



DRAFT DECISION

TasNetworks Distribution Determination 2019 to 2024

Attachment 10 Service target performance incentive scheme

September 2018

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Note

This attachment forms part of the AER's draft decision on TasNetworks' 2019–24 distribution determination. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanism

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 16 – Negotiated services framework and criteria

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Shortened forms

Shortened form	Extended form
ACS	alternative control services
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP 13	Consumer Challenge Panel, sub-panel 13
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA/DMIAM	demand management innovation allowance (mechanism)
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for Electricity Distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider

Shortened form	Extended form
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SCS	standard control services
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

10 Service target performance incentive scheme

Under clauses 6.3.2 and 6.12.1(9) of the National Electricity Rules (NER) our regulatory determination must specify how any applicable distribution service target performance incentive scheme (STPIS) is to apply in the next regulatory control period.

This attachment sets out how we will apply the distribution STPIS to TasNetworks for the 2019–24 regulatory control period.

AER's service target performance incentive scheme

We published the current version of our national STPIS for distribution in November 2009.¹ The STPIS is intended to balance incentives to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to distributors to maintain and improve service performance where customers are willing to pay for these improvements.

AER framework and approach (F&A) to the application of STPIS

In the final F&A, we stated that we will continue to apply the distribution STPIS to TasNetworks in the next regulatory control period. We proposed to:²

- set revenue at risk for TasNetworks within the range of ± 5 per cent
- segment the network according to the Tasmanian Electricity Code (TEC) supply reliability categories (critical infrastructure, high density commercial, urban, high density rural and low density rural)
- apply the system average interruption duration index (or SAIDI), system average interruption frequency index (or SAIFI) and customer service (telephone answering) parameters
- set performance targets based on TasNetworks' average performance over the past five regulatory years
- apply the method in the distribution STPIS for excluding specific events from the calculation of annual performance and performance targets
- apply the method and value of customer reliability (VCR) values as indicated in AEMO's 2014 Value of Customer Reliability Review final report³ to calculate the incentive rates.

¹ AER, *Electricity distribution network service providers—service target performance incentive scheme*, November 2009. (AER, *STPIS*, November 2009).

² AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2019*, July 2017, pp. 50–51.

³ AEMO, *Value of Customer Reliability Review, Final Report*, September 2014.

We also stated that we will not apply the GSL component if TasNetworks remains subject to a jurisdictional GSL scheme.⁴

We noted that we are currently undertaking a review of the STPIS. We stated that, if the review is completed in time, TasNetworks may need to apply the revised STPIS for the 2019–24 regulatory control period and the application of the revised STPIS will be considered during the revenue determination process.⁵

Given that the revised STPIS is not yet complete in time for this draft decision, we will apply the current version of the distribution STPIS (November 2009)⁶ to TasNetworks for the 2019–24 regulatory period.

10.1 Draft decision

In accordance with our F&A position on STPIS,⁷ our draft decision is to apply the current version of the distribution STPIS (November 2009)⁸ to TasNetworks for the 2019–24 regulatory period in the following manner:

- set revenue at risk for TasNetworks at the range ± 5.0 per cent
- segment TasNetworks' network according to feeder categories:
 - critical infrastructure
 - high density commercial
 - urban
 - high density rural
 - low density rural
- apply reliability of supply parameters of:
 - system average interruption duration index (SAIDI)
 - system average interruption frequency index (SAIFI)
 - customer service (telephone answering)
- set performance targets based on TasNetworks' average performance over the past five regulatory years

⁴ AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2019*, July 2017, p. 51.

⁵ AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2019*, July 2017, p. 51.

⁶ AER, *Electricity distribution network service providers—service target performance incentive scheme*, November 2009. (AER, *STPIS*, November 2009).

⁷ AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2019*, July 2017, pp. 49–58.

⁸ AER, *Electricity distribution network service providers—service target performance incentive scheme*, November 2009. (AER, *STPIS*, November 2009).

- apply the methodology indicated in the national STPIS for excluding specific events from the calculation of annual performance targets
- apply the methodology and value of customer reliability (VCR) values to the calculation of incentive rates using the latest VCR for Tasmania.

In making our draft decision on the STPIS, we have taken into account our F&A, TasNetworks' regulatory proposal, our information requests to TasNetworks and submissions raised by stakeholders.⁹ Our responses to the matters raised by TasNetworks and stakeholders about the application of the STPIS are discussed in this draft decision.

Table 10-1 and Table 10-2 present our draft decision on the applicable incentive rates and targets that will be applied to TasNetworks' STPIS for the 2019–24 regulatory period. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.¹⁰

Table 10-1 Draft decision—STPIS incentive rates for TasNetworks for the 2019–24 regulatory period

	Critical Infrastructure	High Density Commercial	Urban	High Density Rural	Low Density Rural
SAIDI	0.0029	0.0037	0.0388	0.0094	0.0140
SAIFI	0.3053	0.2802	3.2566	1.0114	1.9296

Source: AER analysis.

Table 10-2 Draft decision—STPIS reliability targets for TasNetworks for the 2019–24 regulatory period

	value
Critical Infrastructure	
SAIDI	33.572
SAIFI	0.280
High Density Commercial	
SAIDI	24.229
SAIFI	0.283

⁹ TasNetworks, *Tasmanian Transmission Revenue and Distribution Regulatory Proposal, Regulatory Control Period 1 July 2019 to 30 June 2024*, 31 January 2018, pp. 184–185.

¹⁰ AER, *STPIS*, November 2009, cl. 5.3.2(a).

Urban	
SAIDI	81.645
SAIFI	1.003
High Density Rural	
SAIDI	242.710
SAIFI	2.451
Low Density Rural	
SAIDI	412.671
SAIFI	3.257
Telephone answering	
Percentage of calls will be answered within 30 seconds	76.19

Source: AER analysis.

10.2 TasNetworks' proposal

TasNetworks proposed to adopt the approach specified in the F&A.¹¹

10.3 AER's assessment approach

We are required to make a decision on how the STPIS is to apply to TasNetworks.¹² 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.¹³

We outlined our proposed approach to, and reasons for, the application of the STPIS in our F&A for TasNetworks. Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by TasNetworks and by stakeholders. No submissions were received regarding how the STPIS should be applied to TasNetworks.

¹¹ TasNetworks, *Tasmanian Transmission Revenue and Distribution Regulatory Proposal, Regulatory Control Period 1 July 2019 to 30 June 2024*, 31 January 2018, pp. 184–185.

¹² NER, cl. 6.12.1(9).

¹³ AER, *STPIS*, November 2009, cl. 2.1(d).

10.3.1 Interrelationships

In implementing the STPIS we must take into account any other incentives available to the distributor under the NER or relevant distribution determination.¹⁴ One of the objectives of the STPIS is to ensure that the incentives are sufficient to offset any financial incentives the distributor may have to reduce costs at the expense of service levels. For the 2019–24 regulatory control period, the STPIS will interact with the Capital Expenditure Sharing Scheme (CESS) and the opex Efficiency Benefit Sharing Scheme (EBSS).¹⁵

The reward and penalty mechanism under the STPIS (the incentive rates) are determined based on the average customer value for the improvement, or otherwise, to supply reliability (the VCR). This is aimed at ensuring that the distributor's operational and investment strategies are consistent with customers' value for the services that are offered to them.

For the purposes of setting the incentive rates under the STPIS, we apply the feeder-type specific VCR values that reflect the weighted average VCR value across all customer types, weighted by the customer numbers and the energy consumption of different customer types for each feeder type.

The above approach of the use of a weighted average VCR is distinct from the value of VCR that is used to assess capex proposals from network businesses to quantify or monetise the risks of the proposed investment. This risk assessment informs our view on whether a proposed investment is likely to be economically efficient and whether the network business proposals are reasonably likely to reflect the optimal timing of the proposed projects. The specific VCR input values used in capex assessments is dependent on the predominant customer type that may be impacted by the proposed projects (e.g. residential or industrial customer)—that is a locational VCR value reflective of the specific customer characteristics of each location.

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

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

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

¹⁴ NER, cl. 6.6.2(b)(3)(iv).

¹⁵ AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2019, July 2017*, pp. 49–58.

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

10.4 Reasons for draft decision

We will apply the STPIS in accordance with our F&A paper to TasNetworks.¹⁶ The following section sets out our detailed consideration on applying the STPIS to TasNetworks for the 2019–24 regulatory control period.

10.4.1 Revenue at risk

TasNetworks' revenue at risk for each regulatory year of the 2019–24 regulatory control period will be capped at ± 5.0 per cent as per the scheme standard. This was also the revenue at risk applied to TasNetworks in the current regulatory period.

Revenue at risk caps the potential reward and penalty for TasNetworks under the STPIS. We consider an incentive of ± 5.0 per cent of the annual allowable revenue would result in the right balance with the operation of the EBSS and CESS to ensure that the incentives to reduce costs will not be delivered at the expense of service levels to customers—hence meeting the long term interest of consumers.

We received no submissions from stakeholders regarding the application of TasNetworks' revenue at risk.

10.4.2 Reliability of supply component

Applicable components and parameters

We will apply unplanned SAIDI and unplanned SAIFI parameters under the reliability of supply component to TasNetworks' feeders for the 2019–24 regulatory control period. Unplanned SAIDI measures the sum of the duration of each unplanned sustained customer interruption (in minutes) divided by the total number of distribution customers. Unplanned SAIFI measures the total number of unplanned sustained customer interruptions divided by the total number of distribution customers.

Exclusions

The STPIS allows certain events to be excluded from the calculation of the s-factor revenue adjustment. These exclusions include the events specified in the STPIS, such as the effects of transmission network outages and other upstream events. They also

¹⁶ AER, *Final framework and approach for TasNetworks Distribution, for the Regulatory control period commencing 1 July 2019*, July 2017, pp. 49–58.

exclude the effects of extreme weather events that have the potential to significantly affect TasNetworks' underlying STPIS performance.

TasNetworks proposed to calculate the major event day (MED) threshold using the 2.5 beta method in accordance our F&A. Since we have not received any submissions that we should depart from our F&A, we accept TasNetworks' proposal.

Performance targets

The STPIS specifies that the performance targets should be based on the average performance over the past five regulatory years. It also states that the performance targets must be modified for any reliability improvements completed or planned where the planned reliability improvements are included in the expenditure program proposed by the network service provider and expected to result in a material improvement in supply reliability.¹⁷

Since TasNetworks' capex for the current and next regulatory control period does not contain reliability improvement expenditure, we have not made adjustments to the targets, which are based on the relevant historical average levels.

We received no submissions from stakeholders regarding the application of TasNetworks' performance targets.

Our calculated performance targets for TasNetworks for the 2019–24 regulatory control period are presented in the table below.

Table 10-3 Draft decision—STPIS reliability targets for TasNetworks for the 2019–24 regulatory period

	value
Critical Infrastructure	
SAIDI	33.572
SAIFI	0.280
High Density Commercial	
SAIDI	24.229
SAIFI	0.283
Urban	
SAIDI	81.645
SAIFI	1.003

¹⁷ AER, *STPIS*, November 2009, cl. 3.2.1.

High Density Rural	
SAIDI	242.710
SAIFI	2.451
Low Density Rural	
SAIDI	412.671
SAIFI	3.257
Telephone answering	
Percentage of calls will be answered within 30 seconds	76.19

10.4.3 Customer service component

The STPIS customer service target applicable to TasNetworks is the telephone response measured as the number of telephone calls answered within 30 seconds. This measure is referred to as the telephone Grade of Service (GOS).

We have identified minor data accuracy issues with the historical performance data previously provided to the AER in the relevant regulatory information notices (RINs). However, TasNetworks has not provided any specific information in this regard. We consider that any attempt to modify historical RIN data must be subject to the same level of scrutiny as the standard RIN reporting process and must be independently verified. Hence, for the purpose of this draft decision, we applied TasNetworks' originally reported historical performance to set the performance targets as a placeholder. We consider that TasNetworks should clarify this matter in its revised proposal. This will provide transparency to the process as well as enabling TasNetworks adequate time to submit properly verified data to us.

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

10.4.4 Incentive rates

The incentive rates applicable to TasNetworks for the reliability of supply performance parameters of the STPIS have been calculated in accordance with clause 3.2.2 and using the formulae provided in appendix B of the National STPIS. Our draft decision on TasNetworks' incentive rates are set out in Table 10-4. The incentive rate for the customer service component will be -0.040 per cent per unit of the telephone answering parameter.¹⁸

¹⁸ AER, *STPIS*, November 2009, cl. 5.3.2(a).

Table 10-4 Draft decision—STPIS incentive rates for TasNetworks for the 2019–24 regulatory period

	Critical Infrastructure	High Density Commercial	Urban	High Density Rural	Low Density Rural
SAIDI	0.0029	0.0037	0.0388	0.0094	0.0140
SAIFI	0.3053	0.2802	3.2566	1.0114	1.9296

Source: AER analysis

10.4.5 Value of customer reliability to calculate the incentive rates

Our F&A paper stated that we will apply a latest value for VCR through the distribution determination in calculating TasNetworks' incentive rates.¹⁹ TasNetworks provided energy usage information based on AEMO's load classification of residential, commercial, industry and agriculture. Hence, for this draft decision, we have calculated TasNetworks' VCR for the incentive rates by deriving it from its consumption data and AEMO's published segment VCR.

The VCR for network segments is outlined in Table 10-5. We have applied this VCR to calculate TasNetworks incentives rates for the 2019–24 regulatory control period.

Table 10-5 Value of customer reliability (\$/MWh)

	Critical Infrastructure	High Density Commercial	Urban	High Density Rural	Low Density Rural
VCR	44,381.51	44,010.52	35,308.19	37,349.90	40,329.49

Source: AER analysis, and AEMO, *Value of customer reliability review, final report*, September 2014, p. 30.

¹⁹ AER, *STPIS*, November 2009.