

28 June 2015

Mr Craig Oakeshott
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Dear Mr Oakeshott,

Review of Transmission Service Target Performance Incentive Scheme (STPIS)

Thank you for the opportunity to provide comments on the AER's proposed changes to the STPIS. AEMO has an interest in this review because:

- we have a role in reviewing and providing advice on TNSPs' draft network capability incentive parameter action plans (NCIPAPs), and
- third party initiated outages count towards a TNSPs' market impact component performance, which affects our Victorian transmission planner-procurer functions.

This submission sets out AEMO's views with respect to the proposed changes to the network capability component and the market impact component.

1. Network Capability Component

AEMO considers that the AER's proposed changes to the NCC better align the process with the objective of achieving low cost improvements to network capability. In particular, pro-rating the incentive reward to 1.5 times the total cost of approved projects would encourage TNSPs to identify beneficial projects to the full value of the scheme rather than topping up with projects which have longer payback periods or less quantifiable benefits.

AEMO supports the new clause which permits the AER take into account whether a TNSP is incentivised or required to undertake a proposed priority project elsewhere in the regulatory framework. We note that the new clause reinforces the need for greater clarity about the treatment of NCIPAP-type projects elsewhere in the regulatory framework. TNSPs should manage their networks efficiently as part of their business as usual capital and/or operating expenditure. Explicit consideration on whether a project would have taken place without the NCC in place will ensure TNSPs are not rewarded for projects they should be undertaking as part of their normal planning processes

The additional rewards associated with the NCC should only available to TNSPs if they have "gone the extra mile" and explored options beyond business as usual to drive additional benefits for consumers. This approach, combined with the proposal to pro-rata payments, will help to ensure that only projects with clearly demonstrable net benefits are eligible for premium payments. We note that if the availability of the NCC is limited in this fashion, it will affect how AEMO approaches the development of the Victorian NCIPAP.

AEMO also supports the proposed amendments setting out the information the TNSP must provide AEMO and clarification of AEMO's role in the NCC process. Finally, flexibility within the period to add or remove projects incentivises TNSPs to deliver efficient levels of network capability and respond to changes affecting the ranking of priority projects.

2. Market Impact Component

This section describes our reasons for supporting the AER's proposed changes to the MIC, and sets out two issues for the AER's consideration:

- the transitional arrangements relating to the reinstatement of the exemption for third party initiated outages; and
- a possible additional exclusion relating to inter-network power system tests.

We agree that it is reasonable to shift to a symmetrical scheme given that the operating costs associated with the MIC are built into TNSPs' allowed revenues. A symmetrical scheme will help to limit some of the perverse incentives that arise under a benefit-only scheme. For instance, under the current scheme a TNSP that has exceeded its performance target has an incentive to incur as many outages as possible over the remainder of the year in order to benefit from a higher target in future years.

We also agree that the revenue at risk under the MIC scheme should be ± 1 per cent MAR, and there should be a minimum performance target of 100 dispatch intervals. The current scheme has the potential for TNSPs to face very high forgone revenue per dispatch interval, which may not accurately reflect the actual costs associated with the outage.

We support the new clauses which enable the AER to amend a TNSP's performance target to allow for statistical outliers or for performance where the objectives of the scheme will not be met. This flexibility is necessary and appropriate given the volatility of MIC results in some jurisdictions.

2.1. Third party outages

AEMO supports the reinstatement of the exemption for third party initiated outages. Under the current regime, the contractual arrangements adopted by some TNSPs could have the effect of removing the incentives on the TNSP to control planned outages on their own network, since they recover equivalent revenue from third parties.

Our concern relates to the windfall gains and losses that could arise when the AER reinstates the third party outage exemption. The transitional arrangements should seek to minimise windfall gains and losses to TNSPs, third parties and customers as a result of regulatory instability. If a TNSP has borne the upfront cost of forgone incentive revenue themselves rather than shifting the full costs onto third parties, then they should be permitted to retain the higher performance target associated with those outages. It is appropriate for the regulatory framework to recognise the customer benefits associated with such risk-sharing arrangements: outage costs are likely to be reduced if the TNSP bears the risk associated with their future outage performance instead of passing the cost onto parties who are unable to manage the risk.

Finally, we understand that in an earlier version of the STPIS, the AER determined that the third party exclusion did not apply to AEMO-initiated outages. We do not support this interpretation. The scheme should recognise that the Victorian framework has been designed to create incentives for efficiency by giving an independent planner responsibility for developing the network in a fashion that promotes the NEO. Given that AEMO-initiated projects are funded outside the revenue determination, we question whether it is appropriate for such projects to be included in the STPIS.

2.2. Inter-network power system tests

The MIC could have the unintended consequence of causing TNSPs to postpone or avoid desirable testing and/or commissioning activities due to the risk that the activity triggers a MIC count. For instance, a TNSP might defer the commissioning of a NCIPAP project, with the result that the customer benefits are also deferred.

Clause 5.7.7 of the National Electricity Rules (NER) establishes a process for inter-network power system tests which allows for such assets to be commissioned. This framework is capable of taking into account both the market impact of outages and the customer benefits associated with having the asset operational. AEMO must determine a test program having regard to various principles including minimising the variation from the central dispatch outcomes that would otherwise occur if there were no inter-network test.¹ AEMO must also consult on and publish the test program.

Given the benefits associated with inter-network power system tests, and the existing NER provisions which ensure that the market impact of any outages are already taken into account, it is unnecessary and potentially counter-productive for the MIC to apply in these cases. We propose a further exclusion to the MIC to apply in the case of transmission outages taken as part of test program developed in accordance with NER 5.7.7.

We hope you find this submission helpful. If you would like to discuss matters relating to this review, please don't hesitate to contact Jess Hunt (08 8201 7315).

Yours sincerely



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¹ NER 5.7.7(r)