



# **FINAL DECISION** **Essential Energy** **Distribution Determination**

**2019 to 2024**

## **Attachment 10** **Service target performance** **incentive scheme**

Updated February 2022

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## Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Essential Energy for the 2019-2024 regulatory control period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The attachments have been numbered consistently with the equivalent attachments to our longer draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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## Shortened forms

Shortened form	Extended form
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Capex	capital expenditure
CCP10	Consumer Challenge Panel (subpanel 10)
CESS	capital expenditure sharing scheme
Distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
F&A	framework and approach
GSL	guaranteed service level
MAR	maximum allowable revenue
NER	National Electricity Rules
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

## 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 revised attachment sets out how we will apply the STPIS to Essential Energy (Essential) for the 2019–24 regulatory control period. This attachment has been updated under clause 6.13 of the NER to correct the effect of the erroneous data previously provided by Essential Energy for 2015-16, 2016-17 and 2017-18 financial years.

### AER's service target performance incentive scheme

The STPIS is intended to balance incentives to reduce expenditure with the need to maintain or improve service quality. AER achieves this by providing financial incentives to distributors to maintain and improve service performance where customers are willing to pay for these improvements.

We published the current version of our national scheme, STPIS 2.0, in November 2018.<sup>1</sup> In STPIS 2.0, among other changes, we adjusted the STPIS formula to better balance the weights given to the frequency and duration of supply interruptions. The modified STPIS will increase the incentive for distributors to reduce the average duration of supply interruptions for all customers, while keeping the number of outages at low levels.

Key amendments in the STPIS 2.0 include the following:

- changing the weighting ratio ( $w$ ) for the STPIS incentive rates to 1.5 for all network segments<sup>2</sup>
- simplifying the scheme by specifying STPIS outcomes as a fixed monetary amount, rather than as a percentage adjustment to the maximum allowable revenue (MAR)
- changing the threshold for momentary interruptions from less than 1 minute to less than 3 minutes.

### 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 Essential in the next regulatory control period.<sup>3</sup>

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<sup>1</sup> AER, *Electricity distribution network service providers—service target performance incentive scheme, Version 2.0*, November 2018. (AER, *STPIS*, November 2018).

<sup>2</sup> AER, *STPIS*, November 2018, clause 3.2.2, table 1, p. 12.

Our F&A also stated that the revised STPIS may apply to Essential in the next regulatory period if the review of the STPIS is completed on time.<sup>4</sup>

## 10.1 Final decision

Based on Essential's revised proposal and stakeholders' submissions, we will apply the STPIS 2.0 (November 2018)<sup>5</sup> to Essential and other ACT/NSW distributors for the 2019–24 regulatory period in the following manner:

- set revenue at risk at the range  $\pm 5.0$  per cent
- segment the network according to CBD, urban, short rural and long rural feeder categories as applicable
- apply the system average interruption duration index (SAIDI), system average interruption frequency index (SAIFI) and customer service (telephone answering) parameters
- set performance targets based on Essential'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
- apply the method and value of customer reliability (VCR) values as indicated in AEMO's 2014 Value of Customer Reliability Review final report<sup>6</sup>
- not apply the guaranteed service level (GSL) of the STPIS as Essential is subject to a jurisdictional GSL scheme.

In making our final decision on STPIS, we have taken into account our draft decision, Essential's regulatory and revised regulatory proposals and submissions raised by stakeholders.<sup>7</sup> Our response to the matters raised by Essential and stakeholders about the application of the STPIS are discussed in section 10.5.

Table 10.1 and Table 10.2 present our updated final decision on the applicable incentive rates and targets that will be applied to Essential's STPIS for the 2019–24 regulatory period..

In October 2020, Essential Energy notified the AER of errors in STPIS data relating to the 2015–16, 2016–17, 2017–18 and 2018–19 reporting years. The reported data

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<sup>3</sup> AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59–65.

<sup>4</sup> AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019 to 30 June 2024*, July 2017, p. 60.

<sup>5</sup> AER, *STPIS*, November 2018.

<sup>6</sup> Australian Energy Market Operator, *Value of customer reliability review, final report*, September 2014.

<sup>7</sup> Essential Energy, *2019-24 Revised regulatory proposal*, January 2019, p. 24; Consumer Challenge Panel (CCP10), *Response to the Endeavour Energy revised regulatory proposal 2019-24 and AER draft determination*, February 2019; AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy control period commencing 1 July 2019 to 30 June 2024*, July 2017, pp. 59-65.

inadvertently included supply outages that should not have been reported under the STPIS, because they were exempt under the scheme. Specifically, the reported data included sustained outages arising from Total Fire Ban (TFB) days due to the mandated requirement to disable auto-reclosers. Essential Energy has since adjusted its systems to report the correct level of outages.

The data errors caused two effects:

- First, the STPIS performance targets for the 2019–24 period are easier to achieve than they would have been if the correct data had been used. This is because the targets are determined based on historic performance, and the historical data included too many events because the TFB days were included.
- Second, the penalties under the STPIS for not meeting its performance targets for the 2017–18 and 2018–19 years (and applied in 2019–20 and 2020–21 years respectively) were higher than should have been applied—resulting in an under-recovery of the correct revenue (or, “overpaid penalties”). This under-recovery (or overpaid penalties) amount is \$4.0m (in 2020–21 dollars).

It is open to us whether to correct the financial effect of the data errors, which resulted in revenue under-recovery to Essential Energy for 2019–20 and 2020–21.

After consultation with Energy Consumers Australia, Public Interest Advocacy Centre and Essential Energy’s Customer Advocacy Group, we consider that:

- The 2019-24 Essential Energy distribution determination is affected by a material error or deficiency relating to the performance targets under the Service Target Performance Incentive Scheme (STPIS).
- The 2019-24 Essential Energy distribution determination is affected by a material error or deficiency, in that incorrect STPIS penalty amounts for the 2017-18 and 2018-19 reporting years were entered into the Revenue Cap Price Control formula of 2019-20 and 2020-21, resulting in an incorrect allowable revenue requirement.

To correct the above-mentioned errors, we have:

- pursuant to clause 6.13(a) of the NER, to revoke the STPIS and control mechanism attachments of Essential Energy 2019–24 distribution determination on the basis that the distribution determination is affected by these material errors or deficiencies; and
- pursuant to clause 6.13(b) of the NER, made a new Essential Energy 2019–24 distribution determination in substitution for the revoked distribution determination, which makes amendments to the Service Target Performance Incentive Scheme and control mechanisms attachments to the extent necessary to correct the relevant errors or deficiencies.

Consequently, we have:

- updated the targets with the correct data as shown in table 10.1 and 10.2. The corrected STPIS targets will be tighter than the original targets previously set in the revoked STPIS attachment.
- apply a ‘true-up’ amount in the control mechanism for 2022–23 to correct the effect of the previous overpaid penalties related to performance in the 2017–18 and 2018–19 years, that was applied to the revenues in the 2019–20 and 2020–21 years.



The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.<sup>8</sup>

**Table 10.1 Final decision (updated)—STPIS incentive rates for Essential for the 2019–24 regulatory period**

	Urban	Short rural	Long rural
ir – SAIDI	0.01537	0.03613	0.00941
ir – SAIFI	0.82750	2.64131	0.94389

Source: AER analysis.

**Table 10.2 Final decision (updated)—STPIS reliability targets for Essential for the 2019–24 regulatory period**

	value
<b>Urban</b>	
SAIDI	72.885
SAIFI	0.903
<b>Short rural</b>	
SAIDI	203.890
SAIFI	1.860
<b>Long rural</b>	
SAIDI	440.107
SAIFI	2.926
<b>Telephone answering</b>	
Percentage of calls will be answered within 30 seconds	69.3%

Source: AER analysis.

<sup>8</sup> AER, *STPIS*, November 2018, cl. 5.3.2(a).

## 10.2 Our draft decision

We applied the earlier version of the distribution STPIS (November 2009)<sup>9</sup> to Essential for the 2019–24 regulatory period, given that the revised STPIS (November 2018) was not yet complete in time for the draft decision.

Our draft decision for Essential applied the national STPIS to the distributor except for the GSL component. It also applied the revised values for VCR in calculating the incentive rates for Essential.<sup>10</sup>

## 10.3 Essential Energy's revised proposal

In the revised regulatory proposal, Essential and other ACT/NSW distributors (Evoenergy, Ausgrid and Endeavour Energy) requested to apply the latest version of the STPIS 2.0 for the 2019–24 regulatory control period.<sup>11</sup>

Essential also provided the re-cast historical information required to apply the STPIS 2.0 and an audit opinion confirming the accuracy of this data.<sup>12</sup>

Essential also proposed collating and trial some alternative customer service measures during the 2019–24 regulatory period. Essential will seek to have it included in the scheme and its revenue determination for the 2024–29 regulatory control period.<sup>13</sup>

## 10.4 Assessment approach

We are required to decide on how the STPIS is to apply to Essential.<sup>14</sup> 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.<sup>15</sup>

We outlined our proposed approach to, and reasons for, the application of the STPIS in our F&A and draft decision for Essential. Our final decision has adopted the position in the draft decision, except for the application of the revised STPIS to ACT/NSW distributors. We have considered materials submitted to us by Essential and stakeholders.

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<sup>9</sup> AER, *Electricity distribution network service providers—service target performance incentive scheme*, November 2009. (AER, *STPIS*, November 2009).

<sup>10</sup> Values determined from the most recent Australian Energy Market Operator (AEMO) review of VCR values; AER, *Draft decision Essential Energy distribution determination - Attachment 10 - STPIS*, September 2018, pp. 13–14.

<sup>11</sup> Essential Energy, *2019-24 Revised regulatory proposal*, January 2019, p. 24.

<sup>12</sup> Essential Energy, *Re-cast historical STPIS performance data and Review opinion*, 28 February 2019.

<sup>13</sup> Essential Energy, *2019-24 Revised regulatory proposal*, January 2019, p. 24.

<sup>14</sup> NER, cl. 6.12.1(9).

<sup>15</sup> AER, *STPIS*, November 2018, cl. 2.1(d).

## 10.5 Reasons for final decision

We will apply the revised STPIS (November 2018) to Essential. The following section sets out our detailed consideration on applying the STPIS to Essential for the 2019–24 regulatory control period.

### 10.5.1 Application of revised STPIS to ACT/NSW distributors

In the draft decision, we applied the earlier version of the distribution STPIS (November 2009) to ACT/NSW distributors, including Essential, for the 2019–24 regulatory period, given that the revised STPIS (November 2018) was not yet completed in time for the draft decision.<sup>16</sup>

We will apply the revised STPIS to ACT/NSW distributors in this final decision because the revised scheme would deliver better outcomes for consumers—the modified STPIS will increase the incentive for distributors to reduce the average duration of supply interruptions for all customers while keeping the number of outages at low levels.<sup>17</sup>

This is consistent with our F&A paper — that we intended to apply the revised version once the revised version was finalised.<sup>18</sup>

The CCP10 submission supports applying the new STPIS.<sup>19</sup>

### 10.5.2 Reliability of supply component and Customer service component

We requested and received from Essential independently verified historical reliability performance data over the past five years to incorporate the revised definitions for:

- Sustained interruptions (outages longer than 3 minutes)
- Single-phase low voltage outages (33 per cent of customers impacted)
- Single-phase high voltage outages (67 per cent of customers impacted).

Our calculated performance targets for the reliability of supply component and customer service component for Essential for the 2019–24 regulatory control period are presented in the table below.

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<sup>16</sup> AER, *Draft decision Essential Energy distribution determination - Attachment 10 - STPIS*, September 2018, pp. 5-6.

<sup>17</sup> AER, <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/service-target-performance-incentive-scheme-2018-amendment/final-decision>

<sup>18</sup> AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019 to 30 June 2024*, July 2017, p. 60.

<sup>19</sup> Consumer Challenge Panel (CCP10), *Response to the Ausgrid revised regulatory proposal 2019-24 and AER draft determination*, January 2019, p. 44.

**Table 10.3 Final decision (updated)—STPIS reliability targets for Essential for the 2019–24 regulatory period**

	value
<b>Urban</b>	
SAIDI	72.885
SAIFI	0.903
<b>Short rural</b>	
SAIDI	203.890
SAIFI	1.860
<b>Long rural</b>	
SAIDI	440.107
SAIFI	2.926
<b>Telephone answering</b>	
Percentage of calls will be answered within 30 seconds	69.3%

Source: AER analysis.

### Development of a new customer service metric for 2024–29

Essential has proposed collating and trial some alternative customer service measures during the 2019–24 regulatory period. Essential will seek to have it included in the scheme and its revenue determination for the 2024–29 regulatory control period.<sup>20</sup>

We will consider this new customer service metric after further information is available and, if deemed suitable, amend the STPIS accordingly. This will be a separate process outside of our regular revenue determination process.

### 10.5.3 Value of Customer Reliability

For our draft decision, we calculated the VCR values based on the AEMO 2014 VCR report recommendations and escalated it into October 2018 dollar value for Essential and other ACT/NSW distributors.<sup>21</sup>

<sup>20</sup> Essential Energy, *2019-24 Revised regulatory proposal*, January 2019, p. 24.

For this final decision, we have maintained the same approach as in our draft decision and updated VCR values using December 2018 CPI index to be \$41,125 per MWh for non-CBD feeders.

Our proposed VCR values for Essential's network segments are outlined in the table below. We have applied these VCR values to calculate its incentives rates for 2019–24.

**Table 10.4 Value of customer reliability (\$/MWh)**

	Urban	Short rural	Long rural
VCR <sup>a</sup>	41,125	41,125	41,125

Source: AER analysis; AEMO, *Value of customer reliability review, final report*, September 2014, pp. 2, 30.

<sup>a</sup> Values based on AEMO 2014 VCR report, escalated to July 2019 dollar value using December 2018 CPI index.

### 10.5.4 Incentive rates

The incentive rates applicable to Essential 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 STPIS 2.0. Our final decision on Essential's incentive rates is set out in the table below. The incentive rate for the customer service component will be –0.040 per cent per unit of the telephone answering parameter.<sup>22</sup>

**Table 10.5 Final decision (updated)—STPIS incentive rates for Essential for the 2019–24 regulatory period**

	Urban	Short rural	Long rural
ir – SAIDI	0.01537	0.03613	0.00941
ir – SAIFI	0.82750	2.64131	0.94389

Source: AER analysis.

<sup>21</sup> AER, *Draft decision Ausgrid distribution determination - Attachment 10 - STPIS*, September 2018, pp. 13–14; AER, *Draft decision Essential Energy distribution determination - Attachment 10 - STPIS*, September 2018, p. 12.

<sup>22</sup> AER, *STPIS*, November 2018, cl. 5.3.2(a).