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Dear Mr Wilson

### **Draft Service Target Performance Incentive Scheme**

AEMO welcomes the opportunity to provide feedback on AER's Draft of the Service Target Performance Incentive Scheme (STPIS).

This review comes at a time where there are number of electricity market reviews that attempt to address the challenges of rising network charges. To address these challenges the Productivity Commission's draft report and the AEMC's second interim report on the Transmission Frameworks Review have proposed different models which attempt to strengthen the national planning and investment decision making processes.

AEMO strongly endorses the Productivity Commission's proposed model as the best able to drive efficient investment. The proposal for improvements to the STPIS needs to consider those proposals and provide an avenue that is capable of complementing those models.

AEMO supports enhancements to the revenue regulation that promote the provision of services rather than the construction of assets. The STPIS is the only element of the current revenue setting arrangements that rewards service delivery. While the broader consideration of planning and investment decision making are being dealt with other reviews, it is important that network businesses are provided the right incentives to maximise the value of infrastructure that is built. More efficient operation of network assets and targeted incremental investments should supplement better planning and investment decision making to provide efficient services to network users.

AEMO also supports measures that drive innovation and deliver dynamic efficiency in the current regulated environment. Innovation is critical to the longer term efficient development of the grid and to deal with the changes expected in the energy industry.

### **The AER's proposed network capability component**

In light of recent significant increases in network expenditure, AEMO believes the AER's proposed network capability component which aims to increase network capability from existing assets is a positive, albeit incremental, step forward.

The AER proposes that TNSPs consult with AEMO on prioritising projects that would deliver best value for money for consumers and ranking those priority projects<sup>1</sup>. While AEMO

<sup>1</sup> AER's Explanatory Statement on the STPIS, Page 36.

supports this approach, it believes that AEMO must be the ultimate decision maker on how and which of these projects are to be implemented. This is consistent with the views of the Productivity Commission's draft report which recognises the need to have an independent national planner-decision maker. AEMO has the capability to effectively undertake this role as the national system operator and transmission planner.

There will be a trade-off between increasing existing network capability and investing in additional infrastructure. The framework for this must be aligned with the RIT-T objectives to ensure that the projects identified provide the most efficient overall outcome for the market. In order to fulfil this role effectively, AEMO must therefore be supplied with all relevant information on the network expenditure programs of the TNSPs at the time that it conducts this assessment.

AEMO notes that the AER's draft proposal on the new component of the STPIS does not specify the approach towards improving the capability of interconnectors which form part of the networks of two regions. AEMO believes that capability improvements to interconnectors are an important factor in providing an efficient national grid to customers and should therefore be encouraged through the network capability component incentive.

If the AER adopts AEMO's proposed amendments, this would align it with the current process in Victoria which has delivered superior overall outcomes for network customers. AEMO envisages that in Victoria network asset owners, such as SP AusNet, will propose capability improvements to AEMO and that AEMO will consider and approve those projects which deliver the most efficient outcomes. AEMO will work with the AER and the Victorian transmission businesses on whether there are any additional requirements that need to be included in the STPIS given the separation of roles and responsibilities in Victoria.

### **Victoria's Availability Incentive Scheme (AIS) and the STPIS**

AEMO acknowledges the AER's draft decision not to merge Victoria's Availability Incentive Scheme (AIS) which applies to SP AusNet into the STPIS<sup>2</sup>. The AIS is a more detailed scheme for each of SP AusNet's network assets requiring specific information or data in order to calculate the rebate that SP AusNet receive. AEMO believes the approach undertaken in the AIS is valuable as it provides more transparency on the utilisation of network assets (due to the depth of information required on each asset) which assists in the operation of the system and therefore the interests of consumers. Given the AER's proposed network capability component will require network businesses to reveal more detailed information on their assets, similar to the information required in the AIS, there may be some scope in a future STPIS review to consider amalgamating the two schemes. AEMO would be willing to work with the AER on the requirements of merging the two schemes successfully.

### **Consideration of other market reviews**

AEMO would also like to add that it is important to consider the outcomes of other reviews currently being undertaken which may affect the application of the STPIS on network businesses. For example, the Productivity Commission's draft report and the AEMC's second interim report on the Transmission Frameworks Review have both proposed different planning and investment decision making processes.

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<sup>2</sup> Part of SP AusNet's submission to amend the transmission circuit availability parameter.

Also part of the AEMC's Transmission Frameworks Review second interim report, an Optional Firm Access (OFA) regime has been proposed. The information required to be provided by the network business under the AIS supports this regime and therefore integrating aspects of the AIS with the STPIS would provide further benefits to the market.

### **Potential to promote further efficiency of existing assets through the STPIS**

AEMO recognises that the current regime does not provide an incentive to prolong the life of existing assets, where possible, to maximise their use. The consequence of the current revenue setting framework has resulted in significant asset replacement program proposals by the businesses. A transmission business will not receive any regulated revenue for a transmission asset that is depreciated beyond its economic life. A rational business would therefore have an incentive to replace the asset that is beyond its economic life. It is likely that in many cases an asset that is at the end of its accounting life is still capable of providing a service.

A transmission business should therefore be rewarded for retaining and utilising that asset if they believe that it is technically capable of continuing to provide a service. AEMO acknowledges that this is not always possible but considers that we need to develop a better scheme to drive efficient asset management within the regulatory regime. Transmission businesses should be rewarded for good asset management which, in the longer term, will lower transmission charges for consumers.

AEMO is willing to work with the AER, asset owners, and any other relevant parties, to develop this concept further.

If you have any questions please do not hesitate to contact Louis Tirpcou, Group Manager Regulatory Policy, on (03) 9609 8415 or [louis.tirpcou@aemo.com.au](mailto:louis.tirpcou@aemo.com.au).

Yours sincerely



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