



Australian Energy Market Commission

RULE DETERMINATION

National Electricity Amendment (Early application of service target performance incentive scheme (STPIS) components to transmission businesses) Rule 2015

Rule Proponent

ElectraNet

19 February 2015

**RULE
CHANGE**

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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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Summary

The Australian Energy Market Commission has determined to make a final rule that would allow an electricity transmission business to apply to the Australian Energy Regulator to seek early application of the network capability component of the service target performance incentive scheme (STPIS) within its current regulatory control period.¹

The network capability component of the STPIS provides an incentive of up to 1.5 per cent of a transmission business's maximum allowed revenue, subject to the completion of projects that improve the capability of the transmission network at those times of greatest benefit.

The Commission considers that, in some cases, early access to the network capability component may have the potential to bring forward benefits to electricity consumers that otherwise would not be realised until a transmission business's next revenue determination. Expected benefits of the final rule may include improvements to the volume of generated electricity that can be dispatched across the transmission network without constraint due to capacity limitations. Such an outcome has the potential to lead to more efficient pricing in the wholesale electricity market. This may, in turn, provide more efficient pricing for electricity consumers.

While the final rule may bring forward some administrative costs for a transmission business relating to consultation on its network action plan, the Commission considers that these potential costs would be unlikely to outweigh the potential benefits that may arise from bringing forward potentially more efficient pricing in the wholesale electricity market to electricity consumers.

The final rule is consistent with the draft rule and ElectraNet's proposed rule with minor amendments, reflecting stakeholders' submissions and the Commission's analysis, to provide greater certainty to transmission businesses and the Australian Energy Regulator, as well as clarity regarding its application.

Compared to the draft rule, the following clarifications have been incorporated in the final rule:

- clarifies that the relevant version of the STPIS is version 4.1, as version 4 (which was used in the draft rule) was superseded in September 2014;
- provides the Australian Energy Regulator with a period of 10 business days to assess a transmission business's proposal for its compliance with the National Electricity Rules;

¹ The network capability component applies to each transmission business that is subject to the STPIS, which excludes Directlink and Murraylink. See section 2.2(a) of version 4.1 of the STPIS for further information on its eligibility to transmission businesses.

- provides the Australian Energy Regulator with the ability to request a transmission business to resubmit its proposal, if required, with any additional required information within 10 business days of receiving notice;
- requires a transmission business's network capability incentive parameter action plan (the network action plan) to contain all of the relevant information from the network capability component section of the STPIS; and
- clarifies the provisions relating to the relevant actions of a transmission business performed prior to the commencement of the final rule; in particular, recognition of the consultation undertaken by a transmission business with Australian Energy Market Operator in developing its network action plan.

The commencement date of the final rule is 19 February 2015.

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1 ElectraNet's rule change request

1.1 The rule change request

ElectraNet's rule change request proposed to enable early application of the network capability component of the service target performance incentive scheme (STPIS) to an electricity transmission business within its current regulatory control period.²

Specifically, the rule change request proposed the addition of a savings and transitional rule under Chapter 11 of the National Electricity Rules (NER) to permit a transmission business to:³

- apply to the Australian Energy Regulator (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 consumers.

A copy of ElectraNet's rule change request, including the proposed rule, is available from the Australian Energy Market Commission's (AEMC, or Commission) website (www.aemc.gov.au).

1.2 Rationale for rule change request

ElectraNet considered 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.

In its rule change request, ElectraNet stated that such projects may include, transmission line uprating works and improving capacity limits on the 275 kV and/or 132 kV transmission network in the Mid-North and Riverland regions of South Australia.⁴ ElectraNet considered that the delivery of these projects would, in turn, increase transfer capacity, improve power flows and, as a consequence, enable more efficient generation dispatch.

ElectraNet contended that, in the absence of an 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. This was because ElectraNet

² The network capability component applies to each transmission business that is subject to the STPIS, which excludes Directlink and Murraylink. See section 2.2(a) of version 4.1 of the STPIS for further information on its eligibility to transmission businesses.

³ ElectraNet, Rule change request, p1.

⁴ ElectraNet, Rule change request - Fact sheet, p2.

considered such projects to be essentially "unfunded" projects during the current regulatory control period. Further, ElectraNet considered that the regulatory incentives that currently apply to it operate to penalise it for incurring the additional costs associated with the projects identified, and so, provide a disincentive to undertaking such projects.⁵ As a result, not undertaking such projects would be to the detriment of customers on its network.

1.3 Relevant background

1.3.1 Overview of the Service Target Performance Incentive Scheme

The STPIS is an incentive scheme developed by the AER for application to electricity transmission businesses.⁶ The objective of the scheme is to assist the AER in the setting of efficient capital and operating expenditure allowances in a transmission business's revenue determination. This is achieved by balancing the incentive to reduce actual expenditure, with the need to maintain and improve reliability for customers and reduce the market impact of transmission congestion.⁷

The first STPIS (version 1) comprised a single incentive component – 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 only to the proposed early application of the network capability component.

A new version 4.1 of the STPIS was published in September 2014. Compared to version 4, version 4.1 only amended the application of the market impact component of the STPIS to Directlink. Obligations relating to the network capability component were not changed.

The network capability component provides an incentive of up to 1.5 per cent of a transmission business's maximum allowed revenue, subject to the completion of projects that improve the capability of the transmission network at those times of greatest benefit. It 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.⁸

⁵ ElectraNet, Rule change request, pp8-9.

⁶ The STPIS applies to both electricity transmission and distribution businesses. The obligations relating to the STPIS that applies to transmission businesses are set out in clause 6A.7.4 of the National Electricity Rules (NER).

⁷ AER, *Final decision – electricity transmission network service providers – service target performance incentive scheme – Version 4*, December 2012, pp3-4.

⁸ AER, *Final decision – Electricity transmission network service providers service target performance incentive scheme –Version 4*, 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 action plan. This plan must include a list of projects designed to improve some of the network capability limitations identified and the value of the priority project improvement target for the projects.

Further background information on the development of the STPIS can be found in Appendix B of the draft rule determination.⁹

1.3.2 Context for the rule change request

This section provides some context about ElectraNet's decision to submit this rule change request. Section 2.2 of the AEMC consultation paper¹⁰ provides further detail on the revenue determination process and the consultation that was undertaken by the AER prior to this rule change request being submitted.

ElectraNet's revenue determination process

As part of its revenue proposal for the 2013-14 to 2017-18 regulatory control period, ElectraNet included a number of low cost operational 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 operating expenditure called 'network optimisation opex'.¹¹

The AER did not agree to the inclusion of such proposed expenditure in ElectraNet's revenue determination. The AER noted that it was in the process of making changes in the STPIS that would incentivise this type of expenditure through a new network capability component. This was subsequently introduced in version 4 of the STPIS in December 2012 after the AER's draft decision on ElectraNet's revenue proposal.¹²

ElectraNet's request for early application of the network capability component

ElectraNet wrote to the AER in May 2013 seeking early application of the network capability component of version 4 of the STPIS to apply within its current regulatory control period (2013-14 to 2017-18).

Following a period of consultation, the AER concluded that it did not have the power to apply an amended STPIS to a transmission business in its current regulatory control

⁹ AEMC 2014, *Early application of STPIS components to transmission businesses*, Draft rule determination, 6 November 2014, Sydney, pp18-23.

¹⁰ AEMC, *Early application of the Service Target Performance Incentive Scheme (STPIS) to transmission businesses*, Consultation paper, July 2014, pp2-4.

¹¹ ElectraNet, *ElectraNet transmission network revenue proposal*, Chapter 6 – Forecasting operating expenditure, May 2012, pp98-99.

¹² The AER published its draft decision for ElectraNet's 2013-14 to 2017-18 revenue determination on 30 November 2012, and final decision on 30 April 2013.

period. In its final decision, the AER stated that it supported the early application of the network capability and/or market impact components of version 4 of the STPIS. 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.¹³

1.3.3 Other relevant rule changes and recommendations

A number of previous AEMC rule changes, and other legislative amendments within the energy sector more generally, may be of relevance to this rule change request. Those that have been reviewed as part of the Commission's consideration of this rule change request include:

- early implementation of the market impact parameters rule change (2010);¹⁴
- economic regulation of network service providers rule change (2012);¹⁵ and
- amendment of the limited merits review regime (2013).¹⁶

1.4 The Commission's rule making process to date

On 31 July 2014, the Commission published ElectraNet's rule change request and an AEMC consultation paper identifying specific issues and questions for public consultation. Submissions on this first round of consultation closed on 28 August 2014. Three submissions were received, which are available on the AEMC website.

On 6 November 2014, the Commission published a draft rule determination, including a draft rule, in relation to the rule change request. Submissions on this second round of consultation closed on 8 January 2015. Two submissions were received, which are also available on the AEMC website (www.aemc.gov.au).

Where relevant to the discussion, the Commission has summarised the issues raised in submissions as part of its analysis presented in the following chapters.

¹³ AER 2013, *Final decision – Early application of version 4 of the STPIS*, December 2013, pp4-5.

¹⁴ www.aemc.gov.au/Rule-Changes/Early-Implementation-of-Market-Impact-Parameters.

¹⁵ www.aemc.gov.au/Rule-Changes/Economic-Regulation-of-Network-Service-Providers.

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

2 Final rule determination

2.1 Commission's final rule determination

The Commission has determined to make a final rule. The final rule inserts a 'one-off' framework of savings and transitional provisions into Chapter 11 of the NER.

The final rule is attached to, and published with, this final rule determination. The key features of the final rule are described in Chapter 3, as are the Commission's reasons for making this final rule determination. Appendix A sets out further detail regarding the legal requirements for the making of this final rule determination.

The final rule will permit a transmission business, which will be subject to the network capability component of the STPIS at its next regulatory control period, to:

- submit a proposal to the AER for it to determine whether the network capability component could be applied within the transmission business's current regulatory control period; and
- submit a network action plan to the AER for approval, following review of the network action plan by AEMO and consultation with customers.

The final rule is consistent with the draft rule with minor amendments, reflecting stakeholders' submissions and the Commission's analysis, to provide greater certainty to transmission businesses and the AER, as well as clarity regarding its application. The amendments from ElectraNet's proposed rule now include:

- adding definitions for: 'current regulatory control period'; 'network capability component of the relevant STPIS'; 'relevant STPIS'; the 'proposal' (being that provided by a transmission business to the AER); and the 'start date' (for the early application of the network capability component of the STPIS);
- defining 'relevant STPIS' as version 4.1 of the STPIS dated September 2014, to limit application of the final rule to the network capability component of that version of the STPIS;
- clarifying that a network action plan that is submitted by a transmission business as part of its proposal must set out the matters referred to in clauses 5.2(b)-(j) and (q) of the relevant STPIS, to provide greater consistency between the requirements of the STPIS and the final rule;
- adding a provision that provides the AER with 10 business days to assess a proposal submitted by a transmission business for compliance with the NER;
- adding a provision that, in the case of a non-compliant proposal, requires a transmission business to resubmit its proposal with the additional information sought by the AER within 10 business days of receiving notice;

- clarifying that any person may make a written submission on a proposal published by the AER from a transmission business, so as to emphasise that customer engagement on the prioritised projects is an integral part of the decision making process;
- refining the application provisions of the proposed rule;
- clarifying the provisions relating to 'actions performed prior to the commencement date' of the final rule, to recognise the relevant actions of a transmission business performed prior to the commencement of the final rule as being compliant with the final rule; and
- clarifying procedural aspects of the draft rule (for example, the AER is to publish any final decision on a transmission business's proposal for early application of the network capability component).

2.2 Rule making test

The Commission may only make a change to the NER if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national electricity objective (NEO).¹⁷

The NEO states:¹⁸

“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:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

The objective captures the three dimensions of efficiency: productive (efficient operation), allocative (efficient use of) and dynamic (efficient investment) efficiency.¹⁹

For this rule change request, the Commission considers the relevant aspects of the NEO are:

- efficient use of transmission network services; and

¹⁷ See s. 88 of the NEL.

¹⁸ See s. 7 of the NEL.

¹⁹ Productive efficiency means goods and services should be provided at lowest possible cost to consumers; allocative efficiency means that the price of goods and services should reflect the cost of providing them, and that only those products and services that consumers desire should be provided; dynamic efficiency means arrangements should promote investment and innovation in the production of goods and services so that allocative and productive efficiency can be sustained over time, taking into account changes in technologies and the needs and preferences of consumers.

- efficient investment in transmission networks.

The Commission is satisfied that the final rule will, or is likely to, contribute to the achievement of the NEO.

The final rule will allow an electricity transmission business to apply to the AER to seek early application of the network capability component of the STPIS within its current regulatory control period. In the absence of the final rule, the network capability component would not apply until the commencement of the transmission business's next regulatory control period.

Early access to the network capability component of the STPIS may support efficient investment in transmission networks by providing transmission businesses with an incentive to undertake network optimisation projects that reduce network congestion and improve the overall efficiency of the transmission network. This has the potential to result in improvements to the volume of generated electricity that can be dispatched across the transmission network, without constraint due to capacity limitations. Such an outcome has the potential to lead to more efficient pricing in the wholesale electricity market.

The final rule has the potential to promote efficient investment in transmission networks and the efficient operation of transmission network services, and therefore promote the long term interests of consumers in respect of the efficient pricing of electricity services.

The final rule may bring forward some administrative costs for a transmission business in preparing its network action plan in consultation with AEMO and customers, rather than these costs being incurred as part of its revenue determination process for the next regulatory control period. The Commission considers that these potential costs would be unlikely to outweigh the potential benefits that may arise from bringing forward potentially more efficient pricing in the wholesale electricity market to electricity consumers.

2.3 Assessment approach

To support its assessment of whether ElectraNet's rule change request and any final rule is likely to promote the efficient investment in, and efficient operation and use of, transmission services, the Commission considered the following issues:

- **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 to minimise total system costs:** Incentive-based regulation provides incentives for network service providers to facilitate the delivery of efficient total system (generation and network) costs, promoting efficient and

timely investment, and ultimately greater network reliability and more efficient pricing for consumers. Also, risks should be allocated to those parties that are best placed to manage them through appropriate financial incentives.

- **Proportionality:** The implementation and administrative costs of the solution needs to be proportionate to the benefits of the solution. Where the current rules appropriately address the problem identified in the rule change request, a rule change would be unnecessary.

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

2.4 Strategic priority

This final rule determination relates to the AEMC's strategic priority of market arrangements that encourage efficient investment and flexibility. The final rule has the potential to bring forward benefits to consumers that otherwise would not be realised until a transmission business's next regulatory control period. These benefits may include improvements to the volume of generated electricity that can be dispatched across the transmission network without constraint due to capacity limitations. Such an outcome has the potential to lead to more efficient pricing in the wholesale electricity market. This, in turn, has the potential to provide more efficient pricing for electricity consumers.

3 Commission's assessment

This chapter sets out the Commission's response to the issues raised by ElectraNet, and stakeholders during consultation. It also describes the final rule.

3.1 Early application of the network capability component

3.1.1 Commission's conclusion

The final rule is consistent with the draft rule with minor clarifications, reflecting stakeholders' submissions and the Commission's analysis, to provide greater certainty to transmission businesses and the AER, as well as clarity regarding its application.

3.1.2 ElectraNet's perspective

ElectraNet proposed a transitional rule to allow transmission businesses 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.

3.1.3 Stakeholder views

In response to the AEMC consultation paper, AusNet Services, Powerlink and the AER considered that early application of the network capability component of the STPIS would be beneficial to electricity consumers. Some of these stakeholders provided empirical evidence of the expected customer benefits arising from the network capability component being implemented.

For example, in the case of AusNet Services, as required by the scheme, AEMO quantified the expected market benefits of delivering the projects in the network action plan. The net present value of these benefits over AusNet Service's five-year regulatory control period was approximately \$80 million, which was more than five times the total cost of delivering these projects.²⁰

Similarly, ElectraNet estimated that the expected market benefits of implementing the network capability component would be several multiples of the total cost of implementing the projects.²¹ Since submitting its rule change request, ElectraNet's draft network action plan (published on 23 December 2014), provided a more reflective

²⁰ AusNet Services, Consultation paper submission, p1.

²¹ ElectraNet stated that the expected market benefits to consumers would accrue from improvements in power flows from line uprating works enabling lower generation costs and reducing supply risks. The removal of network capacity constraints on transmission assets would also release transfer capability, improving power flows and enabling lower generation costs. For further information see: ElectraNet, *Network capability proposal fact sheet*, p2.

estimate of the cost of the scheme.²² The draft plan consisted of five priority projects relating to line-uprating and the removal of network capacity limitations within ElectraNet's transmission network. ElectraNet estimated the cost of the priority projects would be approximately \$10.8 million over the remaining three years of their current regulatory control period.²³

Powerlink noted that the projects included under the network capability component of the STPIS are intended to deliver benefits that go beyond minimum transmission reliability standards. As such, transmission businesses should be provided with sufficient incentives to fund these network improvements.²⁴

AusNet Services also stated that preventing the early application of the network capability component would prevent consumers from realising potentially substantial benefits from relatively low cost projects until commencement of the next regulatory control period.²⁵

The AER also outlined that benefits would accrue to consumers, generators and the overall operating efficiency of the market. Generators are expected to benefit from increased network capability as they are less likely to be constrained by network limits, leading to more efficient dispatch. Consumers would benefit from improved competition, potentially lower wholesale costs and efficiency improvements in network capability.²⁶ While the AER conceded that customers would pay slightly more for transmission services as a result of early application, the benefits to the wholesale market would outweigh these additional costs and result in overall lower costs being borne by consumers.²⁷

3.1.4 Commission's analysis

The Commission notes stakeholders' views on the expected financial costs and benefits of bringing forward the application of the network capability component to a transmission business's current regulatory control period.

With reference to ElectraNet's draft network action plan, the net present market benefits are significantly higher than the cost to implement these projects. This suggests that bringing forward the application of the network capability component is likely to incentivise a transmission business to undertake such investments earlier than would otherwise be the case.

The Commission considers that the final rule is likely to provide sufficient opportunity for electricity consumers to be consulted by a transmission business seeking early

²² ElectraNet, *Draft network capability incentive parameter action plan*, December 2014, p10.

²³ For further details on ElectraNet's estimated benefit to cost ratio and the benefit payback period, see: ElectraNet, *Network capability proposal fact sheet*, p2.

²⁴ Powerlink, *Consultation paper submission*, p1.

²⁵ AusNet Services, *Consultation paper submission*, p1.

²⁶ AER, *Consultation paper submission*, p6.

²⁷ *ibid.*

application of the network capability component. For example, in its proposal to the AER, a transmission business would be required to provide a description of how it had engaged with electricity consumers in preparing its network action plan.²⁸

Furthermore, following submission of the proposal, the AER would be required to publish the proposal and seek written submissions on any aspect of it. A period of 20 business days has been provided in the final rule for this stakeholder consultation to occur.

While the Commission does not consider that this type of consultation would be as robust as that of the full revenue determination process, it does consider that the consultation process provided under the final rule is reasonable for the purposes of involving electricity consumers in the decision making process regarding the priority projects included in the network action plan.²⁹

In summary, the Commission considers that bringing forward the application of the network capability component will, or is likely to, contribute to the achievement of the NEO. On balance, the anticipated benefits to the market of applying the network capability component are expected to outweigh the potential costs of its earlier introduction. Furthermore, the consultation process included in the final rule provides electricity consumers with the opportunity to engage in the decision making process. This is expected to provide an appropriate degree of transparency and certainty to the implementation of the network capability component.

3.2 Clarifying the operation of the final rule

3.2.1 Commission's conclusion

The final rule is consistent with the draft rule with minor clarifications, reflecting stakeholders' submissions and the Commission's analysis, to provide greater certainty to transmission businesses and the AER, as well as clarity regarding its application.

3.2.2 Stakeholder views

In response to the draft rule determination, the Commission received two submissions from the AER and ElectraNet. These submissions raised a number of issues about the application of the draft rule. Each of these issues is outlined in the following section.

²⁸ ElectraNet published its draft network action plan in December 2014 and the period of consultation closed on 31 January 2015. It is available at: www.electranet.com.au/media-centre/media-archive/latest-releases/show/network-capability-proposals-consultation/.

²⁹ AEMC 2014, *Early application of STPIS components to transmission businesses*, Draft rule determination, 6 November 2014, Sydney, p10.

(i) Clarification of the process for lodging a proposal with the AER

Application of the final rule to one or more transmission businesses

The AER stated that the draft rule applies to "a transmission business that will be the subject of the network capability component at its next regulatory control period for the current regulatory control period". The AER considered that, as ElectraNet and Powerlink are currently the only eligible transmission businesses that are not subject to the network capability component, and given that Powerlink is too far through its current regulatory control period for the scheme to have any meaningful impact, the rule should be limited to only apply to ElectraNet.³⁰

If the rule were to apply more broadly, the AER suggested the final rule be clarified to refer to a transmission business that would be eligible to have the network capability component apply at their next regulatory control period.³¹ Clause 11.77.3(a) of the final rule replaces the word 'at' with 'during' to address these concerns regarding the application of the final rule.

Reference to version 4 of the STPIS in the draft rule

The AER noted that on 17 September 2014, version 4 of the STPIS was superseded by version 4.1 to address issues around the application of the market impact component to Directlink. The AER considered that it would not be able to apply version 4 of the STPIS under this amending rule or as part of a revenue determination, other than where it already has been applied to a transmission business as part of its revenue determination. Accordingly, the AER suggested the final rule should be updated to refer to version 4.1 of the STPIS.³²

Requirements for the network action plan

The AER sought amendments to the draft rule, which would require transmission businesses to include in their network action plans:³³

- details of any disagreement with AEMO regarding priority projects and the grounds for disagreement; and
- confirmation that the priority projects are not otherwise funded through approved operational or capital expenditure.

³⁰ AER, Draft rule determination submission, p1.

³¹ *ibid*, pp1-2.

³² *ibid*, p3.

Review of the network action plan by the AER

The AER contended that the draft rule did not provide it with the ability to assess and notify a transmission business where its submitted proposal did not comply with the requirements of the NER. The AER noted that similar powers were included in the rules relating to the early application of the market impact component of the STPIS, made in 2010.³⁴ The AER considered that providing it with the same powers for this rule change would be necessary to maintain the robustness of the approval process.³⁵

AER decision on application of the network capability component

The AER submitted that the draft rule specifies the factors the AER must consider when approving a priority project and ranking projects, but it does not specify the factors the AER must or can consider when deciding whether to accept or reject a proposal from a transmission business. Accordingly, the final rule should include a reference to the factors the AER is to have respect to when making its decision, including the NEO, the requirements of the rule and the objective of the STPIS.³⁶

(ii) Actions performed prior to the commencement date of the final rule

The AER and ElectraNet requested that the AEMC clarify the intent and operation of the draft rule in relation to actions performed prior to the commencement date of the final rule.

The AER noted that, as the draft rule did not refer to a transmission business submitting a proposal for early application, it was unclear about the implications of this aspect of the draft rule.³⁷

Similarly, ElectraNet concurred that the draft rule should cross-reference to a transmission business's submission of its proposal to the AER and, at a minimum, retain a cross-reference to the consultation undertaken by the transmission business with AEMO prior to commencement of the final rule.³⁸

(iii) Time between the proposed start date and when a proposal is made

ElectraNet noted that, as the draft rule leaves a relatively narrow window of a few weeks from late February (should a final rule be made) to early April 2015 for submission of its proposal to the AER, the timeframe between submission of the

33 *ibid*, p2.

34 NER clauses 11.32.3(f)-(h).

35 AER, Draft rule determination submission, p2.

36 *ibid*, pp2-3.

37 *ibid*.

38 ElectraNet, Draft rule determination submission, p2.

proposal and the proposed start date should be reduced from 60 business days to around 50 business days in the final rule.³⁹

3.2.3 Commission's analysis

(i) Clarification of the process for lodging a proposal with the AER

The following section outlines the Commission's consideration of each of the issues raised by the AER relating to the process for lodging a proposal:

- **Application of the final rule to one or more transmission businesses.** The Commission has determined to retain the provisions of the draft rule in relation to these matters for the final rule. The final rule only provides the ability for a transmission business to submit a proposal to the AER where it wishes the network capability component to apply during its current regulatory control period.^{40/41} Any decision made by the AER about whether or not to apply the network capability component to a transmission business's current revenue determination is guided by the NEO and the STPIS objectives.⁴²
- **Reference to version 4 of the STPIS in the draft rule.** The definition of 'relevant STPIS' in final rule has been amended to reference version 4.1 of the STPIS, dated September 2014.⁴³ The Commission considers amending the final rule is appropriate, as the AER should apply the latest version of the scheme, and there have been no changes to the network capability component of the STPIS between versions 4 and 4.1.
- **Requirements for the network action plan.** The final rule has been amended to require a transmission business's network action plan to set out the matters in clauses 5.2(b)-(j) and (q) of the relevant STPIS.⁴⁴ This cross-reference in the final rule appropriately aligns the requirements in the STPIS with the obligations in the final rule.
- **Review of the network action plan by the AER.** The final rule has been amended to provide the AER with 10 business days to assess and notify a transmission business if its proposal does not meet the requirements of the

³⁹ ElectraNet, Draft rule determination submission, p1.

⁴⁰ Clause 11.77.3(b) of the final rule.

⁴¹ Aside from ElectraNet, Powerlink is the only other transmission business eligible to apply to the AER for early application of the network capability component. However, Powerlink indicated in its consultation paper submission that its revenue determination already contained an allowance to undertake network capability component type projects, and it was therefore not intending to apply to the AER in this instance.

⁴² Clauses 11.77.3(k)-(n) of the final rule and clauses 5.2(k)-(q) of version 4.1 of the STPIS

⁴³ Clause 11.77.1 of the final rule.

⁴⁴ Clause 11.77.3(b)(3) of the final rule.

NER.⁴⁵ Where a proposal is incomplete, the final rule provides a further 10 business days for a transmission business to resubmit its proposal with the additional information requested by the AER.⁴⁶ While the Commission considers that the risk of a proposal being non-compliant is low, due in part to the clarifications included in the final rule as outlined above, the AER's proposed clarification has the potential to further incentivise a transmission business to prepare a rules-compliant network action plan before submission, and to provide prompt support to the AER if requested.

- **AER decision on application of the network capability component.** The Commission has determined to retain the provisions of the draft rule in relation to these matters for the final rule. The draft rule already provided the AER with the ability to reject a transmission business's proposed priority project if it was inconsistent with the requirements of clause 5.2, and/or the objectives, of the scheme.⁴⁷

(ii) Actions performed prior to the commencement date of the final rule

ElectraNet and the AER sought clarification on the intent and operation of the draft rule in relation to those actions undertaken by a transmission business and the AER prior to the commencement date of the final rule (if made).

The Commission agrees that the final rule should recognise some of the actions undertaken by a transmission business, or the AER, prior to its commencement date. Therefore, in the interest of improving regulatory certainty, the final rule clarifies that any action undertaken by a transmission business in preparing its network action plan prior to the commencement date of the final rule is taken to satisfy the requirements of the final rule.⁴⁸ These actions include:⁴⁹

- identification of the proposed priority projects in the network action plan;
- consultation with AEMO on the priority projects in the network action plan;
- any disagreement with AEMO relating to the priority projects identified and the grounds for disagreement; and
- confirmation that the cost of the priority projects is not included in the total forecast operating and capital expenditure in the transmission business's revenue determination.

⁴⁵ Clauses 11.77.3(c)-(d) of the final rule.

⁴⁶ Clause 11.77.3(e) of the final rule.

⁴⁷ Clause 11.77.3(k)-(n) of the final rule and clauses 5.2(k)-(q) of version 4.1 of the STPIS.

⁴⁸ Clause 11.77.3(o) of the final rule.

⁴⁹ Clause 11.77.3(b)(3) of the final rule and clauses 5.2(b)-(j) and (q) of version 4.1 of the STPIS.

(iii) Time between the proposed start date and when a proposal is made

The draft rule stated that the proposed start date for the network capability component must be a date no earlier than 60 business days after a transmission business's proposal to the AER is made.⁵⁰ In response, ElectraNet suggested that this timeframe should be shortened to around 50 business days in the final rule to account for any unforeseen delays.⁵¹

The Commission acknowledges ElectraNet's concerns, but considers that the 60 business days timeframe, between when a transmission business's proposal is made and the proposed start date of the network capability component, is appropriate. This is because maintaining the overall timeframe provides:

- sufficient time for the AER to assess and adequately consult on the proposal; and
- an incentive for the transmission business to submit a proposal to the AER that meets all requirements, and provide prompt support to the AER if requested.

In addition, given a commencement date of 19 February 2015 for the amending rule, the Commission considers there is sufficient time for ElectraNet to submit their proposal to the AER prior to their proposed start date of 1 July 2015.

3.3 Altering revenue determinations within regulatory control periods

3.3.1 Commission's conclusion

The final rule is consistent with the draft rule and only applies to the early application of the network capability component of version 4.1 of the STPIS, dated September 2014. The final rule does not extend to any amendments made to either the market impact or service components of this version of the STPIS, nor apply to any other incentive scheme. Neither does it provide a general process that would allow the AER and a transmission business to apply an amended STPIS component to a transmission business's revenue determination part-way through any regulatory control period.

3.3.2 Context

In May 2013, the AER undertook a consultation process relating to the early application of the network capability component for those transmission businesses not currently operating under version 4 of the STPIS. The AER published its draft decision in August 2013. The AER's draft decision was to allow the eligible transmission businesses to opt-in to the network capability component. In respect of the other amended components in version 4 of the STPIS, the AER intended to apply the market impact component of the STPIS for the remainder of these businesses' regulatory control period, but did not intend to amend the service component.

⁵⁰ Clause 11.77.3(b)(1) of the draft rule.

⁵¹ ElectraNet, Draft rule determination submission, p1.

However, in its final decision, the AER concluded it did not have the power to apply an amended STPIS to a transmission business in its current regulatory control period.⁵²

Although ElectraNet's rule change request sought a limited application of the STPIS, the AEMC consultation paper sought stakeholder views on a potential broader application, including whether any STPIS components that have been amended between versions should be applied at the same time.⁵³

3.3.3 Stakeholder views

In response to the consultation paper, Powerlink noted as a general regulatory practice principle, "incentives established at the start of a regulatory control period should not be changed within the regulatory control period unless there are clear and demonstrated benefits in doing so".⁵⁴ The AER expressed a similar view.

However, the AER also explained that while the "components of the STPIS are relatively independent of each other and could potentially be applied individually, ideally they should be applied together as this provides the greatest level of certainty and consistency for the AER, participants and customers".⁵⁵ Nevertheless, in this case, as the network capability component is an additional component and largely independent of the other STPIS components, submitting stakeholders considered its early application should not compromise the overall incentive arrangements of the scheme.

In relation to a proposal for a more general rule allowing components of the STPIS to be amended, AusNet Services stated that "there have been two cases (both the market impact and network capability components) where transmission businesses have been required to propose rule changes to allow the early application of components of the STPIS".⁵⁶ To provide a more efficient and streamlined process in the future, AusNet Services suggested a more generalised rule change could be made that "would allow the early application of a new STPIS component to a transmission business, subject to the AER's assessment of the compatibility of early participation and the transmission business's willingness".⁵⁷

Stakeholder submissions to the draft rule determination did not raise any further issues regarding the alteration of revenue determinations within a regulatory control period.

52 For further information on the AER's consultation process, see section 1.3.2 of this final rule determination.

53 AEMC 2014, *Early application of the Service Target Performance Incentive Scheme (STPIS) components for transmission businesses*, Consultation paper, 31 July 2014, pp12-13.

54 Powerlink, Consultation paper submissions, p2.

55 AER consultation paper submission, p3.

56 AusNet Services, Consultation paper submission, p2.

57 *ibid.*

3.3.4 Commission's analysis

(i) Amending STPIS components within a regulatory control period

The Commission considers that, ideally, all components of the STPIS should be applied together, as this provides the greatest level of regulatory certainty and consistency for market participants. It would also be consistent with the intended application of the scheme. This is especially the case where a decision to apply a new version of the STPIS, a new component of the STPIS, or amended components of the STPIS, requires either a partial or full review, and possible amendment, of these values within a transmission business's existing revenue determination.

Where a partial or full review of a revenue determination is required, the AER noted that it is likely that the costs of implementation would be higher than the benefits that may accrue. This is because any review would be complex, resource intensive and could conflict with the established balance of incentives and expenditure allocations that exist under the revenue determination.⁵⁸ It would also result in a diminution of regulatory certainty for transmission businesses. If a review of a revenue determination is required, undertaking these amendments as part of the next regulatory determination process would generally be more appropriate.

ElectraNet's rule change request only proposes that a transmission business be able to seek early application of one component (that is, the network capability component) of the version 4 of the STPIS. In relation to this specific case, the AER considered that its early application can be accomplished without "upsetting the regulatory certainty and the associated balance of incentives underpinning the transmission business's revenue determination".⁵⁹

Furthermore, and specifically in the context of ElectraNet, the AER noted that while STPIS components and the overall regulatory determination are closely interlinked, ElectraNet had modified their revised revenue proposal to remove any network optimisation expenditure.⁶⁰ This expenditure was equivalent to that of the network capability component of the STPIS. That is, the network capability component could be applied to a transmission business's revenue determination without requiring a review of its revenue determination.

As noted in the draft rule determination, the Commission considers that in the specific circumstances of the network capability component, given that it can be applied without a review of a transmission business's revenue determination, allowing its early application is appropriate.⁶¹ In addition, and as noted in section 3.1.4, its early

⁵⁸ AER, Consultation paper submission, p1.

⁵⁹ *ibid.*

⁶⁰ ElectraNet, *ElectraNet transmission network revised revenue proposal, Chapter 7 - Operating expenditure*, January 2013, p106.

⁶¹ AEMC 2014, *Early application of STPIS components to transmission businesses*, Draft rule determination, 6 November 2014, Sydney, p13.

application has the potential to bring forward benefits to electricity consumers that would otherwise not be realised until the next regulatory control period.

(ii) General rule to allow early application of new STPIS components

The Commission considers that the making of a more general rule, as suggested by AusNet Services, is outside of the scope of this rule change request. This is because ElectraNet's rule change request is focussed on the application of one component of the STPIS (that is, the network capability component) to transmission businesses, and does not contemplate a more general application.

While there may be some merit in making a more general rule, any process to allow this to occur should not be a simple administrative process. Any new process should provide for the new STPIS components to be assessed on a case-by-case basis, so as to analyse properly and fully understand the potential impacts, including any potential interactions that may exist between the components and how they apply to the business.

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
MCE	Ministerial Council on Energy
NCIPAP	Network capability incentive parameter action plan
NEL	National Electricity Law
NEM	national electricity market
NEO	national electricity objective
STPIS	service target parameter incentive scheme

A Legal requirements under the National Electricity Law

This appendix sets out the relevant legal requirements under the NEL for the AEMC in making this final rule determination.

A.1 Final rule determination

In accordance with ss. 102 and 103 of the NEL, the Commission has made this final rule and associated final rule determination in relation to the rule proposed by ElectraNet.

A.2 Commission's power to make the rule

The Commission is satisfied that the proposed rule falls within the subject matter about which the Commission may make rules. The proposed rule falls within s. 34 of the NEL, as it relates to the operation of the National Electricity Market (NEM) (s. 34(1)(a)(i)), and the activities of persons (including registered participants) participating in the NEM or involved in the operation of the national electricity system (s. 34(1)(a)(iii)).

The subject matter of the proposed rule also falls under those matters set out in Schedule 1 of the NEL under s. 34(2). In particular, items 15, 17, 20 and 23, which relate to:

- **Item 15** – the regulation of revenues earned or that may be earned by owners, controllers or operators of transmission systems from the provision by them of services that are the subject of a transmission determination.
- **Item 17** – principles to be applied, and procedures to be followed, by the AER in exercising or performing an AER economic regulatory function or power relating to the making of a transmission determination.
- **Item 20** – the economic framework, mechanisms or methodologies to be applied or determined by the AER for the purposes of items 15 and 16 including (without limitation) the economic framework, mechanisms or methodologies to be applied or determined by the AER for the derivation of the revenue (whether maximum allowable revenue or otherwise) or prices to be applied by the AER in making a transmission determination.
- **Item 23** – incentives for regulated transmission system operators to make efficient operating and investment decisions including, where applicable, service performance incentive schemes.

A.3 Commission's considerations

In assessing the rule change request, the Commission considered:

- the Commission's powers under the NEL to make the rule;

- the rule change request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;⁶²
- submissions received during first and second round consultation;
- the Commission's analysis as to the ways in which the proposed rule will, or is likely to, contribute to the NEO;
- other relevant rule changes and review recommendations; and
- the revenue and pricing principles under s. 7A of the NEL.

A.4 Revenue and pricing principles

In applying the rule making test in s. 88 of the NEL, the Commission has taken into account the revenue and pricing principles as required under s. 88B of the NEL as the rule change request relates to matters specified in items 15, 17, 20 and 23 of Schedule 1 to the NEL. Having considered the issues raised by ElectraNet, the proposed rule, and submissions received during first and second round consultation, the Commission has concluded that the final rule is consistent with the revenue and pricing principles.

Section 7A(2) of the NEL, states that network service providers should be provided with a reasonable opportunity to recover at least the efficient costs they incur in providing direct control network services. The Commission considers that the final rule will not affect the opportunity for transmission network service providers to recover at least the efficient costs they incur in providing direct control services.

The revenue and pricing principle in s. 7A(3) of the NEL requires network service providers to be provided with effective incentives in order to promote economic efficiency with respect to the direct control network services they provide.⁶³ The economic efficiency that should be promoted includes:

- efficient investment in a distribution system or transmission system with which the operator provides direct control network services;
- the efficient provision of electricity network services; and
- the efficient use of the distribution system or transmission system with which the operator provides direct control network services.

⁶² Under s. 99(2)(a)(iv) of the NEL, the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated Council is now called the COAG Energy Council.

⁶³ NEL s. 7A(3).

The Commission considers that the final rule is consistent with the revenue and pricing principles as it provides transmission businesses with effective incentives under the STPIS to undertake low cost network optimisation projects that facilitate efficient investment in the transmission network. These projects are likely to result in a lower risk of generation dispatch being constrained, which has the potential to lead to the efficient use of the transmission system by transmission network users.

A.5 Civil penalty provisions

The final rule does not amend any clauses that are currently classified as civil penalty provisions under the NEL or the National Electricity (South Australia) Regulations. The Commission will not recommend to the COAG Energy Council that any of the amendments made by the final rule be classified as civil penalty provisions.

A.6 Participating jurisdictions

Under s. 91(8) of the NEL, the Commission may only make a rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the rule is compatible with the proper performance of AEMO's declared functions.⁶⁴

The final rule is compatible with AEMO's declared network functions because it is unrelated to them and therefore it does not affect the performance of these functions.

⁶⁴ These are specified in s. 50C of the NEL