

3 September 2010

Chairman
Australian Energy Markets Commission
PO Box A2449
Sydney South NSW 1235

Via email: <http://www.aemc.gov.au/About-Us/Contact-Us/Lodge-A-Submission.html?RuleChange=ERC0108>

Dear Sir

Network Support and Control Ancillary Services (NSCAS) Rule Change Proposal

Grid Australia welcomes this opportunity to make a submission on the AEMC's Consultation Paper on the Network Support and Control Ancillary Services (NSCAS) Rule Change Proposal dated 22 July 2010. The submission on behalf of Grid Australia is attached.

In preparing this submission careful consideration was given to the issues raised in the AEMC Consultation Paper. However, because of the structure of the submission it may not be immediately apparent how each of the questions raised by the AEMC has been addressed. Furthermore, the issues are complex and responses may be open to misinterpretation.

With these considerations in mind Grid Australia would welcome the opportunity to meet with AEMC staff to discuss this submission. To this end, either the Convenor of the Grid Australia Regulatory Managers, Mr Rainer Korte, or I, will be contacting AEMC staff in the near future. In the meantime, if you require any further information, please do not hesitate to contact me on (02) 9284 3434.

Yours sincerely,



Philip Gall
Acting Convenor
Grid Australia Regulatory Managers Group

Attach: Grid Australia's submission in response to the AEMC Network Support and Control Ancillary Services (NSCAS) Rule Change Proposal Consultation Paper

Network Support and Control Ancillary Services (NSCAS) Rule Change Proposal

Submission on AEMC Consultation Paper

3 September 2010

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1. Introduction

KEY POINTS:

Grid Australia generally supports the following aspects of AEMO's proposed Rule changes:

- A single point of accountability to ensure that the transfer capability of transmission networks is maximised, and that this accountability rests with TNSPs.
- A role for AEMO in which AEMO identifies future investment opportunities for delivering network capability to achieve a net economic benefit, but not a role to actively deliver that investment. This is consistent with the recently introduced National Transmission Network Development Plan (NTNDP) process and AEMO's role in developing that plan.

The key reason for generally supporting this proposal is that it provides a more efficient mechanism for planning and procuring NSCAS on a NEM-wide basis. Grid Australia maintains that regulatory incentives can and do operate to provide continually more effective mechanisms for ensuring this outcome.

However, Grid Australia does not support arrangements that give AEMO the capacity to procure NSCAS on a last resort basis. Grid Australia considers that:

- It is inefficient and poor regulatory design to have two separate "last resort" frameworks operating in respect of the provision of network services. AEMO's last resort procurement role can be addressed by the last resort planning process already in place; and,
- AEMO involvement in the procurement of network services is inconsistent with the policy guidance and direction previously provided by COAG and the MCE.

Grid Australia also considers that the definition of NSCAS needs to be carefully reconsidered as it is open to interpretation and the inclusion of a wider range of network services than intended.

Grid Australia makes this submission in response to the Australian Energy Market Commission (AEMC) Consultation Paper in relation to the National Electricity Amendment (Network Support and Control Services) Rule 2010.

The Rule Change request seeks to implement recommendations from AEMO's Final Determination of its Review of Network Support and Control Services (NSCS Review). Grid Australia has made a number of submissions to AEMO (and previously NEMMCO) on this Review over the past two years.

While Grid Australia generally supports this proposal on efficiency benefits grounds, this is not without qualification. This submission sets out why TNSPs are best-placed to efficiently manage the planning and procurement of NSCAS on a system-wide basis. It also explains Grid Australia's concerns with some elements of the proposed Rule change, including AEMO's proposed procurement role and 'last resort' mechanism, and the breadth of the proposed definition of NSCAS.

Responses to some additional matters raised in the AEMC's Consultation Paper are also provided.

2. Procurement and planning of NSCAS

Grid Australia agrees that NSCAS provided by TNSPs and AEMO, and the outcomes they seek to achieve, are in many ways difficult to distinguish under the current arrangements.

Accordingly, the proposed Rule change should help deliver transmission network capability to a level above the minimum level required to meet mandated transmission service levels, when there is a net economic benefit to do so. It should also reduce duplication and uncertainty inherent in the current procurement arrangements for NSCAS, and thus streamline the provision of NSCAS.

Grid Australia supports the proposed move to a single point of accountability for ensuring that the transfer capability of transmission networks is maximised. Placing this accountability with TNSPs is a more efficient outcome than current arrangements, and is consistent with policy guidance on the role of TNSPs in undertaking investment planning. This is discussed further below.

3. Policy guidance on the role of TNSPs

NSCAS are essentially services that contribute to the delivery of overall network capability. That is, they are network services. Moreover, the definitions in the Rules infer that these services are prescribed transmission services (see Attachment 1).

For TNSPs, decisions to procure NSCAS are intimately linked to transmission investment decision-making. Through the RIT-T process, TNSPs are required to consider both network and non-network alternatives to determine the option which has the least overall cost to meet network performance standards, or which maximises net market benefits.

The provision of transmission services has been the subject of a number of reforms in recent years. The most significant of these has been the establishment of a National

Transmission Planning (NTP) function, located within AEMO¹. In tasking the AEMC to develop the new national planning arrangements, the Ministerial Council on Energy (MCE) requested consistency with the Council of Australian Governments' (COAG) directive that:

“The National Transmission Network Development Plan (NTNDP) will provide information to the market on the longer term efficient development of the power system in order to guide network investment decisions and provide signals for efficient generator investment. The NTNDP, however, will not replace localised transmission planning, bind transmission companies to specific investment decision, override TNSP performance obligations, or constrain the timeframes for the revenue approval process of the transmission companies. Accountability for transmission investment, operation and performance will remain with the transmission network service providers.”²

Grid Australia considers that the procurement of NSCAS is intimately linked to investment decisions made to provide network services. The MCE, reflecting COAG requirements, has clearly set out that accountability for these types of decisions is to remain with TNSPs. Furthermore, the AEMC has clearly recognised the need to have regard to this issue in its current Review of Transmission Frameworks³. AEMO's proposal to have an ongoing role in the procurement of NSCAS is in conflict with these positions.

4. Efficiency benefits resulting from TNSPs planning and procuring NSCAS

4.1 Nature of NSCAS services

The primary recommendations of the NSCS Review Draft Determination were to remove NEMMCO's safety net obligation to plan and procure NSCS⁴, and reinforce the existing obligations on TNSPs to plan and procure all NSCAS.

Grid Australia supported these recommendations as it considers that NSCAS are services that contribute to the delivery of overall network capability, essentially making them network services. Furthermore, a decision to procure NSCAS is usually a decision

¹ References to AEMO throughout this submission refer to AEMO in its capacity as the operator of the NEM and as National Transmission Planner. Grid Australia recognises that AEMO has a separate and distinct transmission role in Victoria, and that in this role, AEMO may be required to directly procure NSCAS.

² COAG response to the Final Report of ERIG, cited in MCE correspondence to AEMC, 3 July 2007. http://www.ret.gov.au/Documents/mce_documents/MCE_Direction_to_AEMC20070713112430.pdf (accessed 24 August 2010).

³ AEMC Transmission Frameworks Review Issues Paper, 18 August 2010, p. 4. <http://www.aemc.gov.au/Media/docs/Transmission%20Frameworks%20Review%20Issues%20Paper-7a5c0f3f-d97a-4dd0-ad34-0add27fa6de3-0.pdf> (accessed 31 August 2010).

⁴ The proposed Rule change has recommended that the previously used definition and acronym of 'NCAS' be replaced with a new definition and acronym termed 'NSCAS', which is broader in its scope.

resulting from an investment decision assessment process (e.g. the RIT-T) and is intimately linked to a TNSP's accountability to deliver timely and efficient investments.

Grid Australia recognises that NSCAS plays a role in operating the system securely, which AEMO is responsible for as the system operator. However, AEMO can meet this responsibility under abnormal circumstances through its power of direction to maintain the real-time security and reliability of the power system.

While AEMO, as the system operator, is responsible for the secure operation of the power system, it is the responsibility of TNSPs to plan and develop their transmission networks so that they are capable of being operated securely while meeting forecast peak demands. That is, TNSPs are responsible for providing the most efficient technical envelope within which AEMO operates the system to ensure security and reliability.

Further, the planning and procurement of NSCAS more appropriately sits with TNSPs who are best positioned to understand and manage their networks, and the connection agreements with parties connected to those networks (including providers of NSCAS). Therefore, TNSPs can more effectively optimise the use of NSCAS.

4.2 Incentives and requirements to utilise NSCAS efficiently

Submissions to AEMO's review of NSCAS raised concerns about whether TNSPs would have appropriate incentives in place to coordinate the planning and procurement of NSCAS efficiently on a NEM-wide basis.

Grid Australia maintains that there are adequate incentives for TNSPs to ensure planning and procurement of NSCAS is undertaken efficiently on a NEM-wide basis. Specifically, the RIT-T process expressly requires consideration of options involving other TNSPs. This process is to be conducted jointly between TNSPs when the most efficient option involves actions by more than one TNSP.

The role of the RIT-T in facilitating the efficient identification and application of network support services by TNSPs is also important. The RIT-T allows for market benefits to be considered while still meeting the mandated reliability standards. The RIT-T achieves this by allowing additional capital expenditure to produce an asset which delivers more than the minimum reliability standard, provided there is a net market benefit from the incremental investment.

The RIT-T Rule also requires TNSPs to consider a broad range of possible market benefits, rather than only the impact of augmentations within a particular jurisdiction or

region⁵. This is consistent with the desired NEM-wide approach to NSCAS planning and procurement.

Further, the current ex-ante capital expenditure framework for transmission provides financial incentives for TNSPs to seek out efficient network support solutions to meet network reliability and market benefits investment requirements where it is economic to do so. For example, the regulatory framework provides meaningful incentives for TNSPs to implement the most efficient option to address an identified network need, which may result in the efficient deferral of investment within a regulatory period.

A central role for TNSPs in procuring network support services enables the management of these services to be subjected to commercial incentives via the regulatory regime administered by the AER. To the extent the AEMC determines that these incentives need improvement to encourage more efficient management of network support services, then this can be achieved by further refinement to incentive arrangements or new administrative requirements (e.g. new Rules). As AEMO is not a commercial entity, the option of commercial incentive arrangements is not available where AEMO retains a role in the provision of these services. That is, the ability to develop even more efficient provision of these services over time is enhanced if TNSPs are responsible for their procurement.

Furthermore, the views that TNSPs do not adequately plan to address underlying NSCAS requirements through their own regulated investment process, or that TNSPs rely on AEMO to procure NSCAS, are questionable in practice. For example, as part of its Revenue Proposal for the 2007 – 2012 period, Powerlink identified that the NEMMCO NCAS contracts with Swanbank and Wivenhoe power stations were due to expire in June 2007. From that date, there was no certainty that the reactive power provided by those generators would continue to be available. Powerlink therefore sought, and the AER approved, an allowance for the procurement of reactive power. The end of NEMMCO's NCAS contracts subsequently coincided with the start of Powerlink's next regulatory period.

In summary, the NTNDP arrangements, together with the NEM-wide scope of the RIT-T for TNSPs to improve economic capability (when economic to do so), addresses concerns regarding the efficient planning and coordination of NSCAS on a NEM-wide basis. This is reinforced by commercial incentives applying to TNSPs as a result of the regulatory framework established in the Rules, which encourages TNSPs to seek out and efficiently implement network support services.

⁵ *National Electricity Amendment (Regulatory Investment Test for Transmission) Rule 2009, Final Rule Determination*, 25 June 2009, p12. <http://www.aemc.gov.au/Electricity/Rule-changes/Completed/Regulatory-Investment-Test-for-Transmission.html> (accessed 19 August 2010).

However, in the unlikely event that an identified NSCAS need is not addressed by a relevant TNSP within 18 months of publication of the NTNDP, the existing LRPP framework for which the AEMC is responsible may need to be utilised.

Grid Australia agrees that AEMO should retain a power of direction to maintain the real-time security and reliability of the power system. This is consistent with the powers AEMO already has in respect of the energy market.

4.3 NSCAS for market benefits

Grid Australia agrees with the AEMC's observation that AEMO's proposal to procure network support services for market benefits across the NEM may be a broader role than its current obligations⁶ (which relate to increasing the benefits from trade from the spot market). Grid Australia also concurs that this procurement role shifts accountability for performance of the network away from TNSPs and towards AEMO. Such a shift is inconsistent with COAG's requirements⁷.

Grid Australia notes that there is currently a disconnect between the spot trading benefits which AEMO pursues in real-time in its role as the market operator, and the economic benefits which are seen under the RIT-T arrangements. The former benefits are based on spot prices and the offers presented by generators and other providers of energy and NSCAS in real-time. The latter benefits are based on underlying economic costs such as capital invested and fuel costs. Grid Australia considers there is potential for significant loss of efficiency if NSCAS was justified and procured by AEMO on one basis (benefits under the RIT-T) and then decisions on the deployment of NSCAS were made on a different basis (spot market trading benefits).

For example, there may be two choices for the provision of NSCAS as follows:

- Option 1 has a fixed annual cost of \$1 million and no usage cost.
- Option 2 has a usage cost of \$40,000/hr.

Each option delivers benefits of \$2 million from being deployed during the 20 highest demand hours of the year and no benefit outside of these times. Under the RIT-T, Option 2 would be the preferred option as it can deliver the same benefit as Option 1 at a lower overall cost (i.e. \$800,000 vs. \$1million).

⁶ *AEMC Consultation Paper*, National Electricity Amendment (NSCAS) Rule 2010, p11.

⁷ *COAG response to the Final Report of ERIG*, cited in *MCE correspondence to AEMC*, 3 July 2007. http://www.ret.gov.au/Documents/mce/documents/MCE_Direction_to_AEMC20070713112430.pdf (accessed 24 August 2010).

However, if AEMO then deploys the NSCAS service to deliver spot market trading benefits, it may result in Option 2 being used for greater than 20 hours, perhaps to reduce inter-regional price differences, with a consequent increase in the costs for Option 2. However, this type of spot market trading benefit is not an economic benefit that can be included under the RIT-T assessment and so couldn't form part of the procurement decision. The impact of using Option 2 for more than 20 hours is that it will then cost more than Option 1 and could no longer be justified under the RIT-T resulting in a net loss of economic efficiency.

5. Proposed 'last resort' arrangements.

Grid Australia submits that retaining a role for AEMO in procuring NSCAS, even on a last resort basis, is inefficient, inconsistent with policy settings, and unnecessary.

Grid Australia considers that AEMO's current role in contracting for NSCAS contributes to the inefficiency by maintaining confusion over accountabilities and by acting as a disincentive to TNSP action.

Removing AEMO's role in procuring NSCAS is consistent with a TNSP's accountability for assessing the relative efficiency of both network support and network investment options to address network needs.

Grid Australia supports AEMO's proposal to identify unmet NSCAS needs in the NTNDP, notwithstanding that the timeframes suggested are within the investment planning timeframes for which TNSPs have planning responsibility. That is, Grid Australia supports a role for AEMO in which it identifies when additional investment is required to deliver network capability above a mandated level of service where this would provide a net economic benefit.

However, preserving a role for AEMO in actively delivering that investment is unnecessary and inconsistent with COAG's requirements.⁸

Prior to establishing the National Transmission Planner (NTP) function, the Ministerial Council on Energy (MCE) instituted a Rule change to provide the AEMC with a Last Resort Planning Power (LRPP).

The Rules now provide that the AEMC may direct a party to conduct a RIT-T assessment in circumstances where there is a network constraint or a potential project that may have a significant impact on the efficient operation of the NEM, and that without exercising the LRPP the problem is unlikely to be addressed. This power is intended to mitigate any

⁸ COAG response to the Final Report of ERIG, cited in MCE correspondence to AEMC, 3 July 2007. http://www.ret.gov.au/Documents/mce/documents/MCE_Direction_to_AEMC20070713112430.pdf (accessed 24 August 2010).

perceived risk that TNSPs will fail to adequately co-ordinate transmission investment from a whole-of-NEM perspective.

Importantly, the LRPP was specifically considered in developing the arrangements for the NTP. The MCE accepted the recommendation from the AEMC that the LRPP continue under the new transmission planning arrangements⁹.

The AEMC's NTP Report also noted that transferring the LRPP from the AEMC to AEMO would be inconsistent with the role of AEMO.

*The Commission advises against the LRPP being transferred to the NTP and also the NTP having a more active planning responsibility with respect to interregional projects. A more activist role for the NTP would be inconsistent with the governance framework decided by COAG that assigns responsibility and accountability for investment to TNSPs.*¹⁰

Given these recent reforms, Grid Australia is concerned that AEMO now proposes to retain a direct role in the procurement of NSCAS which is significantly beyond the last resort power of direction proposed by AEMO (NEMMCO) in its Draft Determination. Specifically, AEMO proposes that where two successive NTNDPs identify a likely need for NSCAS, and the need remains unmet (i.e. unaddressed by the relevant TNSP), then AEMO will procure the required NSCAS. This proposed framework is contrary to the LRPP framework where the AEMC, after receiving advice from AEMO, may direct a TNSP to conduct a RIT-T assessment.

AEMO has previously responded to Grid Australia's concerns about the proposed last resort framework by advising that it considers that "a safety net provision for it to acquire NSCAS to maintain power system security and reliability is consistent with its power system security functions and obligations, similar to its role under the Reliability and Emergency Reserve Trader (RERT) provisions."¹¹ Grid Australia notes the review of the RERT (which is now under way) is giving consideration to whether, as previously expressed by the Reliability Panel, the market should be able to operate in the longer term without the need for such safety net mechanisms¹².

⁹ *National Transmission Planning Arrangements – Ministerial Council on Energy Response to Australian Energy Market Commission Final Report*, November 2008, p.6.

¹⁰ AEMC *National Transmission Planning Arrangements - Final Report to MCE*, 30 June 2008, p.78. <http://www.aemc.gov.au/Media/docs/National%20Transmission%20Planner%20Final%20Report%20to%20MCE-448faa16-c4c0-4f52-a922-114975692985-0.pdf> (accessed 18 August 2010).

¹¹ *AEMO Proposed Rule Change Request (Attachment A) 13 April 2010*, p. 12. <http://www.aemc.gov.au/Electricity/Rule-changes/Open/Network-Support-and-Control-Ancillary-Services.html> (accessed 18 August 2010)

¹² *AEMC Reliability Panel Rule change proposal, NEM Reliability Settings Information, Safety Net, and Directions*, February 2008, p.11. <http://www.aemc.gov.au/Media/docs/Reliability%20Panel%20Proposal-d249826b-a814-4c2b-b7ef-ef97d44783be-0.pdf> (accessed 14 August 2010)

Grid Australia also notes that TNSPs are obligated to plan and develop the transmission network to meet the technical and quality of supply standards sets out in the Rules and other applicable regulatory instruments. It is difficult to envisage there being a need for additional NSCAS beyond these requirements to maintain power system security and reliability. In contrast, there are no parties with any underlying obligations to invest in new generating capacity or demand management in order to maintain the required levels of capacity reserve.

Finally, it is inefficient and poor regulatory design to have two separate “last resort” frameworks both operating in respect of the provision of network services. This is also inconsistent with good regulatory practice which underpins the National Electricity Objective. Having AEMO directly involved in the procurement of network services is also inconsistent with the policy guidance and direction previously provided by the MCE. If there is to be any “last resort” arrangements in respect of NSCAS, these should utilise the LRPP framework that already exists for the provision of network services.

6. Proposed definition of NSCAS

Grid Australia recommends that further consideration be given to the currently proposed definition to ensure it does not become unintentionally too broad. For example, this definition could be taken to include something as simple as a circuit breaker, or even a protection setting.

Opening circuit breakers is often undertaken to improve transmission capability by, for example, removing fault level constraints or limiting parallel flows through lines with low ratings. Similarly, reductions in protection clearance times could result in increased power flow capability.

If the AEMC intends that the definition capture a broad range of situations, the full scope of this intention should be laid out and the Rule change proposal assessed with express consideration of each situation.

7. Other Matters

7.1 NSCAS service providers

Grid Australia considers that any NSCAS service provider, regardless of who engages their services and whether they are a Registered Participant or not, must be required to comply with the National Electricity Rules. For example, any generator who sought to connect to a TNSP’s network for the purposes of providing network support services must comply with the connection arrangements and meet the performance standards outlined in the Rules (e.g. Schedule 5.2).

Grid Australia would also seek to ensure that the Rules place obligations on NSCAS service providers to disclose any arrangements in place that could reasonably affect the

provision of the required transmission network support services. This will ensure that TNSPs have sufficient information to properly assess the risks to network performance of entering into agreements with third parties for the provision of network support services.

7.2 Information provision

Grid Australia agrees that the efficient deployment of NSCAS procured by TNSPs under network support agreements requires the provision of information to AEMO to allow the arrangements to be properly represented in the dispatch systems. However, instead of being overly prescriptive as in the current draft Rules, AEMO should set out the general types of information it requires to perform its functions. This modification would recognise that the specifics of the information required will vary depending on the particular circumstances of each network support arrangement. More detailed requirements could then be captured by agreed information sharing protocols.

7.3 Funding and cost recovery of NSCAS

AEMO has proposed that under a framework where it is required to procure NSCAS, the costs for these services be recovered from Market Customers in benefiting regions on the basis of the proposed new Regional Benefit Ancillary Services Procedures. Allocating responsibility to TNSPs for the procurement of NSCAS obviates the need for AEMO to develop this new procedure. Under an arrangement where NSCAS procurement rests with TNSPs, and in the event that a NSCAS procured by one TNSP results in a benefit in another region, the proposed interregional TUOS arrangements could be developed to allow TNSPs to recover the appropriate costs of this service from an adjoining region.

Under AEMO's proposed arrangements, the AEMC has flagged in its consultation paper that there is the potential for a TNSP to be paid twice for providing NSCAS (e.g. the TNSP is provided with a revenue allowance for the NSCAS it proposes to procure during a regulatory period, but then competitively tenders to provide the service to AEMO). Such a situation could easily be addressed in guidelines to accompany the proposed Rule change. Again, allocating sole responsibility to TNSPs for the procurement of NSCAS, and removing AEMO from the tendering process, overcomes this potential situation altogether.

Furthermore, TNSPs are already required to have effective auditable systems for ensuring appropriate allocation of costs between prescribed services and other services offered by TNSPs. These systems are reviewed by the AER as part of the five-yearly revenue cap reset process.

7.4 Transitional arrangements

Should the AEMC concur with Grid Australia that TNSPs are best placed to take on responsibility for the procurement of NSCAS, some transitional arrangements may be required. For example, Grid Australia expects it would be necessary for AEMO and Grid

Australia to jointly develop and agree on protocols for the new arrangements, including information sharing arrangements.

These transitional arrangements would also need to include appropriate provisions to enable some TNSPs to recover the additional capital and operating costs associated with the provision of these additional services. This could arise, for example, where these costs are not already provided for in a TNSP's current revenue cap.

Attachment 1

Prescribed transmission services include:

A *shared transmission service* that:

- does not exceed such *network* performance requirements (whether as to quality or quantity) as that *shared transmission service* is required to meet under any *jurisdictional electricity legislation*;
- except to the extent that the *network* performance requirements which that *shared transmission service* is required to meet are prescribed under any *jurisdictional electricity legislation*, does not exceed such *network* performance requirements (whether as to quality or quantity) as are set out in schedule 5.1a or 5.1; or
- is an *above-standard system shared transmission service*;

A *shared transmission service* is:

- A service provided to a *Transmission Network User* for use of a *transmission network* for the conveyance of electricity (including a service that ensures the integrity of the related *transmission system*).

While an *above-standard system shared transmission service* is:

- A *shared transmission service* that exceeds the requirements referred to in paragraph (a)(1) or (2) of the definition of *negotiated transmission service* principally as a consequence of investments that have *system-wide benefits*. That is, a service that exceeds the jurisdictional or Rules requirements will be considered a prescribed service if it provides benefits to Transmission Network Users other than those at a single connection point.

From the above definitions it would appear that if NSCAS is required to meet the established planning criteria it satisfies either (a)(1) or (a)(2) of the definition of *prescribed transmission service*. Alternatively, if it provides an economic increase in power transfer capability, beyond the established planning criteria, then it will be providing *system-wide benefits* and so will satisfy (a)(3) of the definition.