Parameters of revenue adjustment rates

In accordance with clause 8(1) of the Order, the AER must make an f-factor amount determination in respect of each regulatory control period.

Under clause 9(5), an f-factor scheme determination may specify how the revenue adjustment is to occur. For the avoidance of doubt and without limitation, the revenue adjustment may –

(A) be by way of a pass through;

(B) be by way of an annual adjustment to be included in the control mechanism for a distribution determination;

(C) be expressed as a percentage adjustment to revenue;

(D) take effect over more than one regulatory year; and

(E) take effect over more than one regulatory control period.

Pursuant to clause 9(5), this f-factor scheme determination specifies that the revenue adjustment will be made by way of an ‘I-factor’ component in the annual revenue requirement calculation formula, as set out in our final decision for Jemena for the 2021–2026 regulatory control period.

What is a fire start?

Under clause 5 of the Order, for the purpose of being counted in the f-factor scheme determination a fire start is any fire:

- that starts in or originates from a distribution system;
- started by any tree, or part of a tree, falling upon or coming into contact with a distribution system;
- started by any person, bird, reptile or other animal coming into contact with a distribution system;
- started by lightning striking a distribution system or a part of a distribution system;
- started by any other thing forming part of or coming into contact with a distribution system; or
- otherwise started by a distribution system.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
distributor	distribution network service provider
ECA	Energy Consumers Australia
ESV	Energy Save Victoria
F&A	framework and approach
IRU	ignition risk units