



Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (Early application of service target performance incentive scheme (STPIS) components to transmission businesses) Rule 2014

Rule Proponent

ElectraNet

6 November 2014

**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 draft rule that would allow eligible¹ electricity transmission businesses to apply to the Australian Energy Regulator to seek early application of the network capability component of the service target performance incentive scheme (STPIS) dated December 2012, within their current regulatory control period.

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 draft rule is consistent with ElectraNet's proposed rule, which focussed on the process that a transmission business would use to facilitate the timely and efficient earlier application of the network capability component – albeit with some minor amendments to provide greater clarity regarding its application.

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 the transmission businesses' next revenue determination.

The expected 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 may in turn, provide more efficient pricing for electricity consumers.

Stakeholders are invited to make written submissions in response to this draft rule determination, and draft rule, by no later than **8 January 2015**.

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

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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 eligible² electricity transmission businesses within their current regulatory control period.

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 an eligible transmission business to:

- 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 a proposed rule, has been published on 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.³ ElectraNet considers 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 Ausgrid, Directlink and Murraylink. See section 2.2(a) of version four of the STPIS for further information on its eligibility to transmission businesses.

³ 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.⁴ 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.⁵ 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.⁶

The first STPIS (version one) 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.

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.⁷

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.

⁴ ElectraNet, Rule change request, pp8-9.

⁵ 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).

⁶ AER, *Final decision – electricity transmission network service providers – service target performance incentive scheme*, December 2012, pp3-4.

⁷ AER 2012, *Final decision – Electricity transmission network service providers service target performance incentive scheme –Version four*, December 2012.

Further background information on the development of the STPIS can be found in Appendix B.

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 paper⁸ 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'.⁹

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 December 2012 after the AER's draft decision on ElectraNet's revenue proposal.¹⁰

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 four 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 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 four 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.¹¹

⁸ AEMC, Early application of the Service Target Performance Incentive Scheme (STPIS) to transmission businesses, Consultation paper, July 2014, pp2-4.

⁹ ElectraNet, *ElectraNet transmission network revenue proposal*, Chapter 6 – Forecasting operating expenditure, May 2012, pp98-99.

¹⁰ The AER published its final decision for ElectraNet's 2013-14 to 2017-18 revenue determination on 30 April 2013.

¹¹ AER 2013, *Final decision – Early application of version four of the STPIS*, December 2013, pp4-5.

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);¹²
- economic regulation of network service providers rule change (2012);¹³ and
- amendment of the limited merits review regime (2013).¹⁴

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.

The Commission received three submissions, which are 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.

1.5 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination, including its draft rule, by no later than **8 January 2015**. The period of consultation has been extended by three weeks to account for the Christmas and New Year holiday period.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission by no later than 13 November 2014.¹⁵

Submissions and requests for a hearing should quote project number "ERC0173" and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

¹² www.aemc.gov.au/Rule-Changes/Early-Implementation-of-Market-Impact-Parameters

¹³ www.aemc.gov.au/Rule-Changes/Economic-Regulation-of-Network-Service-Providers

¹⁴ G Yarrow, M Egan and J Tamblyn, *Review of the limited merits review regime - stage two report*, September 2012, pp2-9.

¹⁵ In accordance with section 101(1a) of the NEL. A public hearing is a formal requirement for the Commission to appear before the applicant to enable the applicant to make a presentation to the Commission.

2 Draft rule determination

2.1 Commission's draft rule determination

The Commission has decided to make a draft rule that is consistent with ElectraNet's proposed rule, with some minor amendments to provide greater clarity regarding its application. It inserts a 'one-off' framework of savings and transitional provisions into Chapter 11 of the National Electricity Rules.

The draft rule is attached to, and published with, this draft rule determination. Its key features are described in Chapter 3.

The draft rule, if implemented, will 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 action plan to the AER for approval, following review of the network action plan by the AEMO and consultation with customers.

The draft rule includes additional amendments that are intended to provide greater clarity regarding its application:

- adding definitions for 'current regulatory control period', 'network capability component of the relevant STPIS', 'relevant STPIS', the 'proposal' – being that provided by the transmission business to the AER, and the 'start date' – for the early application of the network capability component of the STPIS;
- replacing 'version four of the STPIS' in the proposed rule with the definitions 'network capability component of the relevant STPIS' and 'relevant STPIS' to limit application of the draft rule to the network capability component of that version of the STPIS;
- clarification that any person may make a written submission on a proposal published by the AER from a transmission business, so as to clarify that customer engagement on the prioritised projects is an integral part of the decision making process;
- refining the application provisions of the proposed rule; and
- clarification of procedural aspects of the draft rule (for example, the AER is to publish any final decision it makes on an application for early application of the network capability component).

The Commission's reasons for making this draft rule determination are set out in Chapter 3. Appendix A sets out further detail regarding the legal requirements for the making of this draft rule determination.

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).¹⁶

The NEO states:¹⁷

“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.¹⁸

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

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

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

The draft rule, if implemented, will provide eligible electricity transmission businesses with the ability 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. Early access to this component 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 value 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.

¹⁶ See s. 88 of the NEL.

¹⁷ See s. 7 of the NEL.

¹⁸ 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.

The draft rule, if implemented, 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 draft rule may bring forward some administrative costs for transmission businesses in preparing their network action plans in consultation with AEMO and customers, rather than these costs being incurred as part of their revenue determination. 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 draft 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 draft rule determination relates to the AEMC's strategic priority of market arrangements that encourage efficient investment and flexibility. If implemented, the draft rule has the potential to bring forward benefits to consumers that otherwise would not be realised until the transmission businesses' 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 draft rule in relation to the early application of the network capability component of the STPIS.

3.1 Early application of the network capability component

3.1.1 Commission's conclusion

That a transmission business is to be allowed to seek approval from the AER to apply for early application of the network capability component of the STPIS dated December 2012 within its current regulatory control period.

3.1.2 Context and stakeholder views

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.

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, AusNet Services estimated that, in its case, the net present value of these benefits was approximately \$80 million, which was more than five times the total cost of delivering these projects.¹⁹ Similarly, ElectraNet estimated that the expected benefits of implementing the network capability component would be several multiples of the total cost of approximately \$11.5 million.²⁰

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.²¹ 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.²²

¹⁹ AusNet Services, Consultation paper submission, p1.

²⁰ ElectraNet, Rule change request - Fact sheet, p2.

²¹ Powerlink, Consultation paper submission, p1.

²² AusNet Services, Consultation paper submission, p1.

The AER also outlined that benefits would accrue to consumers, generators and the overall operating efficiency of the market. For example, 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. The AER also considered that consumers would also benefit from improved competition, potentially lower wholesale costs and efficiency improvements in network capability.²³ The AER conceded that customers would pay slightly more for transmission services as a result of early application, but the benefits to the wholesale market would outweigh these additional costs and result in overall lower costs to be borne by consumers.²⁴

3.1.3 Commission's analysis

The Commission notes stakeholders' views on the expected financial benefits of bringing forward the application of the network capability component to a transmission business's current regulatory control period. With reference to AusNet Services, which currently has the network capability component as part of its STPIS, 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 be the case.

The Commission considers that the draft rule is likely to provide sufficient opportunity for electricity consumers to be consulted by transmission businesses. For example, in its proposal to the AER, a transmission business would be required to provide a description of how they engaged with electricity consumers in preparing their network action plan. 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 for this stakeholder consultation.

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 it is reasonable for the purposes of involving electricity consumers in the decision making process regarding the priority projects included in the network action plan.

The Commission notes the AER's comments that applying the network capability component of the STPIS earlier would marginally increase the cost to consumers of transmission services in order to bring forward the benefits to consumers that would otherwise be delayed. However, this is likely to be offset by 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.

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

²³ AER, Consultation paper submission, p6.

²⁴ *ibid.*

NEO. On balance, the anticipated benefits to the market of applying the network capability component are expected to outweigh the costs of its earlier introduction. Furthermore, the consultation process included in the draft 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 Altering revenue determinations within regulatory control periods

3.2.1 Commission's conclusion

The draft rule only applies to the early application of the network capability component of the STPIS dated December 2012. The draft rule does not extend to any amendments made to either the market impact or service components of the STPIS dated December 2012, nor apply to any other incentive scheme. Neither does it provide a general process that would allow the AER and transmission businesses to apply an amended STPIS component to a transmission business's revenue determination part-way through any regulatory control period.

3.2.2 Context and stakeholder views

In May 2013, the AER also undertook a process of consultation relating to the early application of the network capability component for those transmission businesses not currently under version four 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 four of the STPIS, the AER intended to apply the market impact component of the STPIS for the remainder of these businesses' regulatory control period. The AER did not intend to amend the service component. 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.²⁵

Although ElectraNet's rule change request seeks a limited application of the STPIS, the consultation paper sought stakeholder views on a potential broader application. It considered whether any STPIS components that have been amended between versions should be applied at the same time.²⁶

In response, Powerlink noted as a general regulatory practice principle, "incentives established at the start of a regulatory control period should not be changed within the

²⁵ For further information on the AER's consultation process, see section 1.3.2 of this draft rule determination.

²⁶ AEMC 2014, Early application of the Service Target Performance Incentive Scheme (STPIS) components for transmission businesses - consultation paper, 31 July 2014, pp12-13.

regulatory control period unless there are clear and demonstrated benefits in doing so".²⁷ 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".²⁸ 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".²⁹ 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' willingness".³⁰

3.2.3 Commission's analysis

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 a full or partial review, and possible amendment, of these values within a transmission business's existing revenue determination.

Where a full or partial 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.³¹ It would also result in a diminution of regulatory certainty for transmission businesses. If a review of a revenue determination

²⁷ Powerlink, Consultation paper submissions, p2.

²⁸ AER consultation paper submission, p3.

²⁹ AusNet Services, Consultation paper submission, p2.

³⁰ *ibid.*

³¹ *ibid.*, p1.

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 transmission businesses be able to seek early application of one component (that is, the network capability component) of the version four of the STPIS. In relation to this specific case, the AER considers that its early application can be accomplished without "upsetting the regulatory certainty and the associated balance of incentives underpinning the transmission businesses revenue determination".³²

Furthermore, specifically in the context of ElectraNet, the AER noted that while components of the STPIS and the overall regulatory determination are closely interlinked, ElectraNet had modified their revised revenue proposal to remove any network optimisation expenditure.³³ 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.

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. In addition, as noted in section 3.1.3, its early application has the potential to bring forward benefits to electricity consumers that would otherwise not be realised until the next regulatory control period.

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 eligible 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.

³² *ibid.*

³³ ElectraNet, *ElectraNet transmission network revised revenue proposal, Chapter 7 - Operating expenditure*, January 2013, p106.

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 NEL

This appendix sets out the relevant legal requirements under the National Electricity Law (NEL) for the AEMC in making this draft determination.

A.1 Draft rule determination

In accordance with s. 99 of the NEL, the Commission has made this draft rule determination in relation to the rule proposed by ElectraNet.

A.2 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 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;³⁴
- submissions received during first 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 to the consultation paper, the Commission has concluded that the draft 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 draft 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.³⁵ 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 provisions of electricity network services; and
- the efficient use of the distribution system or transmission system with which the operator provides direct control network services.

³⁴ 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.

³⁵ NEL s. 7A(3).

The Commission considers that the draft 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.

B Overview of the STPIS

Table B.1 Overview of evolution of the STPIS

Date of final decision	Version number	Components	Brief explanation of components
August 2007	1	Service component.	<p>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:</p> <ul style="list-style-type: none"> • 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.	<p>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.</p>

Date of final decision	Version number	Components	Brief explanation of components
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.
December 2012	4	Service component; Market impact component; and Network capability component.	<p>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.</p> <p>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.</p>
September 2014	4.1	As above.	The AER published a limited amendment to the STPIS which wholly relates to Directlink for its next regulatory control period. This consultation was 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.

B.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.

B.2 Requirement 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:³⁶

- 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.

B.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;

³⁶ 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.

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

B.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:³⁷

- 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.

³⁷ 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.

B.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.³⁸

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.

B.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.³⁹

³⁸ AER 2012, *Final decision – Electricity transmission network service providers service target performance incentive scheme – Version three*, March 2011.

³⁹ 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 (NCIPAP, network action plan). The network action plan 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 customers and ranking those priority projects.