

30 April 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
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By email: submissions@aemc.gov.au

Dear John,

Proposed Rule Change: Early Implementation of Market Impact Parameter

1. Overview of Proposal

The Australian Energy Regulator (AER) published its final decision on the second version of the transmission service target performance incentive scheme (the scheme) on 7 March 2008. The second version of the scheme now incorporates two elements:

- The scheme provides incentives for TNSPs to minimise the number and duration of loss of supply events, and to maximise circuit availability; and
- The market impact parameter provides an incentive for TNSPs to minimise the market impact of transmission outages.

The development of the market impact parameter followed a detailed review by the AER, which included the publication of an issues paper in June 2007 and subsequent consultation with stakeholders. Whilst the design and operation of the market impact parameter raised a number of complex and difficult matters, Grid Australia considers that it will contribute to the achievement of the National Electricity Objective¹.

¹ The National Electricity Objective (NEO) is stated in section 7 of the National Electricity Law (NEL) where the object of the NEL 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 –

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

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

As presently drafted, the National Electricity Rules (the Rules) have the effect, for most TNSPs, of delaying the introduction of the market impact parameter for a number of years until the beginning of the next regulatory control period. Grid Australia considers that the National Electricity Objective would be enhanced by addressing this delay as a transitional issue and allowing earlier introduction of the market impact parameter.

The proposed Rule change would promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers in accordance with the National Electricity Objective. In particular, the earlier introduction of the market impact parameter - as envisaged in this Rule change proposal - will:

- provide improved incentives to ensure that the transmission system is available at times most valued by the market; and
- encourage improvements in the quality and reliability of the transmission network experienced by network users.

As the market impact parameter has already been designed by the AER in accordance with the Rules requirements, there are no significant design or consultation costs arising from the Rule change. It is noted, however, that each TNSP affected by this Rule change will incur implementation costs in collating the necessary data to assess an appropriate company-specific performance target.

Grid Australia notes that some TNSPs may find the implementation costs prohibitive, when compared to the potential benefits from an earlier introduction of the scheme. For this reason, the proposed Rule change provides an option for each TNSP to introduce the scheme earlier than timetabled, but the Rule change proposal does not mandate an earlier introduction. This approach ensures that the earlier introduction of the scheme only arises in cases where the TNSP is confident that net benefits will be achieved.

Grid Australia considers that the Rule change proposal should be broadly supported by market participants because:

- it seeks to bring forward an incentive scheme that is designed to deliver net benefits to market participants;
- the incentive scheme has been subject to extensive consultation by the AER, and it is already provided for in the Rules;
- the earlier introduction of the scheme would not impose any additional net costs on market participants; and
- market participants have previously expressed strong support for the timely implementation of the scheme².

The subject of this Rule change proposal falls within the matters on which the AEMC is permitted to make changes to the Rules.

² Refer submission from the National Generators Forum to the AER dated 11 January 2008 to consultation on the Service Target Performance Incentive Scheme.

2. Explanation of the matter to be addressed by the Rule change

The Rules currently provide for the market impact parameter to be introduced for each TNSP as part of the AER's next Revenue Determination for each particular TNSP. The current timetable for introducing the market impact parameter is therefore as follows:

- 1 July 2009 for TransGrid;
- 1 July 2012 for Powerlink;
- 1 July 2013 for ElectraNet;
- 1 April 2014 for SP AusNet; and
- 1 July 2014 for Transend.

Sections 2.1 to 2.5 below provide a brief overview of the key provisions relating to the service target performance incentive scheme in the Rules and the current scheme published by the AER. In doing so, these sections highlight those elements of the Rules that together mandate the above timetable and preclude an earlier introduction of the market impact parameter. Section 2.6 concludes with a summary of the matters that the Rule change proposal aims to address.

2.1 Requirement to propose values for the scheme in a revenue proposal

Schedule S6A.1.3 of the Rules states that a Revenue Proposal must contain:

- the values that the TNSP proposes to be attributed to the performance incentive scheme parameters for the purposes of the application of the scheme in respect of the relevant regulatory control period; and
- an explanation of how the values proposed to be attributed to those parameters comply with any requirements relating to them set out in that scheme.

Clause 6A.4.2(a)(5) of the Rules states that a revenue determination for a TNSP is to specify, for a regulatory control period, the values that are to be attributed to the performance incentive scheme parameters for the purposes of the application to the provider of any service target performance incentive scheme that applies in respect of the regulatory control period.

2.2 Rules governing the design of the scheme

Clause 6A.7.4 of the Rules sets out the principles governing the design and application of the service target performance incentive scheme. Paragraph (b) of this clause describes the principles that should be incorporated in the design of the scheme. Paragraph (e) of the same clause requires that the AER must develop and publish the first service target performance incentive scheme under the Rules by 28 September 2007 and there must be a service target performance incentive scheme in force at all times after that date. As noted earlier, the current service target performance incentive scheme was published by the AER in March 2008.

Clause 6A.7.4(f) of the Rules imposes constraints on the AER regarding the amendment or replacement of an existing scheme as follows:

“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 Network Service Provider* 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.”

2.3 Existing scheme restricts addition, removal or variation of parameters

The AER’s current scheme includes clause 2.3 which deals with the addition, removal or variation of parameters. This clause includes the following provisions:

- (b) While this *scheme* can be amended at any time, an amendment cannot apply to a TNSP for a *regulatory control period* unless it is promulgated no less than 15 months before the commencement of that *regulatory control period* (the ‘cut off date’).
- (c) Amendments to this *scheme* can be initiated by the AER or proposed by a TNSP. However, a TNSP that wants the AER to amend this scheme for the TNSP’s next *regulatory control period* will need to submit proposed amendments to the AER in the timeframes and in the manner set out below. This will apply where, for example, a TNSP wishes to propose amendments to:
 - (1) add, remove or vary a *parameter*
 - (2) vary the definition of a *parameter*, or
 - (3) vary the maximum revenue increment or decrement that the TNSP may receive under the *service component* or the *market impact component*.
- (d) In order to ensure that the *transmission consultation procedures* can be completed before the cut off date, a TNSP must submit any proposed amendments to the AER at least 22 months before the commencement of the next *regulatory control period* (i.e. nine months before its *revenue proposal* is due to be lodged with the AER).
- (e) A proposal by a TNSP to amend this *scheme* to add or vary a *parameter* or vary the definition of an existing *parameter* must:
 - (1) demonstrate how the proposed amendment is consistent with the objectives in clause 1.4 of this *scheme*
 - (2) provide information and quantitative data on its performance history of at least the most recent three to five years as measured by its proposed *parameter*, and
 - (3) where this performance history information is not available, provide an appropriate benchmark or methodology to set values for the proposed *parameter*.
- (f) A proposal by a TNSP to amend this *scheme* to:
 - (1) remove a *parameter*, or
 - (2) vary the maximum revenue increment or decrement that a TNSP may receive under the *service component* or the *market impact component*must demonstrate how the proposed amendment is consistent with the objectives in clause 1.4 of this *scheme*.

Clause 2.5 of the current scheme sets out adjustments to maximum allowed revenue. Clause 2.5(c) states:

“This *scheme* does not operate retrospectively. An adjustment to a TNSP’s *maximum allowed revenue* can only be made as a result of its performance in a period where *parameters* and values have been established under the *scheme* for the TNSP in advance of the relevant period.”

2.4 Rules governing revocation or reopening of a revenue cap

Clause 6A.7.1 provides for the reopening of revenue determination for capital expenditure. Apart from the circumstances set out in clause 6A.7.1, clause 6A.15 limits the scope for the revocation of a revenue determination to circumstances where it was based on false or misleading information or where it includes a material error.

2.5 Chapter 11 – Savings and transitional provisions

Part E of chapter 11 includes various savings and transitional provisions relating to the economic regulation of transmission services. In effect, these provisions are intended to preserve previous regulatory determinations made by the ACCC and to effect a smooth transition to the new Rules in Chapter 6A. Notwithstanding the provisions outlined in sections 2.1 to 2.4 above, Part E of Chapter 11 provides a potentially useful vehicle for effecting the introduction of the market impact parameter *during* the current regulatory control period. As presently drafted, however, Part E of Chapter 11 does not include any transitional provisions that would allow an early introduction of the market impact parameters.

2.6 Summary of matters to be addressed

In light of the provisions described above, the Rule change proposal is intended to allow, as a transitional measure, the earlier introduction of the market impact parameter for a particular TNSP at the discretion of that TNSP.

The proposed introduction of the market impact parameter part-way through a regulatory period should be treated as a special case “transitional issue”. This is appropriate because, as a general principle, regulatory stability is enhanced by strictly limiting the circumstances in which a Revenue Determination may be revisited. Notwithstanding this important principle, Grid Australia considers that the earlier introduction of the market impact parameter through the provisions contained in this Rule change proposal would deliver net benefits, and can be achieved without affecting any other aspects of the Revenue Determination.

As already noted, Grid Australia considers that the Rule change should provide the relevant TNSPs with an option to introduce the market impact parameter earlier than present timeframes in the Rules. Furthermore, Grid Australia considers that it is essential that the key features of the market impact parameter as set out in the AER’s service target performance incentive scheme published on 7 March 2008 should not be subject to change. This aspect of the Rule change proposal is important because the current features of the market impact parameter have been determined by the AER following stakeholder consultation, and therefore it would be inappropriate to amend or adjust any features of the scheme through this Rule change (with the exception of the timing of its introduction).

3. Potential impact of the change on those likely to be affected

The purpose of the market impact parameter is to provide an incentive for TNSPs to minimise the market impact of transmission outages. If the incentive scheme proves to be effective, market participants will benefit through better access to the wholesale generation market and lower dispatch costs. In addition, to the extent that TNSPs are able to take measures to reduce the market impact of transmission outages, the incentive scheme will provide TNSPs with an additional revenue allowance. In summary, therefore the impacts on market participants and TNSPs is potentially positive, and no adverse consequences or impacts arise.

The Rule change proposal provides a role for the AER to consider a TNSP's proposed targets that are essential to make the market impact parameter operational. The AER therefore would be required to examine the proposal submitted by the TNSP. Grid Australia has met with the AER to discuss whether it has any in-principle objections to the proposed Rule change. Grid Australia understands that the AER supports the concept of introducing the market impact parameter earlier than the current timetable.

4. Draft of the Rule change proposal

Grid Australia's draft Rule change is attached to this letter in accordance with the AEMC's *Guidelines for proponents: Preparing a Rule change proposal*, dated January 2008.

5. Explanation of how the proposed Rule addresses the issues raised

The proposed Rule change addresses the matters noted above by allowing the market impact parameter to be introduced (at the discretion of the TNSP but subject to the AER's approval) during the regulatory control period that currently applies. These arrangements provide TNSPs with an opportunity to seek the earlier introduction of the market impact parameter where it is expected that this will lead to the delivery of net benefits.

The proposed Rule change refers to the market impact parameter of the service target performance incentive scheme published by the AER on 7th March 2008. By referring to this specific scheme, TNSPs and stakeholders can fully understand the effect of the amendment.

The proposed Rule change also recognises the role of the AER in assessing whether a TNSP's proposed performance target complies with the scheme. A TNSP's proposed performance target must be submitted to the AER at least three months prior to the commencement of the first regulatory year in which the market impact parameter is proposed to operate. A TNSP's proposal must relate to the remaining years of the regulatory control period. The Rule change proposal also states that the scheme cannot apply retrospectively.

6. Expected benefits and costs of the proposed change

As explained in this submission, the early introduction of the market impact parameter would facilitate potential efficiency improvements by providing TNSPs with incentives to increase the value of transmission services to market participants.

As noted above, some TNSPs may incur additional data collection costs in order to introduce the market impact parameter ahead of the current timetable. Therefore, it is possible that some

TNSPs would prefer not to introduce the scheme earlier than timetabled if the costs of doing so are likely to outweigh the potential benefits.

For the reasons set out in this proposal, Grid Australia strongly commends the proposed Rule change to the AEMC and to stakeholders.

Grid Australia will also continue to work with the AER to review the effectiveness of the scheme for application to subsequent regulatory periods to ensure it achieves its intended objectives.

We look forward to further opportunities to engage with the AEMC and stakeholders in the finalisation of this Rule change proposal. As noted above, Grid Australia's draft proposed Rule change is attached to this letter. If you require any further information, please do not hesitate to contact or me on 08 8404 7983 or Simon Appleby on 08 8404 7324.

Yours sincerely,



Rainer Korte
Chairman
Grid Australia Regulatory Managers Group

RULE CHANGE PROPOSAL

Grid Australia's draft Rule change proposal is set out below:

Insert a new clause 11.6.9A as follows:

11.6.9A Introduction of the market impact component of the service target performance incentive scheme during the first regulatory control period

- (i) In accordance with paragraphs (ii) to (vii), the *revenue determination* applying to a *Transmission Network Service Provider* will be amended during the first *regulatory control period*, or during the *transitional regulatory control period* in the case of Powerlink, to give effect to the *market impact component* of the *service target performance incentive scheme* published by the AER on 7th March 2008 (the *scheme*).
- (ii) A *Transmission Network Service Provider* may propose to the AER a *performance target* (as that term is defined in the *scheme*) and a *cap* (as that term is defined in the *scheme*) in relation to the *market impact component* on the *scheme* at least three months prior to the commencement of a regulatory year. The proposal must address all the matters set out in clause 4.2 of the *scheme* and it must relate to all the remaining years of the first *regulatory control period*.
- (iii) Within 30 business days of receiving the proposal referred to in paragraph (ii), the AER must either accept the proposed *performance target* and *cap* values if they comply with the requirements of clauses 4.2(b) to 4.2(f) of the *scheme* or the AER must otherwise reject the proposed values. If the AER rejects a proposed value, it must determine an amended *performance target* or *cap* value, as the case maybe, that it reasonably considers would comply with the requirements of clauses 4.2(b) to 4.2(f) of the *scheme*.
- (iv) Within 30 business days of receiving the proposal referred to in paragraph (ii) the AER must notify the proponent in writing of a determination pursuant to paragraph (iii) and must provide reasons for any determination which rejects any proposed *performance target* or *cap* values.
- (v) If the AER fails to comply with (iv) the AER is deemed to have accepted the proposed *performance target* and *cap* values.
- (vi) The *Transmission Network Service Provider* may (but is not obliged to) accept the AER's amended value prior to the commencement of the first regulatory year in which the *market impact component* is proposed to apply.
- (vii) Any amendment of the *revenue determination* that is required as a result of the operation of the *market impact component* must be in accordance with clause 4.3 of the *scheme* and cannot include any other amendments. The application of the *scheme* cannot be retrospective.