Australian Energy Market Commission

RULE CHANGE

CONSULTATION PAPER

National Electricity Amendment (Early application of Service Target Performance Incentive Scheme (STPIS) components for transmission businesses) Rule 2014

Rule Proponent
ElectraNet

31 July 2014

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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1 Introduction

The Australian Energy Market Commission has received a rule change request from ElectraNet in regard to the application of the Service Target Performance Incentive Scheme (STPIS) to transmission network businesses.

The rule change request proposes a new rule that would permit an eligible transmission business to apply to the Australian Energy Regulator (AER) to seek early application of one of the three incentive components (that is, the network capability component) of version four of the STPIS within the transmission business's current regulatory control period. The rule change request arises from the AER's ability to periodically review and amend the STPIS within a transmission business's regulatory control period.

ElectraNet considers that such a rule change would provide material benefits to electricity consumers by incentivising eligible transmission businesses to undertake low cost network optimisation projects. Such projects may otherwise be deferred until requisite funding is approved by the AER as part of the relevant transmission business's subsequent regulatory determination, which may be several years away.

This Consultation Paper has been prepared to facilitate public consultation on the rule change proposal, and to seek stakeholder submissions on the rule change request.

The paper:

- sets out a summary of the rule change proposed by ElectraNet;
- provides an overview of the STPIS and identifies a number of issues and questions to facilitate public consultation on this rule change request; and
- outlines the process for stakeholder submissions.

The Commission invites interested stakeholders to make written submissions on this rule change request by no later than 28 August 2014.

2 Background

2.1 Overview of the Service Target Performance Incentive Scheme

The Service Target Performance Incentive Scheme, or STPIS, is an incentive scheme developed by the Australian Energy Regulator (AER) for application to network businesses.[1] The objective of the scheme is to assist the AER in balancing the incentive on transmission businesses to reduce actual expenditure, with the need to maintain and improve reliability for customers and minimise the wholesale electricity market impact of transmission congestion.

The first STPIS (version one) comprised a single incentive component (that is, the service component) and was published by the AER in August 2007. The AER has progressively released updated versions of the STPIS to reflect either definitional amendments or to introduce additional components. The market impact component and network capability component were introduced in March 2008 and December 2012, respectively.

ElectraNet's rule change request relates to the proposed early application of the network capability component within an eligible transmission business's current regulatory control period.

An outline of the STPIS can be found in Appendix A of this paper, including an overview of the evolution of the STPIS and a summary of its three incentive components.

2.2 Context for the rule change request

This section provides some context around ElectraNet's decision to submit this rule change request.

2.2.1 ElectraNet's revenue determination process

As part of its revenue proposal for the 2013-14 to 2017-18 financial years, ElectraNet included a number of low cost operations and/or minor capital works type projects to increase the capability of its transmission network in South Australia. These projects were proposed to be funded by a new category of operational expenditure called 'network optimisation opex'.[2]

In its draft decision on ElectraNet's revenue proposal in November 2012, the AER did not accept ElectraNet's proposed network optimisation expenditure as a step-change in

1 The obligations relating to the STPIS are set out in clause 6A.7.4 of the National Electricity Rules (NER).

2 ElectraNet, *ElectraNet transmission network revenue proposal*, Chapter 6 – Forecasting operating expenditure, May 2012, pp98-99.

its operational expenditure forecast. The AER considered that ElectraNet's proposed network optimisation was part of a core business objective – that is, a business-as-usual practice for any efficiently operated transmission business.[3]

The AER also noted in the draft decision that it was in the process of making changes to the STPIS that would incentivise this type of expenditure through a new network capability component, which was subsequently introduced in December 2012.

The AER considered that ElectraNet was not precluded from spending its opex allowance on network optimisation projects, and recovering the benefits over time through the existing efficiency benefit sharing scheme (EBSS)[4] and the STPIS. [5]

As a result, ElectraNet stated in its revised revenue proposal in January 2013 that, due to the AER's amendments in version four of the STPIS, ElectraNet intended to remove all of the initiatives under its proposed network optimisation opex. Instead, ElectraNet would seek to have the new network capability component of the STPIS applied to its 2013-14 to 2017-18 regulatory control period, as considered in the next section.[6]

2.2.2 AER consultation on ElectraNet's request for early application of the network capability component

On 29 May 2013, ElectraNet submitted a proposal to the AER seeking early application of the network capability component of version four of the STPIS within its current regulatory control period (2013-14 to 2017-18).

In response, the AER released a draft position paper on 14 August 2013 setting out its draft decision on the application of version four of the STPIS to ElectraNet, as well as other eligible transmission businesses, namely Powerlink and Murraylink. The AER proposed that:[7]

- In respect of ElectraNet and Powerlink, both transmission businesses would be allowed to opt-in to the network capability component of version four of the STPIS in their current regulatory control period from the next regulatory year (2014-15 to 2017-18). If either transmission business chose to opt-in, they would need to submit a network capability incentive parameter action plan (NCIPAP) proposal to the AER prior to its next regulatory year.[8] The AER stated that

3 AER, *Draft decision – ElectraNet 2013-14 to 2017-18*, Appendix A – Opex allowance, November 2012, pp285-286.

4 The EBSS is a scheme that provides transmission businesses with a continuous incentive (that is equal in each year of any regulatory control period) to reduce operating expenditure. NER clause 6A.6.5(b).

5 AER, *Draft decision – ElectraNet 2013-14 to 2017-18*, Appendix A – Opex allowance, November 2012, pp285-286.

6 ElectraNet, *ElectraNet transmission network revised revenue proposal, Chapter 7 – Operating expenditure*, January 2013, p106.

7 AER 2013, *Draft decision – Early application of version four of the STPIS*, August 2013, pp4-5.

8 A NCIPAP must outline the key network capability limitations on each transmission circuit or load injection point on the transmission network and include a list of projects designed to improve,

Murraylink would not be eligible to participate in the network capability component.[9]

- In respect of ElectraNet, Powerlink and Murraylink, the AER would apply the market impact component of version four of the STPIS from 1 January 2014 for their current regulatory control period.
- In respect of ElectraNet, Powerlink and Murraylink, the AER would not apply the service component of version four of the STPIS in their current regulatory control period.
- The AER did not intend to amend Directlink's STPIS.[10]

At the time of its draft decision, the AER considered that, with the removal of clause 6A.7.4(f) from the NER as part of National Electricity Amendment (Economic regulation of network service providers) Rule 2012 No. 9, it had the power to apply an amended STPIS to a transmission business in its current regulatory control period.[11]

In response to its draft decision, the AER received six submissions. Following consideration of these submissions, the AER reviewed its draft decision and concluded that it did not have the power to apply an amended STPIS to a transmission business in its current regulatory control period. Consequently, in its final decision in December 2013, the AER stated that it was not able to approve the early application of a revised STPIS within a regulatory control period.[12]

In its final decision, the AER noted that it supported the views that it had previously expressed in its draft decision – that is, that early application of the network capability and/or market impact components of version four of the STPIS should be permitted, as it would promote the National Electricity Objective. The AER also stated that it would be supportive of prospective rule change requests to enable the early application of these components to transmission businesses in regulatory control periods that have already commenced.

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through operational and/or minor capital expenditure, some of those limitations identified. Further information on NCIPAPs may be found in Appendix A, section A.6, of this consultation paper.

9 The Murraylink transmission system is a single underground cable interconnection of 220 MW capacity, which extends 176 km from Red Cliffs in Victoria to Berri in South Australia. The interconnection allows power to be traded between the two States on a purely commercial basis. As Murraylink is a single cable, it is not eligible for the network capability component of the STPIS.

10 Similarly to Murraylink, Directlink would also not be eligible for the network capability component.

11 The now–deleted clause 6A.7.4(f) of the NER read: "The AER may from time to time and in accordance with the transmission consultation procedures, amend or replace any scheme that is developed and published under this clause, except that no such amendment or replacement may change the application of the scheme to a transmission business in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement coming into operation".

12 AER 2013, *Final decision – Early application of version four of the STPIS*, December 2013, pp4-5.

2.3 Other relevant rule changes and recommendations

2.3.1 Early implementation of the market impact parameters rule change (2010)

ElectraNet noted in its rule change request that, following the introduction of the market impact component in the STPIS in March 2008, a rule change request was made to the AEMC to allow transmission businesses to apply for the application of this component in circumstances where they were part-way through their regulatory control period.[13] The AEMC made a rule in March 2010 to allow for such application, albeit a more preferable rule with a more rigorous acceptance process than was outlined in the proposed rule.[14]

2.3.2 Economic regulation of network service providers rule change (2012)

Since the above rule change, there have been a number of amendments to the arrangements for regulating network service providers. Of particular importance are the NER amendments made by the Commission in November 2012 as part of the Economic regulation of network service providers rule change request.

In its final rule determination, the Commission considered that the amendments to the NER comprised an integrated package of measures that, at a general level:[15]

- promoted flexibility and adaptability, to allow the regulator to make decisions in changing circumstances, and for service providers with different characteristics, such as network size and geography;
- improved the regulatory determination process, to allow the regulator adequate time for decision making, to improve consumer engagement, and to improve transparency and accountability; and
- addressed ambiguities and clarified regulatory provisions, to put beyond doubt the interpretation of certain provisions.

2.3.3 Review of the Limited Merits Review regime (2012)

Concurrent to the AEMC's consideration of the above rule change request, a review of the Limited Merits Review regime in the National Electricity Law (NEL) and the National Gas Law was being undertaken by an Expert Panel.

A final stage two report was published on 9 October 2012. In this report, the Expert Panel proposed changes so that the merits review of regulatory decisions under those

13 ElectraNet, Rule change request, p2.

14 AEMC, *Early implementation of the market impact parameters*, Final rule determination, March 2010.

15 AEMC, *Economic regulation of network service providers*, and *Price and revenue regulation of gas services*, Final rule determination, November 2012, pii.

rules should be more holistic and broader, focussing on overall outcomes and the long term interests of consumers rather than component elements.[16] A number of these changes were passed by the South Australian parliament on 8 December 2013 and made under the Statutes Amendment (National Electricity and Gas Laws – Limited Merits Review) Bill 2013.

2.3.4 Other relevant rule changes

The Expert Panel's above recommendations and subsequent Law changes, which seek to encourage a greater focus on objectives and overall outcomes, are consistent with the policy position advocated by the Commission in its final rule determination for the Economic regulation of network service providers rule change.[17]

These decisions have informed the Commission's policy position when considering subsequent rule change requests relating to the regulation of electricity networks.

For example, for the following two rule change requests, the Commission's final rule determination was to not make a rule:

- Assumed utilisation of imputation credits rule change (2012).[18]
    - The Commission did not consider it appropriate to allow the value of gamma for ElectraNet and SP AusNet's revenue determinations to be changed part-way through their regulatory control periods in isolation of a review of all weighted average cost of capital (WACC) parameters.
- Recovery of network support payments rule change (2013).[19]
    - The Commission considered that the NER already provided an appropriate cost recovery mechanism for network support costs as part of the revenue determination process.

For the following rule change request, the Commission's final rule determination was to make a more preferable rule with limitations regarding its application:

- Cost pass through arrangements for network service providers rule change (2012).[20]
    - The Commission made a more preferable rule that, while not approving the cost pass through events proposed in the rule change request, introduced

16 G Yarrow, M Egan and J Tamblyn, *Review of the limited merits review regime – stage two report*, September 2012, pp2-9.

17 AEMC, *Economic regulation of network service providers*, and *Price and revenue regulation of gas services*, Final rule determination, November 2012, pxi.

18 AEMC, *Assumed utilisation of imputation credits*, Final rule determination, September 2012.

19 AEMC, *Recovery of network support payments*, Final rule determination, October 2013.

20 AEMC, *Cost pass through arrangements for network service providers*, Final rule determination, February 2012.

criteria that the AER must consider when approving a network service provider's nominated cost pass through events at the time that a network business undertakes its revenue determination.

3 Details of the rule change request

ElectraNet's rule change request proposes to enable earlier application of the network capability component of the STPIS to eligible transmission businesses in respect of their current regulatory control period.

Specifically, the rule change request proposes the addition of a transitional rule under Chapter 11 of the NER so as to permit an eligible transmission business to:

- apply to the AER to seek early application of the network capability component of the STPIS where it would not otherwise apply until the commencement of its next regulatory control period; and
- submit a network capability incentive parameter action plan (NCIPAP, or network action plan) to the AER for approval, following review of the network action plan by the Australian Energy Market Operator (AEMO) and consultation with customers.

A copy of ElectraNet's rule change request, including a proposed rule, has been published on the AEMC's website (www.aemc.gov.au).

3.1 Rationale for the proposed rule

ElectraNet considers that early application of the network capability component of the STPIS in its current regulatory control period would provide an incentive for it to undertake low cost network optimisation projects. Delivery of such projects would, in turn, provide a material benefit to electricity customers.

ElectraNet contends that, in the absence of early application of the network capability component, it does not have an incentive to undertake the low cost optimisation projects that it has identified for its network, as they are essentially unfunded projects during the current regulatory control period. Further, the regulatory incentives that currently apply to ElectraNet operate to penalise it for incurring the additional costs associated with the projects identified, and so, provide a disincentive to undertaking such projects.[21] This would be to the detriment of customers on its network.

3.1.1 National Electricity Objective

The National Electricity Objective (NEO) is set out under s. 7 of the NEL as follows:

> "The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

21 ElectraNet, Rule change request, pp8-9.

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system."

ElectraNet considers that the proposed rule promotes the efficient investment in, and efficient operation and use of, transmission services through:[22]

- The network capability component incentivising transmission businesses to identify the limitations on their networks which may be improved through minor operational and/or capital expenditure for the benefit of users of the network. This promotes economically efficient outcomes through the maximisation of network capability that is valued by customers or improved wholesale market outcomes at least cost.

- The network action plan providing improved capability of those elements of the transmission system most important in determining spot prices, or improved capability of the transmission system at times when users place greatest value on the reliability of the transmission system.

3.1.2 Expected costs and benefits of the proposed rule change

ElectraNet considers that the proposed rule will result in a net benefit to the electricity market. This is because the priority projects identified by an eligible transmission business in its network action plan must be reviewed by AEMO, be approved by the AER, and must demonstrate that their completion would result in a material benefit to the market.[23]

In its rule change request, ElectraNet provided estimates of the costs and benefits of possible priority projects for its network that may be contained within a network action plan, as indicated in Table 3.1[24] ElectraNet estimates total costs of approximately $11.5 million are exceeded by benefits that amount to several multiples of this figure. Therefore, ElectraNet considers that the costs associated with the proposed rule would be relatively minor and administrative in nature, compared to the benefits that are likely to accrue.

ElectraNet also expects there to be some costs associated with a transmission business's consultation process with its electricity customers and AEMO on the proposed network action plan, and the AER's subsequent review of the submitted plan

22 ElectraNet, Rule change request, pp7-10.

23 ElectraNet, Rule change request, p10.

24 ElectraNet, Rule change request - Fact sheet, p2.

Table 3.1 ElectraNet's network action plan proposals

Initiatives	Benefit: cost ratio	Cost ($million)	Customers benefits
Transmission line uprating works	2:1 to 70:1	9.0	Line uprating works in the Riverland, Tailem Bend to South East and Mid-North transmission corridors that will improve power flows, enable lower generation costs and reduce supply risks.
Minor plant limit fixes	3:1 to 130:1	1.6	Fixing limits on minor 275kV assets in the Mid-North region and 132kV assets in the Mid-North and Riverland will release transfer capacity, improving power flows and enabling lower generation costs.
Investigation and monitoring projects	Positive	0.9	More accurate representation of major loads in planning studies potentially unlocks greater network capacity. Also increased monitoring of transmission line tension and transformers potentially enables rating increases, releasing network capacity.

4 Assessment framework

The Commission's assessment of this rule change request must consider whether the proposed rule promotes the NEO.

In particular, the rule change request will be assessed for its effect on the:

- efficient use of transmission network services; and
- efficient investment in transmission network services.

Accordingly, to give effect to the NEO, it is proposed that the following principles will be used to guide the assessment of this rule change request:

- **Appropriate regulatory processes**: Efficient levels of investment are more likely to occur where the regulatory process is certain, robust, transparent, and with appropriate checks and balances in place. Electricity consumers are also more likely to have confidence that the price and supply outcomes they experience will be more efficient in such an environment.
- **Effective incentives**: Incentive-based regulation provides incentives for network service providers to minimise costs, promoting efficient and timely investment, and ultimately greater network reliability and lower prices for consumers. Also risks should be allocated to those parties that are best placed to manage them through appropriate financial incentives.
- **Recovery of efficient costs and minimising total system costs**: Transmission businesses should be able to recover costs where they are efficient having regard to the need to incur costs, given the expected benefits, and minimising the actual costs to deliver a particular benefit. The expected benefits of network capability component projects are expected to include more efficient, lower cost generation.
- **Proportionality**: The implementation and administrative costs of the solution needs to be proportionate to the benefits of the solution, and where the current rules appropriately address the problem identified in the rule change request, a rule change would be unnecessary.

The proposed rule will be assessed against the relevant counterfactual arrangements which, in this case, are the existing provisions in the NER.

5 Issues for consultation

Taking into consideration the proposed assessment framework and potential requirements to implement the proposed rule change, a number of issues appear relevant to the consideration of this rule change request.

These issues are outlined below and are provided for guidance only. Stakeholders are encouraged to comment on these issues, as well as any other relevant aspect of the rule change request or this paper.

5.1 Altering revenue determinations within regulatory control periods

ElectraNet noted in its rule change request that, in 2010, the AEMC made a rule allowing the early application of STPIS components within a transmission business's regulatory control period. However, as outlined in section 2.3, there have been some enhancements to the approach to regulating network service providers since that rule was made.

In light of these enhancements, there is a question as to whether transmission businesses should be allowed to apply to have their STPIS amended for application part-way through a regulatory control period, or whether all components should potentially be amended at the same time.

For example, where a transmission business seeks approval from the AER for the early application of STPIS amendments:

- there may be less consumer consultation because under the NEL, the AER is required to consult with relevant persons as appropriate over a period of many months before making a revenue determination;
- the decision is not eligible for merits review because it is not part of the broader regulatory determination process; and
- the AER is unable to consider the amended component as a package in conjunction with other aspects of the revenue determination, because the AER may be unable to take into account any interactions between the components.

In the Recovery of network support payments rule change, the Commission stated that it was "cautious in making rule changes that would have the effect of revisiting specific decisions made by the AER in regulatory determinations during an existing regulatory control period". The Commission considered that "if a rule change was to be made and commence immediately as requested, it would detract from the certainty of having a revenue allowance determined for a given regulatory control period".[25]

25 AEMC, *Recovery of network support payments, Rule determination*, 31 October 2013, p24.

As such, there is a question as to whether consideration of the application of STPIS amendments in conjunction with the whole revenue determination is more likely to better promote the long term interests of consumers.

In the event that early application of STPIS amendments is determined to be appropriate, the next issue to consider is whether only one component of an amended STPIS, or all components, should be applied to a transmission business's revenue determination even if this requires reopening of its revenue determination.

With this in mind, stakeholders are encouraged to provide comments on the following questions.

Question 1 Appropriate regulatory processes

(a) What costs and benefits are likely to arise for electricity market stakeholders including customers, as a result of the earlier application of the network capability component to a transmission business's current regulatory control period? Issues to consider include:

(i) potential stakeholder impacts, including magnitudes, on end-use customers, network businesses, market agencies (such as AEMO and AER) and other relevant parties; and

(ii) potential impacts on regulatory certainty arising from any change(s) to a transmission business's current regulatory determination, including from when such change(s) should be applied.

Question 2 Early application of STPIS components

For STPIS components (that is, service component, market impact component and/or network capability component) that have been amended between STPIS versions:

(a) should any (including all) of the components be open to early application, noting that this may require reopening a transmission business's current revenue determination? Please give reasons why.

5.2 Interaction of TNSP incentive schemes

In its rule change request, ElectraNet submits that the regulatory incentives that currently apply operate to penalise transmission businesses for incurring the additional costs associated with network capability component type projects, and so, provide a disincentive to undertaking such projects.

Under the NER, there are currently two incentive schemes that apply to transmission businesses. These are the STPIS and the efficiency benefit sharing scheme (EBSS).[26]

The EBSS is linked to the AER's forecasting approach for operating expenditure. It is used by the AER to minimise two potential incentive problems with forecasting operational expenditure from a base year. When an EBSS is not in place:

- A network service provider has an incentive to increase operational expenditure in the expected base year, to increase its forecast expenditure allowance for the following regulatory control period.
- A network service provider's incentive to make changes to its business practices, and reduce its recurrent operational expenditure, declines as the regulatory control period progresses. It then increases again after the base year that is used to forecast expenditure for the following regulatory control period. By deferring these ongoing efficiency gains until after the base year, the network business can retain the benefits of doing so for longer because they won't be reflected in the operational expenditure forecasts for the following regulatory control period.

Therefore, to address these incentive problems, the EBSS is applied in combination with a revealed cost "base-step-trend" forecasting approach.[27] This provides transmission businesses with the same reward for an underspend, and the same penalty for an overspend, in each year of the regulatory control period.

In practice, this means that if a transmission business spends more than its allocated operational expenditure, it incurs a penalty in the next regulatory control period. In contrast, if it spends less, the transmission business receives a reward. As such, were a transmission business to undertake network capability component type projects that are not included in its forecast operational expenditure, and as a result exceed its total forecast operational expenditure, the transmission business would incur an EBSS penalty.

Question 3 Interaction with the EBSS

(a) To what extent would transmission businesses be penalised under the EBSS for undertaking network capability component type projects during their current regulatory control period?

In accordance with version four of the STPIS, any projects approved by the AER to be undertaken as part of the network capability component of the STPIS, can only be projects that do not already form part of an approved forecast operating or capital

26 AER 2013, *Better regulation – efficiency benefit sharing scheme for electricity network service providers*, November 2013, p6.

27 Under the "base-step-trend" approach, the AER identifies an efficient cost base, which it can then adjust (step-change) if the circumstances have changed from when the previous expenditure was incurred. Potential step changes and trends may be driven by regulatory changes, input cost changes, output growth and productivity changes.

expenditure. That is, there are mechanisms in place to prevent the double counting of expenditure amounts for undertaking network capability component type projects.[28]

However, even without approved expenditure for the network capability component of the STPIS, transmission businesses may still be able to undertake network optimisation projects where there is an overall improvement in the reliability of the transmission system. In this case, the transmission business may be able to receive a STPIS reward under the service or market impact components irrespective of whether the network capability component is part of its revenue determination.

Question 4 Network optimisation projects between regulatory control periods

Could a transmission business still undertake investment in network capability component type projects (without the network capability component of the STPIS), and recoup the benefits through:

(a) through other components of the STPIS in its current regulatory control period?

(b) via the STPIS in its next regulatory control period?

5.3 Other relevant issues

In addition to the issues outlined above, stakeholder comments of the following questions are also welcomed.

Question 5 Other relevant issues

Are there any further issues that stakeholders consider are relevant to this rule change request? This may include:

(a) Do stakeholders have any comments on proposed assessment framework outlined in Chapter 4?

(b) Are there any other relevant matters of importance to stakeholders regarding this rule change request or this consultation paper?

28 AER, *Final – Electricity transmission network service providers STPIS*, December 2012.

6 Lodging a submission

The Commission has published a notice under s. 95 of the NEL for this rule change proposal inviting written submissions from interested stakeholders.

Submissions are to be lodged online or by mail **by no later than 28 August 2014** accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on rule change proposals.[29] The Commission publishes all submissions on its website, subject to a claim of confidentiality.

All enquiries on this project should be addressed to James Eastcott on (02) 8296 7800.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code "ERC0173". The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: "ERC0173".

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

29 This guideline is available on the Commission's website.

Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
EBSS	efficiency benefit sharing scheme
LMR	Limited Merits Review
NCIPAP	network capability incentive parameter action plan
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NGL	National Gas Law
NGR	National Gas Rules
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

A Overview of the STPIS

Table A.1 Overview of the evolution of the STPIS

Date of final decision	Version number	Components	Brief explanation of components
August 2007	1	Service component.	The aim of the service component is to target transmission network outages that have an adverse impact on wholesale spot market dispatch outcomes. The service component initially consisted of three parameters: • transmission circuit availability – measures the average number of times circuits were unavailable during the relevant time period as a result of unplanned outages; • loss of supply event frequency – measures the number of unplanned outages when there has been a loss of supply; and • average outage duration – measures the average length (in minutes) of unplanned outages where a loss of supply has occurred.
March 2008	2	Service component; and Market impact component.	The market impact component is designed to provide an incentive to transmission businesses to reduce the impact of planned and unplanned outages on wholesale market outcomes. Transmission businesses do so by reducing the length of planned outages and scheduling outages to occur during those times when there will be the least impact on the wholesale market. Transmission businesses are also incentivised to improve reliability on those elements of the network critical to the wholesale market to reduce the incidence of unplanned outages. The AER made no changes to the service component at this time.
March 2011	3	As above.	Version 3 of the STPIS incorporated relatively minor amendments to the parameters and definitions that would apply to Powerlink for its 2012-2017 regulatory control period.

Date of final decision	Version number	Components	Brief explanation of components
December 2012	4	Service component; Market impact component; and Network capability component.	The service component was amended to include a fourth parameter called the "proper operation of equipment" parameter. This parameter measures the number of incidents where a protection or control system has failed or where there has been incorrect operational isolation of equipment during maintenance. The network capability component was introduced to influence a transmission businesses operation and management of its network assets. The component incentivises transmission businesses to deliver benefits through increased network capability, availability or reliability through the development of one-off projects that can be delivered through low cost operational and capital expenditure.
July 2014 (AER draft decision)	4.1	As above.	The AER is proposing a limited amendment to the STPIS which wholly relates to Directlink for its next regulatory control period. This consultation is being undertaken because, as the result of a fire in August 2012, use of the last three years average performance will not reflect an appropriate 'business as usual' benchmark for setting its performance targets under the market impact component.

Source: Prepared by the AEMC from the AER's Service target performance incentive scheme final decision documents versions 1 – 4.1.

A.1 Basis of the STPIS

The AER's STPIS was first applied in 2007, and was based on service standard guidelines developed by the Australian Competition and Consumer Commission (ACCC) in 2003. The guidelines aimed to counter the incentives provided to transmission businesses under an ex-ante revenue cap to reduce operating costs below forecast levels at the expense of service quality. The guidelines attempted to address this incentive by linking a transmission business's regulated revenues to its performance against defined service level measures.

In 2006, the AEMC reviewed the framework for regulating electricity transmission networks. The new arrangements required the AER to release guidelines on its approach to regulation, including a new STPIS.

A.2 Requirements under the NER

Clause 6A.7.4(a) of the NER requires the AER to develop and publish an incentive scheme or schemes for transmission businesses, called the STPIS, that comply with a number of principles. These principles aim to create a scheme which provides incentives for each transmission business to:[30]

- provide greater reliability of the transmission system that is owned, controlled or operated by it at all times when transmission network users place greatest value on the reliability of the transmission system;
- improve and maintain the reliability of those elements of the transmission system that are most important to determining wholesale electricity spot prices; and
- result in a potential adjustment to the revenue that the transmission business may earn, from the provision of prescribed transmission services, in each regulatory year in respect of which the STPIS applies.

The AER must follow the transmission consultation procedures set out in clause 6A.20 of the NER when amending or replacing the scheme.

A.3 Purpose and objectives of the scheme

The STPIS outlines the approach to setting a service target performance incentive within the transmission determination framework. The objectives of the STPIS are to:

- contribute to the NEO;
- be consistent with the principles in the NER;

30 NER clauses 6A.7.4(b)(1) and 6A.7.4(b)(2).

- promote transparency in the information provided by a transmission business and AER decisions; and

- promote efficient transmission business capital and operating expenditure by balancing the incentive to reduce actual expenditure with the need to maintain and improve reliability for customers and minimise the market impact of transmission congestion.

The current version four of the STPIS is made up of three components. An overview of these components is outlined in the following sections.

A.4 Service component

The first version of the STPIS was made by the AER in August 2007. This contained a single component, called the service component. The service component measures the overall availability of a transmission business's network to transport energy and the reliability of the network.

The AER notes that the updated service component in version four of the STPIS is designed to incentivise transmission businesses to reduce the occurrence of unplanned outages and to return the network to service promptly after unplanned outages that lead to an interruption to supply. The service component has been tailored to act as a lead indicator of potential reliability issues and to encourage transmission businesses to maintain or improve performance.

The service component is made up of four parameters to measure a transmission business's performance:[31]

- The **average circuit outage rate** parameter measures the average number of times circuits were unavailable during the relevant time period as a result of unplanned outages. An increase in the frequency of unplanned outages may be a lead indicator of a future reliability issue. This parameter does not measure either the duration of the outage or whether the outage caused a loss of supply or market impact. Any impact of the unplanned outage on the wholesale market is measured by the market impact component.

- The **loss of supply event frequency** parameter measures the number of unplanned outages when there has been a loss of supply. The parameter measures the number of small events (where smaller loads are interrupted for short periods) and large events (where a customer with a large load is interrupted for even a short duration, or a customer with a moderate load is interrupted for a long duration). The parameter is designed to incentivise transmission businesses to reduce the duration of moderate and small customer interruptions through fast response times and to reduce the frequency of large customer interruptions through improved reliability.

31 AER 2012, *Final decision – Electricity transmission network service providers service target performance incentive scheme – Version four*, December 2012, pp8-9.

- The **average outage duration** parameter measures the average length (in minutes) of unplanned outages where a loss of supply has occurred. The parameter uses the time a transmission business takes to restore plant as a proxy for measuring the effectiveness of the transmission business's operational response to unplanned events. The parameter focuses on loss of supply events to incentivise transmission businesses to focus on those unplanned outages with the greatest impact on customers.

- The **proper operation of equipment** parameter measures the number of incidents where a protection or control system has failed or where there has been incorrect operational isolation of equipment during maintenance. These events can cause an unplanned outage of primary transmission equipment and act as a lead indicator of reliability. This is a relatively new parameter introduced on a reporting basis only.

A.5 Market impact component

The market impact component was introduced in version two of the STPIS. The AER developed the market impact component based on a review of the market impact of transmission congestion.[32]

The market impact component has been designed to provide an incentive to transmission businesses to reduce the impact of planned and unplanned outages on wholesale market outcomes. Transmission businesses do so by reducing the length of planned outages and scheduling outages to occur during those times when there will be the least impact on the wholesale market. Transmission businesses are also incentivised to improve reliability on those elements of the network critical to the wholesale market to reduce the incidence of unplanned outages.

A.6 Network capability component

The network capability component, was introduced in version four of the STPIS, and provides an incentive of up to 1.5 per cent of maximum allowed revenue subject to the completion of projects that improve the capability of the transmission network at those times most needed. The total annual average expenditure of the projects listed cannot exceed one per cent of the maximum allowed revenue proposed by the transmission business.

The network capability component is designed to influence a transmission business's operation and management of its network assets to develop one-off projects that can be delivered through low cost operational and capital expenditure.[33]

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32 AER 2012, *Final decision – Electricity transmission network service providers service target performance incentive scheme – Version three*, March 2011.

33 AER 2012, *Final decision – Electricity transmission network service providers service target performance incentive scheme – Version four*, December 2012.

Under the network capability component, a transmission business is required to submit, as part of its STPIS claim in its revenue proposal, a network capability incentive parameter action plan (or NCIPAP). The NCIPAP must outline the key network capability limitations on each transmission circuit or load injection point on the transmission business's network. The transmission business must also include a list of projects designed to improve, through operational and/or minor capital expenditure, some of the network capability limitations identified and the value of the priority project improvement target for the projects.

The transmission business will also rank the priority projects based on the likely impact of the projects on customers or wholesale market outcomes in descending order. AEMO also plays a role in this process by prioritising the transmission business's projects that will deliver the most efficient outcomes for consumers and ranking those priority projects.