



Draft Decision

**Service Target Performance Incentive Scheme
for TNSPs**

Early application of version 4

August 2013

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Executive summary

Under the National Electricity Rules (Electricity Rules), the AER creates, maintains and administers the service target performance incentive scheme (STPIS) for Transmission Network Service Providers (TNSPs). The purpose of the STPIS is to provide incentives to TNSPs to maintain a high level of service for the benefit of participants in the National Electricity Market (NEM) and end users of electricity.

This document sets out the AER's draft decision on the application of the current version of the STPIS (or part thereof) to ElectraNet, Powerlink and Murraylink in their current regulatory control period and sets out the AER's preliminary position on the application of the STPIS to TransGrid and Transend in the transitional year of their upcoming regulatory control period.

Last year the AER concluded a comprehensive review of the STPIS for TNSPs, publishing its final decision on 20 December 2012 (which introduced version 4 of the scheme). Version 4 of the STPIS made amendments to the existing service component and market impact component (MIC) and also introduced a new network capability component (NCC).

On 29 May 2013, ElectraNet made a formal application to the AER seeking early access to the NCC in its current 2013–2018 regulatory control period. The NCC could not be included in ElectraNet's revenue determination for the 2013–2018 regulatory control period as at the time the revenue proposal was submitted, version 3 of the STPIS was applicable and did not include the NCC. As part of its regulatory proposal, ElectraNet submitted values for the service component and MIC in accordance with version 3 of the scheme.

ElectraNet considers it is possible for the AER to grant a TNSP early access to new components introduced under version 4 of STPIS due to recent changes to the Electricity Rules made by the Australian Energy Market Commission's (AEMC) final determination on the AER's Economic Regulation of Network Service Providers rule change proposal (AEMC final determination).

The AER considers that the changes to the Electricity Rules introduced by the AEMC final determination gives it the discretion to determine whether or not any amended STPIS (or part thereof) will apply to a TNSP in its current regulatory control period. Three TNSPs (Murraylink, Powerlink and ElectraNet) are in the early stages of their current regulatory control period. The AER considers it is appropriate to consider whether the amended STPIS (or part thereof) should apply to Murraylink, Powerlink and ElectraNet in their current regulatory control periods.

The AER's draft decision on the early application of version 4 of the STPIS is that:

- ElectraNet and Powerlink will be allowed to opt-in to the NCC of version 4 of the STPIS in their current regulatory control period from the next regulatory year (2014-2015). If Powerlink chooses to opt-in, it must submit a network capability incentive parameter action plan proposal prior to its next regulatory year.
- ElectraNet, Powerlink and Murraylink will apply the MIC of version 4 of the STPIS from the 2014 calendar year.
- ElectraNet, Powerlink and Murraylink will not apply the service component of version 4 of the STPIS in their current regulatory control period.
- As Directlink is in the final stages of its regulatory control period, and considering the nature of its network, the AER does not intend to amend Directlink's STPIS.

Furthermore, the AEMC final determination establishes a default position that as part of TransGrid and Transend's transition to a new regulatory control period under the new Electricity Rules, the STPIS that applied in their previous regulatory control period will apply in the transitional year. However, the AER is able to apply an alternate STPIS as specified in a framework and approach paper to be published in January 2014. To ensure proper consideration is given to the application of the STPIS in the transitional year, the AER considers a preliminary position should be developed as part of the AER's decision on the application of the amended STPIS.

The AER's preliminary position is that the MIC of version 4 of the STPIS will apply to TransGrid and Transend during their transitional year; the NCC will apply subject to confirmation from the TNSPs and the Australian Energy Market Operator (AEMO). The service component of the scheme which currently applies to TransGrid and Transend will continue to apply during their transitional year and the service component of version 4 of the STPIS will apply from the second year of their upcoming regulatory control periods.

The AER is seeking written submissions from interested parties by **25 September 2013**. The AER will publish its final decision before **11 December 2013**.

1 Early application of version 4 of the STPIS

This chapter sets out the AER's draft decision on the application of the current version of the STPIS to those TNSPs which are in the middle of a regulatory control period and to Transend and TransGrid during their transitional year. The chapter sets out the principles the AER has applied in considering the early application of version 4 of the scheme.

1.1 Background

Version 4 of the STPIS

In 2012 the AER conducted a comprehensive review of the STPIS for TNSPs, publishing its final decision on 20 December 2012. Arising out of this review were three key changes:

- the current service component parameters were amended, including by replacing an existing parameter with a new parameter, so that performance against the parameters can be used as a lead indicator of a deterioration of network reliability. The service component was brought into greater alignment between TNSPs through standardisation of definitions, exclusion clauses and weightings for parameters.
- the setting of targets and measurement of performance for the MIC was changed to encourage consistency in TNSP performance. The revised MIC measures performance on a rolling two calendar year basis compared to a target of the previous three calendar year average outcomes, and
- the introduction of a network capability component, which provides an incentive of 1.5 per cent of maximum allowed revenue (MAR) subject to completion of projects that improve the capability of the transmission network at times most needed. The component is designed to influence a TNSP's operation and management of its network assets to develop one-off projects that can be delivered through low cost operational and capital expenditure (up to a total of 1 per cent of the proposed MAR per year). AEMO plays a part in prioritising the projects to deliver best value for money for consumers.

New Economic Regulation of Network Service Providers Rule change

The AER's review of the STPIS coincided with the rule change process for chapter 6A of the Electricity Rules. On 29 November 2012, the AEMC made its final rule determination on the AER's Economic Regulation of Network Service Providers rule change proposal. The rule change amended clause 6A.7.4, which sets out the AER's obligations to develop a STPIS for TNSPs and the principles to be applied.

Prior to the amendments, clause 6A.7.4(f) of the Electricity Rules provided that:

The AER may, from time to time and in accordance with the transmission consultation procedures, amend or replace any scheme that is developed and published under this clause, except that no such amendment or replacement may change the application of the scheme to a Transmission Network Service Provider in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement coming into operation.

This clause of the Electricity Rules, along with other clauses governing the AER's ability to amend or replace the values attributed to a TNSP's performance parameters, were deleted as part of the amendments to Chapter 6A. No replacement clauses were inserted into the Electricity Rules.

The AEMC's final determination amended Chapter 6A to lengthen the determination process (by 4 months) for TNSPs to allow for greater consumer engagement and the introduction of a framework and approach paper stage. The AEMC also published transitional arrangements, which provide time in 2013 for parties to engage in the development of the guidelines under the new rules and ensure that the reset schedule is not unduly congested going forward.

To implement the new regulatory framework, transitional arrangements will apply to the upcoming transmission determinations for TransGrid and Transend. As part of the transitional arrangements, the Electricity Rules establishes a default position that the STPIS that applied in the previous control period will continue to apply for the transitional year. However, the AER is able to apply a different STPIS through the framework and approach paper to be published in January 2014.

TNSP regulatory control cycle

TNSPs are currently in different stages of their regulatory control periods as follows:

- SP AusNet has commenced the reset process for its next regulatory control period from 2014-15 to 2016-17 (Singaporean financial years)
- Transend and TransGrid are in the final year of their current regulatory control period. They are subject to transitional arrangements for the determination process for their upcoming regulatory control period commencing 1 July 2014
- ElectraNet and Murraylink are in the first year of their 2013-14 to 2017-18 regulatory control periods
- Powerlink is in its second year of its current regulatory control period; its next regulatory control period is scheduled to commence in 2017-18, and
- Directlink is in the penultimate year of its nine year regulatory control period ending on 30 June 2015.

1.2 ElectraNet Proposal

On 29 May 2013, ElectraNet made a formal application to the AER seeking early access to the NCC of the current STPIS during its current 2013–2018 regulatory control period. ElectraNet considers the changes to the Electricity Rules in the AEMC's final determination mean that TNSPs are able to seek the early application of any amended STPIS without a rule change.

1.3 Assessment Approach

In determining the AER's approach to early application of the scheme, we considered the following factors:

- The requirements of the Electricity Rules and the scheme;
- Whether early application of version 4 of the scheme would deliver benefits to market participants and end users, as defined by the national electricity objective (NEO); and
- The practicalities of early application of version 4.

1.4 Reasons for draft decision

The requirements of the Electricity Rules and the scheme

Clause 6A.7.4(f) of the Electricity Rules ensured that the STPIS that applied to a TNSP during its regulatory control period was the version of the scheme that was current at the time the reset process commenced. As a result, TNSPs had to seek a rule change to obtain access to a new version of the scheme mid-regulatory control period (as was done when the MIC was first introduced). The AER did not request the removal of clause 6A.7.4(f) in its Economic Regulation of Network Service Providers rule change proposal, the AER understands this clause (and associated clauses) was deleted to provide greater flexibility for the application of the STPIS.

Following the amendments to Chapter 6A, we consider that there is no impediment under the Electricity Rules or the scheme itself to the application of a new STPIS mid-way through a TNSP's regulatory control period. We consider the AER has the discretion to determine whether or not the amended scheme (or part thereof) will apply during the current regulatory control period for a TNSP, notwithstanding that the Electricity Rules and the scheme do not expressly provide for this. We consider this discretion is available to the AER without the need for an application from a TNSP. This is notwithstanding that the AER has set the parameters of the STPIS and their values during the relevant TNSP's revenue determination. Accordingly, we consider that it is appropriate to take a holistic approach to ElectraNet's request. In this regard, the AER is proactively considering whether TNSPs mid-regulatory control period ought to adopt the latest version of the STPIS and, if so, what aspects of the scheme are to be applied.

Benefits of early application

The purpose of the AER's recent review of the STPIS was to conduct a comprehensive examination of every element of the STPIS and identify possible changes to enhance the ability of the STPIS to incentivise TNSPs to improve or maintain the performance of their network. In conducting the review, the AER was mindful that a key objective of the scheme was to contribute to the achievement of the NEO.

The NEO, as stated in the National Electricity 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:

- price, quality, safety, reliability, and security of supply of electricity; and
- the reliability, safety and security of the national electricity system.

We consider that the amendments to the STPIS improve the scheme's incentive for each TNSP to:

- 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; and
- improve and maintain the reliability of those elements of the transmission system that are most important to determining spot prices.

Accordingly, the AER considers that early application of the current version of the scheme to TNSPs will bring forward the benefits associated with the new scheme, for the benefit of transmission network users and consumers of electricity in line with the NEO.

The practicalities of early application of version 4

While we consider the current version of the STPIS is an improvement on previous versions, the AER recognises that changing to a new version of the scheme imposes costs on TNSPs, the AER and stakeholders. TNSPs have to propose revised values for the service and market impact components and develop a network capability incentive parameter action plan (NCIPAP) for the NCC. The AER has to review the data and methodologies applied by the TNSP to determine whether the requirements of the scheme have been properly interpreted and implemented. Stakeholders have to be given the opportunity to provide comment on the TNSP's proposal and the AER's draft position.

Early application of the scheme to TNSPs mid-regulatory control period, or during the transitional year for Transend and TransGrid, does impose additional costs than what would otherwise be incurred by following the usual practice of setting parameters and values during the reset process. Moving to a new scheme as part of the reset process provides synergies for the TNSP, the AER, AEMO (in its role of reviewing the NCIPAPs) and stakeholders. The costs of transitioning to the new version of the scheme differ between the service component, the MIC and the NCC. Accordingly, the AER considers these costs should be considered on a component by component basis and weighed up with the associated benefits. We note that the components are relatively independent of each other and can therefore be applied independently. The AER notes that incentive schemes are most effective when the party has regulatory certainty.

Due to the fact that Directlink is in the final stages of its regulatory control period, and the nature of its network, the AER does not intend to amend Directlink's STPIS.

1.5 AER draft decision

Draft decision 1.1: the AER considers that it has the ability under the Electricity Rules to apply an amended STPIS to a TNSP mid-regulatory control period.

Draft decision 1.2: the AER will apply version 4 of the scheme (or parts thereof) to TNSPs as soon as practicable. The details of which parts of the scheme will apply are discussed below.

2 Network capability component

This chapter outlines the AER's draft decision on the early application of the NCC to:

- ElectraNet and Powerlink during their current regulatory control periods, and
- Transend and TransGrid during the transitional year of their upcoming regulatory control periods.

This chapter also provides confirmation of how NCC incentive payments should be incorporated into a TNSP's MAR.

2.1 Background

The NCC, introduced in version 4 of the STPIS, provides an incentive of 1.5 per cent of MAR subject to completion of projects that improve the capability of the transmission network at times most needed. The component is designed to influence a TNSP's operation and management of its network assets to develop one-off projects that can be delivered through low cost operational and capital expenditure (up to a total of 1 per cent of the proposed MAR per year). AEMO plays a part in prioritising the projects to deliver best value for money for consumers.

Under the NCC, a TNSP is required to submit, as part of the STPIS component of its revenue proposal, a network capability incentive parameter action plan (NCIPAP). The TNSP must consult AEMO in developing the NCIPAP.

The NCIPAP must outline the key network capability limitations on each transmission circuit or load injection point on the TNSP's network. The TNSP would also include a list of projects (priority 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 TNSP will also rank the priority projects based on the likely impact of the projects on customers or wholesale market outcomes in descending order. AEMO's role will include prioritising the projects that will deliver best value for money for consumers and ranking those priority projects. The total annual average expenditure of the projects listed cannot exceed 1 per cent of the MAR proposed by the TNSP.

The AER will take into account the factors outlined in the scheme when determining whether a target would result in a material benefit, including the likely benefits to the wholesale market or to customers. A material benefit in this sense takes into account the effect the achievement of the target would have on spot price outcomes or improved capability of the transmission system at those times when customers place greatest value on its reliability.

The TNSP will be required to report in each STPIS annual compliance review report on steps taken towards reaching the priority project improvement target, including any measurable improvements in network capability as a result of implementing a priority project.

In the first part of the regulatory control period the TNSP will receive incentive payments equivalent to 1.5 per cent of the MAR to fund projects outlined in the NCIPAP. For the final regulatory year, the AER will assess whether the TNSP has achieved the priority project improvement targets for all the priority projects, based on the annual compliance report following the end of the regulatory control period. If the TNSP has not achieved the priority project improvement targets for the regulatory control period or a priority project costs more than the expenditure outlined in the NCIPAP, then the AER may reduce the incentive payment of the TNSP per project by a proportion of the MAR.

No TNSPs are currently participating in the NCC. SP AusNet will be the first TNSP to be subject to the NCC when its 2014–2017 regulatory control period commences on 1 April 2014. The AER is currently assessing SP AusNet's proposal for the NCC as part of its draft decision on SP AusNet's revenue determination for the 2014–2017 regulatory control period.¹ Directlink and Murraylink are not eligible to participate in the NCC.

ElectraNet recently commenced its 2013–2018 regulatory control period on 1 July 2013. The NCC could not be included in ElectraNet's 2013–2018 revenue determination as at the time it submitted its revenue proposal for the 2013–2018 regulatory control period, version 3 of the STPIS applied. ElectraNet submitted as part of its regulatory proposal, targets and values for the service component and MIC in accordance with version 3 of the MIC. While version 4 of the STPIS was published mid-way through the AER's assessment of ElectraNet's revenue proposal, the Electricity Rules did not allow for the revenue proposal to be amended to include a proposal for the NCC. In ElectraNet's revenue proposal for the 2013–2018 regulatory control period, it sought to include in its forecast operating expenditure the costs associated with network optimisation projects. These projects sought to improve the network capability of certain assets in order to release additional capacity and defer the need for investment. ElectraNet's proposal did not include any information demonstrating the economic case for the costs or benefits. Following a request by the AER, ElectraNet provided one example of a network optimisation project on the Bungama–Hummocks 132kV line.

The forecast operating expenditure of a TNSP is extrapolated from an 'efficient base year' which reflects their efficient opex. The extrapolated costs can be adjusted to allow for a 'step change' where the TNSP faces a new requirement or change in circumstance. ElectraNet considered the operating expenditure costs of the network optimisation projects were not included in their efficient base year operating expenditure. ElectraNet sought to include the network optimisation project costs in its forecast operating expenditure on the basis the costs constituted a step change.

The AER draft decision on ElectraNet's 2013–2018 revenue determination did not accept ElectraNet's proposal as the network optimisation projects costs were not a step change in operating expenditure.² The costs were not driven by an exogenous factor or business restructure.

The draft decision noted that network optimisation projects were the type of projects incentivised under the proposed NCC of the STPIS (at the time of ElectraNet's 2013–2018 revenue determination, the AER's STPIS review was still ongoing). If ElectraNet could demonstrate that the network optimisation projects had an overall positive net present value and were included in the NCC, then these projects should not be included in their operating expenditure allowance as they would be funded via the STPIS.³

Subsequent to this, in its revised revenue proposal for the 2013–2018 regulatory control period, ElectraNet stated it would remove all initiatives aimed at improving network capability transfer from its revenue proposal and would seek to have the NCC applied to ElectraNet in the 2013–2018 regulatory control period.⁴

¹ see <http://www.aer.gov.au/node/19819>.

² AER, 30 November 2012, draft decision - ElectraNet 2013-14 to 2017-2018 revenue determination, Appendix A - apex analysis, p. 285-286, available at <http://www.aer.gov.au/node/16617>.

³ AER, 30 November 2012, draft decision - ElectraNet 2013-14 to 2017-2018 revenue determination, Appendix A - apex analysis, p. 285-286, available at <http://www.aer.gov.au/node/16617>.

⁴ ElectraNet, 16 January 2013 Electranet transmission network revised revenue proposal, p.106, available at <http://www.aer.gov.au/node/16617>.

On 29 May 2013, ElectraNet made a formal application to the AER seeking early access to the NCC in its current 2013–2018 regulatory control period. Subject to the AER's decision on granting early access, ElectraNet would make a proposal to the AER to commence application of the NCC at the start of the second regulatory year of its regulatory control period (1 July 2014).

Powerlink's current 2012–2017 regulatory control period commenced on 1 July 2012. The NCC does not apply as Powerlink's current regulatory control period commenced when version 3 of the STPIS was applicable.

Under the arrangements in the AEMC's rule determination transitional arrangements, the NCC will apply to both TransGrid and Transend from the second regulatory year of their upcoming 2014–2019 regulatory control period. The implementation arrangements also set out the default position of the application of the STPIS in the first regulatory year (known as the transitional year) of both TransGrid and Transend's upcoming regulatory control periods. Under these arrangements, the version of the STPIS which applies in their current regulatory control period will apply in the transitional year of their upcoming regulatory control period unless a different arrangement is set out in the AER's framework and approach paper for TransGrid and Transend's respective revenue determinations for the 2014-2019 regulatory control period.

As the framework and approach paper will not be published until January 2014, the AER considers it is appropriate to set out a preliminary position on the application of the STPIS in the transitional year to ensure there is adequate consideration of the issue and to provide increased regulatory certainty about the application of the STPIS in the transitional year. Thus, it is timely to consider this issue as part of this draft decision on the application of the STPIS.

2.2 TNSP views

2.2.1 Early application of the NCC

Since the NCC was first proposed by the AER in the draft of version 4 of the STPIS, TNSPs have supported the early application of the NCC. In Grid Australia's submission to the draft of version 4 of the STPIS and accompanying explanatory statement, it stated the early implementation of the STPIS would be likely to contribute to the achievement of the NEO and would consider lodging a rule change proposal to allow individual TNSPs to seek early application of the NCC.

ElectraNet considers that, following the changes introduced in the AEMC's final determination, a TNSP is no longer precluded from seeking the early application of any amended STPIS without a rule change. Further, the NCC is sufficiently flexible to allow for the application and participation of a TNSP for a period of less than five regulatory years. Thus, ElectraNet consider it is open for it to participate in the NCC in its current regulatory control period, which is the basis for its application. ElectraNet seek for the NCC to apply from the beginning of the second regulatory year of its current regulatory control period. ElectraNet propose to lodge a NCIPAP with the AER consistent with the requirements of the NCC for the AER to assess and approve. ElectraNet proposed that the AER undertake public consultation on ElectraNet's proposal for a reasonable timeframe of 4-6 weeks.

2.2.2 Application of the NCC in the transitional year

In Grid Australia's submission to the draft of version 4 of the STPIS and accompanying explanatory statement, it proposed that the STPIS continue to apply to TNSPs during the transitional arrangements. For the NCC, Grid Australia proposed it apply from the start of the next regulatory control period, with the TNSP's NCIPAP submitted and approved prior to the start of that regulatory

control period. This could be ratified in the revenue determination if required to formalise the incentive.

2.3 Assessment Approach

2.3.1 Early application of the NCC

As explained in chapter one of this draft decision, the AER considers that the removal of clause 6A.7.4(f) of the Electricity Rules in the AEMC's final determination gives the AER the discretion to determine whether or not an amended STPIS will apply during a TNSP's current regulatory control period.

The AER considers that the use of the discretion to apply the NCC to TNSPs in their current regulatory periods should be informed primarily on whether the early application would contribute to the achievement of the NEO. The AER agrees with ElectraNet that the NCC is sufficiently flexible to apply for less than five regulatory years. We consider that if early application of the NCC is likely to assist in the achievement of the NEO, then the AER should promote the early application of the NCC by TNSPs where it is practicable to do so.

In determining whether it is practicable to allow a TNSP early application of the NCC in its current regulatory control period, the AER has considered the following factors:

1. the time remaining in a TNSP's current regulatory control period
2. the time and resourcing requirements of the TNSP in preparing a proposal
3. the time and resourcing requirements of AEMO in reviewing the TNSP's NCC proposal; and
4. the time and resourcing requirements of the AER to assess (including consultation timeframes) and approve the TNSP's proposal.

2.3.2 Application of the NCC in the transitional year

Like the AER's approach to the assessment of the early application of the NCC, the AER considers the primary consideration in determining whether the NCC should apply in the transitional year be informed by whether it would promote the NEO and if so, whether it is practicable to do so.

2.4 Reasons for AER decision

2.4.1 Early application of the NCC

For the following reasons, the AER considers that the early application of the NCC supports the NEO such that the NCC will be applicable to ElectraNet and Powerlink in their current regulatory periods on an 'opt-in' basis. The AER's proposed timeframes for ElectraNet and Powerlink to submit a proposal for the NCC and the assessment guidelines are set out below.

Benefits of early application

When the MIC was introduced in version 2 of the STPIS, early application of the MIC was only possible through a rule change proposal to the AEMC due to clause 6A.7.4(f) excluding the application of an amended STPIS to TNSPs in their current regulatory control periods. In the AEMC's consideration of the rule change proposal by Grid Australia for the early application of the MIC to

TNSPs, it outlined that the NEO was founded on the concepts of economic efficiency, regulatory certainty and reliability, safety and security priorities.⁵

As outlined in the AER's explanatory statement accompanying draft version 4 of the STPIS, we consider the NCC promotes the NEO and economic efficiency by promoting greater value out of transmission networks in the long term.⁶ Under the NCC, TNSPs are incentivised to identify the limitations on their networks which can be improved through minor operational and/or capital expenditure for the benefit of users of the network. This promotes economically efficient outcomes through the maximisation of network capability that is valued by customers or improved wholesale market outcomes at least cost. Improved wholesale market outcomes should ultimately be passed onto consumers. Thus, the early application of the NCC would promote economic efficiency in the NEM. An AER decision on the early application of the NCC to TNSPs would also promote regulatory certainty. The removal of clause 6A.7.4(f) of the Electricity Rules now means there is uncertainty about the availability of the NCC for TNSPs in their current regulatory control period. An AER decision setting out the availability of the NCC to TNSPs during their current regulatory control period, including setting out the AER's assessment and consultation requirements and procedures, would be consistent with regulatory certainty.

Lastly, the early application of the NCC would promote the NEO as it would be consistent with reliability, safety and security priorities. As outlined by the AER's explanatory statement accompanying the draft version 4 of the STPIS, the NCC incentivises increases in the capability of existing assets in the network when most needed as consistent with clause 6A.7.4 of the Electricity Rules, while maintaining adequate levels of reliability.

The AER also considers that the earlier application of the NCC would allow it to assess sooner whether the component, as currently drafted, delivers the benefits outlined and supports the NEO. This will allow the AER to identify at an earlier stage the effectiveness of the NCC and whether further refinements to the component should be made.

Practicability of the early application of the NCC to TNSPs

The AER considers that it would not be practicable for a TNSP nearing the end of its regulatory control period to participate in the NCC. It would be difficult for such a TNSP to prepare a proposal and implement any of the approved projects under the NCC in the time remaining in its regulatory control period. For this reason it would not be appropriate for early application to the NCC to be granted for SP AusNet, TransGrid and Transend, which all have less than 12 months remaining in their current regulatory control period. It would be more appropriate for those TNSPs to commence the application of the NCC in their next regulatory control period.

ElectraNet is currently at the start of the first year of its current regulatory control period and Powerlink is at the start of the second year of its current regulatory control period. Both regulatory control periods go for five years. If the NCC were to apply to ElectraNet and Powerlink from the start of their next regulatory year, then ElectraNet would be subject to the NCC for four years and Powerlink for three years. The AER considers that a minimum period of around three years would be appropriate for the NCC to apply as it would give time for the TNSPs to respond to the incentives of the NCC in a meaningful way. The NCC is ideally designed to run for the length of a TNSP's regulatory control

⁵ AEMC, 10 December 2009, Draft Rule Determination - National Electricity Amendment (Early Implementation of Market Impact Parameters) Rule 2009, p. 9; AEMC, 10 March 2010, Rule Determination - National Electricity Amendment (Early Implementation of Market Impact Parameters) Rule 2010, p. 5.

⁶ AER, 4 September 2012, Explanatory statement - Draft service target performance incentive scheme, p. 38.

period. If the NCC were to apply for less than a period of around three years, it may be problematic for a TNSP to implement all of its approved projects in the small timeframe and will be of limited value.

The AER considers it is unlikely the NCC could apply earlier to ElectraNet and Powerlink, given the time it would take for a proposal under the NCC to be prepared. This would require an assessment and identification of their network limits, the identification of low cost projects to address those limits, the ranking of those projects based on their likely benefits to customers or wholesale market outcomes and consultation with AEMO on the project identification and the ranking of those projects. AEMO would also have to dedicate substantial resources in reviewing a TNSP's proposal to assess the proposed projects and the benefits associated with them. If ElectraNet and Powerlink both seek early application of the NCC to commence in the next regulatory year, then AEMO will have to review both TNSP proposals at the same time. There may also be overlap with its review of TransGrid's and Transend's NCIPAP proposals if the NCC commences in their transitional year.

The NCC expressly excludes the inclusion of the cost of proposed priority projects in a TNSP's forecast operating or capital expenditure. This is to prevent a TNSP being funded for a priority project through both their regulated revenue and NCC incentive payments. However, the assessment of ElectraNet's or Powerlink's NCIPAP in the middle of a regulatory control period may raise concerns about whether the AER can properly assess if the capital or operating costs of any proposed priority projects have already been accepted in a TNSP's forecast expenditure. If the cost has already been included in a TNSP's operating expenditure and the AER approves the proposed priority project, then it will result in the TNSP being compensated twice to undertake the priority project.

We consider this issue should not occur for either forecast operating or capital expenditure. As part of the assessment of a TNSP's NCIPAP, we will review the forecast operating and capital expenditure proposals provided by TNSPs as part of their revenue proposal and review our decision in the TNSP's revenue determination on the approved forecast operating and capital expenditure proposals. We also consider it is unlikely that there will be an overlap with the cost of proposed priority projects. As noted in the explanatory statement accompanying the draft STPIS version 4, the regulatory arrangements outside the STPIS do not incentivise TNSPs undertaking small low cost measures to improve network capability.⁷ Further, as seen in our rejection of ElectraNet's proposed network optimisation projects in their draft 2013–2018 revenue determination, the cost of network capability improvement projects is unlikely to be included in a TNSP's forecast operating expenditure as it would not meet the required criteria of being a step change. We note that there should not be an overlap between the efficiency benefits sharing scheme (EBSS) and approved NCIPAP priority projects. The EBSS aims to provide an incentive for TNSPs to pursue efficiency improvements in opex and to share efficiency gains between NSPs and network users. The EBSS rewards TNSPs that outperform their opex allowance and penalises TNSPs that overspend against their opex allowance. As the cost of NCIPAP projects are not included as part of TNSP's approved forecast operating expenditure, expenditure on NCIPAP projects should be excluded from the EBSS. To this end, a TNSP should record the total opex for its NCIPAP projects separately from its operating expenditure costs in its regulatory accounts

Draft decision and NCC early application timelines

Accordingly, the AER considers that given the significant resources for TNSPs and AEMO in preparing a proposal for the NCC, it would not be appropriate for the AER to mandate the early

⁷ AER, 4 September 2012, explanatory statement - electricity transmission service providers draft STPIS September 2012, p. 35.

application of the NCC for ElectraNet and Powerlink. Instead, the AER's draft decision is that ElectraNet and Powerlink will be allowed to opt-in to the NCC from the next regulatory year via submitting a NCC proposal consistent with the requirements of the NCC for assessment by the AER. ElectraNet and Powerlink may seek to opt-in to the NCC so long as the NCC will be applicable to them for a reasonable period of time. Thus ElectraNet must submit a NCIPAP proposal prior to 1 February 2014 to commence the NCC on 1 July 2014 and allow 3 years to deliver the priority projects. Similarly Powerlink must submit a NCIPAP proposal prior to 1 July 2014, which would allow for a commencement date of 1 January 2015 and give Powerlink 2.5 years to deliver the priority projects.

The AER proposes that if a proposal is made by ElectraNet or Powerlink for the application of the NCC in their current regulatory control period, the following assessment and consultation timeframe be followed:

- the TNSP to submit a NCIPAP consistent with the requirements of version 4 of the STPIS. The NCIPAP should also include written confirmation from the TNSP that the cost of the proposed priority projects has not been included in the approved forecast capital and/or operating expenditure in its current regulatory control period
- a consultation period of 20 business days for submissions from interested parties
- the AER's final decision on the TNSP's proposed NCIPAP to be published within 70 business days of the close of submissions, and
- the TNSP will commence application of the NCC from the start of the next calendar year or next regulatory year following the AER's final decision (whichever occurs first). If the NCC commences at the calendar year, then the NCC incentive payment for that regulatory year will be proportionate to the time the TNSP has been applying the NCC.

2.4.2 Application of the NCC in the transitional year

For the following reasons, the AER's draft decision is that the NCC should apply in the transitional year of TransGrid and Transend. This draft decision is conditional upon confirmation from TransGrid, Transend and AEMO that they will be able to provide a NCC proposal as part of the transitional (place holder) revenue proposal for the transitional year.

For the same reasons outlined in the above section 2.4.1, the AER considers the application of the NCC from the start of the TransGrid and Transend's transitional year instead of the second regulatory year of their upcoming regulatory control periods would support the NEO. The NCC promotes economic efficiency via incentivising TNSPs to improve network capability that is valued by customers or improve wholesale market outcomes at least cost. Improved wholesale market outcomes should ultimately be passed onto consumers. The early application of the NCC in the transitional year would bring forward these benefits to customers on TransGrid's and Transend's networks. A preliminary AER position on the application of the NCC in the transitional year ahead of the framework and approach paper provides increased regulatory certainty for TNSPs, and the NCC is consistent with reliability, safety and security priorities.

Practically, several issues exist which may prevent the application of the NCC in the transitional year for TransGrid and Transend. Firstly, for the NCC to commence operation in the transitional year, the NCIPAP proposal's for TransGrid and Transend may have to be assessed prior to the proposed MAR for both TNSPs being submitted. The transitional arrangements provide for the AER to make a transitional (place holder) revenue determination (place holder determination) by March 2014 for the

transitional year. The proposal for this place holder determination is to be submitted by 31 January 2014. The revenue approved in the place holder determination will be reconciled as part of the AER's revenue determinations for both TransGrid's and Transend's 2014–2019 regulatory control period. TransGrid's and Transend's revenue proposals for the 2014–2019 regulatory control period are due in May 2014 and the AER's final determination must be completed by the end of April 2015.

The NCIPAP would have to be submitted as part of the transitional (place holder) revenue proposal. As a result, the AER may not be able to make an assessment of the number of priority projects which should be included in the TNSP's NCIPAP, as the number of priority projects cannot exceed 1 per cent of the TNSP's proposed MAR for the regulatory control period.⁸ Further, where 1.5 per cent of the TNSP's MAR is less than 1 per cent of their proposed MAR, then the AER must reduce the number of priority projects until their total cost is less than 1.5 per cent of the TNSP's MAR.⁹

We consider this first issue can be addressed through the adoption of an approach suggested in Grid Australia's submission to have the NCIPAPs of TransGrid and Transend approved as part of the transitional (place holder) determination and ratified in the revenue determination. The AER would assess and approve the number of priority projects based on an estimate of the TNSP's proposed MAR provided as part of the NCIPAP. However this would be updated in the revenue determination to account for differences between the proposed MAR and actual MAR approved. This includes the removal of priority projects where the total cost of all priority projects exceeds the 1 per cent of the TNSP's proposed MAR or where 1.5 per cent of their MAR is less than 1 per cent of their proposed MAR. Further, the AER may also include additional projects as priority projects where the estimated proposed MAR in the NCIPAP is less than the proposed MAR of the TNSP in its revenue proposal. To account for the circumstances where the AER has to include additional projects as priority projects, the TNSP should include in its NCIPAP additional projects that the AER can include as additional priority projects. For the additional projects, the TNSP must consult AEMO in the same way it is required to consult with AEMO for priority projects under clause 5.2(h) of the STPIS. We consider this should not result in significant additional work for AEMO or the TNSP as these additional projects would likely be projects which the TNSP had identified as potential priority projects and would have to consult with AEMO as to whether they should be classified as a priority project.¹⁰

Secondly, both TransGrid and Transend must be able to prepare a NCC proposal consistent with the requirements of the NCC for the AER to assess in time for start date of 1 July 2014. This requirement means that TransGrid and Transend have to submit their capital expenditure proposals to AEMO as part of the consultation process between the TNSP and AEMO. TransGrid and Transend will also need to confirm that the priority projects listed in their NCIPAP will not be included in the capital or operational expenditure proposed in their revenue proposals. This timing is likely to mean that AEMO will be required to consult on TransGrid's and Transend's NCC proposals at the same time as it is considering ElectraNet, which has indicated its preference is to have the NCC apply to them from 1 July 2014. The AER seeks the confirmation from TransGrid, Transend and AEMO on whether they are able to meet these timeframes prior to the final decision being made. We also seek confirmation from TransGrid and Transend that they can provide AEMO with an advanced version of their capital expenditure proposals and confirmation the projects will not be included in the capital or operational expenditure proposed in their revenue proposals.

⁸ clause 5.2(b)(2), STPIS version 4.

⁹ clause 5.2(p), STPIS version 4.

¹⁰ clause 5.2(h)(3), STPIS version 4.

Preliminary position on application of the NCC in the transitional year and proposed application timelines

Accordingly, the AER's preliminary position is that the NCC should apply to TransGrid and Transend from the start of the transitional year, commencing 1 July 2014, for their upcoming 2014–2019 regulatory control period. The proposed assessment and consultation timeframes are outlined below:

- TransGrid and Transend will submit as part of their transitional (place holder) revenue proposals, due 31 January 2014, a NCIPAP for the 2014–2019 regulatory control period for assessment by the AER. As part of their NCIPAP submission, TransGrid and Transend must submit an estimated proposed MAR to be used to determine the number of priority projects in their NCIPAPs
- A consultation period of around 15 business days for submissions from interested parties.
- AER decision on the NCIPAPs to be published by 31 March 2014 as part of the transitional (place holder) determinations for TransGrid and Transend, and
- AER decision on the number of priority projects in the NCIPAPs for TransGrid and Transend to be updated in the 2014–2019 revenue determination to account for:
 - differences between the estimated proposed MAR submitted at the time of the NCIPAP proposal and the proposed MAR submitted in the revenue proposal, and/or
 - the circumstances where 1 per cent of the approved MAR is greater than 1.5 per cent of the proposed MAR.

The 2014–2019 revenue proposals for TransGrid and Transend are due May 2014 and the AER's final determination on those revenue proposals must be completed by April 2015.

2.5 Timing of NCC incentive payments

The NCC provides an incentive payment of 1.5% of the TNSP's MAR in each regulatory year. TNSPs have recently approached the AER seeking confirmation on how the incentive payments should be incorporated into their MAR for each regulatory year.

The MAR for each regulatory year of a regulatory control period is calculated in accordance with the Electricity Rules and the TNSP's transmission determination. The MAR includes any financial incentive adjustments resulting from the STPIS in the previous calendar year.

We can confirm that the NCC incentive payments should be treated as a financial incentive adjustment to a TNSP's MAR. Accordingly, consistent with incentive payments received under the service component and MIC, it should be included in the MAR as a financial incentive adjustment resulting from the STPIS in the previous calendar year. Further, while in most regulatory years the NCC incentive payment is fixed and could be incorporated into a TNSP's annual allowed revenue earlier, the incentive payment in the final regulatory year is determined following an assessment by the AER of the TNSP's performance against the NCC for the regulatory control period. Thus, it would be preferable that NCC incentive payments be treated in the same manner as other financial incentive adjustments.

Appendix D of the STPIS provides further information on the adjustment of a TNSP's MAR to account for STPIS incentive payments. This includes a worked example of the adjustment of the MAR to account for service component, MIC and NCC incentive payments.

2.6 AER draft decision

Draft decision 2.1: the AER accepts ElectraNet's proposal to opt-in to the NCC of version 4 of the STPIS from its next regulatory year (2014-2015).

Draft decision 2.2: the AER will allow Powerlink to opt-in to the NCC of version 4 of the STPIS should it choose to do so. Should Powerlink opt-in, Powerlink must submit a NCIPAP prior to its next regulatory year (2014-15).

Draft decision 2.3: the AER will apply the NCC of version 4 of the STPIS to Transend and TransGrid during their transitional year, subject to confirmation from the TNSPs and AEMO.

Draft decision 2.4: the AER confirms that NCC incentive payments should be treated as a financial incentive adjustment when being incorporated into a TNSP's MAR.

3 Market impact component

This chapter sets out the AER's draft decision on the application of the revised MIC to:

- ElectraNet, Powerlink and Murraylink during their current regulatory control period;
- Transend and TransGrid during the transitional year of their upcoming regulatory control periods.

3.1 Background

The MIC provides an incentive to TNSPs to minimise planned transmission outages that can affect wholesale market outcomes. It measures the number of dispatch intervals where an outage on the TNSP's network results in a network outage constraint with a marginal value greater than \$10/MWh.

The MIC operates as a bonus only scheme which provides a TNSP with a payment of up to 2 per cent of its MAR in each calendar year. A TNSP receives the full 2 per cent payment if it can reduce the number of dispatch intervals with a marginal value greater than \$10/MWh to zero. The payment that a TNSP receives in each year is calculated by measuring the TNSP's annual performance (on a calendar year basis) against its target. There is no revenue at risk for the TNSP where the performance count is higher than the target.

Table 3.1 shows the performance count for each participating TNSP to date. The performance count (bolded) is compared to the performance target for each TNSP. On balance, most TNSPs have outperformed (i.e. been under) their performance targets.

Table 3.1 Performance count versus target

TNSP	Performance	2004	2005	2006	2007	2008	2009	2010	2011	2012		
TransGrid	Count	1437	3840	2721	3425	-	-	1149*	780	872	737	
	Target	-	-	-	-	-	-	1428**	2857	2857	2857	
Powerlink	Count	-	2153	3673	1702	179	143	1502	11`	37	6	0
	Target	-	-	-	-	-	-	830	740``	1570	785	785
SP AusNet	Count	-	-	1151	2542	3136	1439	2088	-	1573^	1246	
	Target	-	-	-	-	-	-	-	-	869^^	2072	
ElectraNet	Count	-	2025	2509	2427	1835	515	1762	1388	4487		
	Target	-	-	-	-	-	-	-	1862	1862		

*Measure commenced on 1 July 2009

** Annual performance target was 2857, so the target for six months was half of this (1428.5)

` Powerlink's start date was 13 July 2010. 2010 performance was based on 172 days and performance target was 740. The performance count for this period was 11. For the first half of the year the count was 1502.

`` Annual performance target was 1570 using 2005 to 2009 data.

^ Measure commenced on 1 August 2011

^^ For the period from 1 August 2011 to 31 Dec 2011

SP AusNet, TransGrid, Powerlink and ElectraNet are all currently subject to the MIC under versions 2 and 3 of the STPIS.¹¹ Murraylink is subject to the MIC (as set out in version 3) for the first time from 1 July 2013. SP AusNet is currently mid-reset, with the revised MIC to apply in the first year of its 2014-15 to 2016-17 regulatory control period. Transend will commence participation in the MIC during its next regulatory control period, as will Directlink.

3.1.1 Version 4

During the 2012 review of the scheme, the way in which the targets for the MIC were set and performance measured was amended. Targets had been set using an average of the counts over the five years prior to the regulatory control period, with the same target applying for the duration of the regulatory control period. Performance was measured against the target on a calendar year basis. Under the current version of the scheme, the MIC target for a calendar year is an average of the performance of the previous three years. The rolling target is matched by a two year rolling average performance measure.

The change was designed to reduce the ability for TNSPs to engage in strategic behaviour to influence the outcomes of the scheme. The move to a rolling target and performance measure is designed to reduce the incentive to significantly underperform in one period to facilitate better performance in an adjacent period. The aim of the amendment was to deliver more consistent performance by TNSPs against the MIC.

¹¹ The MIC was unchanged in version 3 of the STPIS.

In addition to changing the method by which performance benchmarks are set and performance measured, the AER amended an exclusion clause which excluded the market impact associated with third party outages from a TNSP's performance count. Exclusion clause three of the MIC was narrowed from 'any outages caused by a third party ...' by adding the word 'unplanned' during the final decision. The rationale for this change was that TNSPs were increasingly seeking to exclude coordinated outages, including those associated with construction projects, from their MIC performance counts. The AER considers the exclusion of these types of outages is beyond the original intent of the scheme.

Third party outages are outages taken or caused by third party owners of non-prescribed assets which are connected to a TNSP's prescribed network. These arrangements are usually governed by connection agreements between the parties. When undertaking maintenance of their non-prescribed asset, third parties frequently request that connecting prescribed assets are taken out of service. The AER considers that, where third parties request a TNSP to take a planned outage of its prescribed asset associated with the party's non-prescribed asset, the TNSP has significant influence over the timing of that outage. Accordingly, we consider that it is appropriate that TNSPs are incentivised to ensure these outages occur during periods when there is less likely to be a market impact. The AER considers it is appropriate to continue to exclude unplanned outages originating on third party equipment (which affect prescribed assets) due to the fact these are outside of TNSPs' control.

The AER acknowledges this change was not adequately discussed in the final decision document.

3.2 ElectraNet Proposal

ElectraNet's proposal did not request, or express a view on, the early application of the MIC of version 4.

In Grid Australia's submission to the AER's draft decision on the STPIS, it proposed that the new MIC from version 4 apply from the transitional year for Transend and TransGrid. Grid Australia considered that the revised MIC could be applied from the start of the upcoming regulatory period as targets are based on rolling average periods and are not set in the revenue determination.

3.3 Assessment Approach

In determining whether to require a TNSP to implement the revised MIC during its current regulatory control period, the AER has considered the following factors:

- the benefits of the early application of the revised MIC, and
- the time and resourcing implications of the TNSP to move to the revised MIC.

3.4 Reasons for draft decision

Benefits of early application

Amending the performance target and measure provide a tighter incentive on TNSPs to ensure outages on their prescribed assets have a limited impact on wholesale spot market outcomes. This benefits market participants and end users more broadly through reduced spot price volatility.

The AER amended the MIC to take into consideration the ability of TNSPs to strongly influence their performance against the parameter. The AER had identified that around 80 per cent of outages affecting the MIC result from planned maintenance, which can be varied to significantly influence

performance against the MIC. The AER considered that this high level of control over market impacts flowing from outages may have allowed TNSPs to engage in strategic behaviour to influence the outcomes of the scheme. The controllability of outages that affect market impact was higher than anticipated when the scheme was first designed.

As a result, there was a disjoint between the historical performance that was used to set a fixed target for the duration of a TNSP's regulatory control period, and the TNSP's most recent performance which is closely linked to TNSP activities.

A rolling three year performance target ensures the benchmark is more relevant to TNSP's current maintenance and construction activities. A rolling performance target and measure provides a higher incentive for continual improvement in the performance against the MIC to receive a financial reward than a fixed target. Similarly, amending exclusion clause three maintains the incentive for TNSPs to influence the timing of third party planned outages to reduce the likelihood of wholesale market impacts.

The practicalities of early application of version 4

Under the new MIC, targets are not formally set as part of the revenue determination process.¹² Once the transition to the revised MIC has been achieved, the targets for a calendar year are set on an automatic basis (as the average of the previous three years' performance measure). The AER will confirm a TNSP's performance target for a calendar year upon endorsement of the TNSP's performance against the MIC for the previous calendar year (i.e. the target for 2015 will be confirmed upon the AER's annual compliance review of a TNSP's performance results for 2014).

We consider that transitioning from the previous version of the MIC to the current version of the MIC does not impose significant costs. TNSPs currently subject to the MIC (namely ElectraNet, TransGrid and Powerlink) would need to review performance counts previously excluded pursuant to exclusion clause 3 to determine whether the relevant third party outage was planned or unplanned. The AER does not consider the amendment to exclusion clause 3 will materially disadvantage TNSPs. TNSPs' historical performance counts will be revised upwards to incorporate previously excluded planned third party outages to set a higher target. As set out above, the AER considers that TNSPs have a strong influence over the timing of planned third party outages.

Application of the revised MIC

In light of the fact that the amendment to historical performance data is relatively minor, and the automated nature of target setting, the AER considers the change to the revised MIC to be relatively straightforward for TNSPs to implement. Accordingly, the AER considers that ElectraNet, Powerlink and Murraylink should move to the revised MIC from the beginning of calendar year 2014. We also consider that Transend and TransGrid should commence the new MIC during their transitional year.

The revised historic performance data for ElectraNet, Powerlink and Murraylink can be provided to the AER prior to, or as part of, their annual submission of performance against the STPIS in February 2014. Murraylink, ElectraNet, TransGrid and Powerlink would also need to report their performance for the 2013 calendar year against both versions of the MIC. This would allow the AER to confirm the target for the 2014 calendar year during the annual compliance review. Transend will need to provide

¹² Under the new scheme, TNSPs are required to submit available performance counts as part of their regulatory proposal. SP AusNet, for example, was required to submit the performance count for 2011 and 2012 in its regulatory proposal for its 2014-15 to 2016-17 regulatory control period.

its historic performance for 2011 to 2013 prior to, or as part of, its transitional (place holder) revenue proposal. We will audit the results and provide confirmation to Transend of the target for the 2014 calendar year as part of the AER's annual compliance review of Transend's 2013 performance against the STPIS. The performance in the second half of 2014 (the first period where Transend will be subject to the MIC) will be a pro-rated average of Transend's average performance count during the 2013 and 2014 calendar years. The same process would apply to TransGrid, with the exception that TransGrid's performance during the first half of 2014 would be against the previous version of the MIC. This will mean there is an overlap in measuring and incentivising of TransGrid's performance in the first half of 2014.

3.5 AER draft decision

Draft decision 3.1: the AER will apply the MIC of version 4 of the STPIS to ElectraNet, Powerlink and Murraylink from the 2014 calendar year.

Draft decision 3.2: the AER will apply the MIC of version 4 of the STPIS to Transend and TransGrid during their transitional year.

4 Service component

This chapter sets out the AER's draft decision on the application of the service component to:

- ElectraNet, Powerlink and Murraylink during their current regulatory control periods;
- Transend and TransGrid during the transitional year of their upcoming regulatory control periods.

4.1 Background

The service component of the STPIS measures the overall availability of a TNSP's network to transport energy and the reliability of the network. The maximum revenue increment or decrement that a TNSP may earn under the service component is 1 per cent of the TNSP's MAR for the year.

Whether a TNSP receives an incentive payment or penalty for a service component parameter is determined by the TNSP's performance against the relevant target. In addition to setting a target, upper and lower bounds are set (the cap and collar). The cap specifies the level of performance that results in a TNSP receiving the maximum financial reward attributed to a parameter; the collar specifies the level for receiving the maximum financial penalty.

The AER has predominantly set performance targets using five years of historical performance data. The AER takes the mean of the performance data from the previous five years to determine the target for the following regulatory period. The cap and collar applied to the target are generally determined through the use of two standard deviations around the mean.

4.1.1 Version 4

The service component was comprehensively revised when developing version 4 of the STPIS, and was amended to incentivise network reliability by focussing on unplanned outages. The service component was tailored to focus on unplanned outages in order to act as a lead indicator of potential reliability issues and to encourage TNSPs to maintain or improve performance. This involved:

- Replacing the transmission circuit availability parameter with the average circuit outage rate parameter, which measures the average number of times circuits were unavailable during the relevant time period as a result of unplanned outages.
- Narrowing the loss of supply event frequency and average outage duration parameters to focus on relevant unplanned outages; and
- Introducing a new parameter, the proper operation of equipment parameter, which 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.

The AER also brought the service component into greater alignment between TNSPs by standardising inclusions, exclusions, sub-parameters and the weighting of sub-parameters.

4.2 TNSP Proposals

ElectraNet did not apply for early application of the service component in its application; nor did ElectraNet express a view on the issue.

In its submission during the STPIS Review, Grid Australia proposed that, as the service component values are set in the revenue determination, the existing service components for Transend and TransGrid continue for the transitional regulatory year with existing parameters, weightings, targets, caps and collars. The new service component would apply from year 2 in the next regulatory control period.

4.3 Assessment Approach

As expressed elsewhere in the draft decision, the AER considers the latest version of the STPIS should be applied as soon as practicable. In forming its draft decision about the early application of service component of version 4 of the STPIS, the AER gave consideration to the following factors:

- the consequences of changing the service component, namely the requirement to set new targets for the revised parameters; and
- the benefits of the new service component compared to the previous versions of the scheme.

4.4 Reasons for draft decision

Due to the nature of the changes to the service component, TNSPs will be required to re-categorise historic data on performance across each parameter in order to set targets. TNSPs also have to assess whether the standardisation of inclusions, exclusions and sub-parameters affects their historic performance for the other parameters.

By narrowing some parameters, the number of events measured by the relevant parameter has been reduced. This can create challenges in the setting of appropriate targets to ensure that the parameter incentivises consistent improvement or maintenance of TNSP performance. In recognition of this, the AER also amended clause 3.2(h) of the scheme to explicitly provide the AER the flexibility to require a performance target to be based on a period other than five years. The AER indicated that it would determine what period is appropriate to set targets for service component parameters during the reset for the relevant TNSP.

The AER also committed to exploring different methodologies where the normal distribution methodologies traditionally used to set targets, collars and caps may not be appropriate due to the fact that TNSPs may be approaching the natural limit. The AER also considers that alternate methodologies may need to be explored where narrower parameters have smaller data sets.

In these circumstances, the setting of targets, collars and caps for the new service component parameters requires more consideration and collaboration by TNSPs and the AER. Accordingly, the AER considers that this process would be more involved and time consuming than the change to the MIC.

The purpose of the 2012 STPIS review was to identify whether improvements could be made to the STPIS to better deliver its prescribed purpose as described in chapter one. The AER considers that the changes to the service component provide a sharper focus on reliability than previous iterations of the scheme.

All TNSPs are currently subject to the service component of the STPIS (or the service standards in Directlink's case), albeit a different version. In the circumstances where the setting of revised targets, caps and collars would require significant consideration by TNSPs and the AER, the AER considers that this is best undertaken during the revenue determination process.

Accordingly, notwithstanding the AER's view that the revisions to the service component would be beneficial to market participants and end users, the AER does not consider that ElectraNet, Powerlink or Murraylink should move to the latest service component under version 4. The AER also considers that the version of the service component which currently applies to Transend and TransGrid should continue during the transitional year, with values set for the new service component parameters during the full reset process.

4.5 AER draft decision

Draft decision 4.1: the AER considers the service components for ElectraNet, Powerlink and Murraylink should remain unchanged.

Draft decision 4.2: the AER considers the existing service components should continue to apply to Transend and TransGrid during their transitional year and the new service component apply from the second year of the upcoming regulatory control period.

5 Invitation for written submissions

Interested parties are invited to make written submissions to the AER on the draft decision by the close of business **25 September 2013**.

Submissions can be sent electronically to: AERinquiry@aer.gov.au with a title that states "Attention Joanna Gall and Paul Rositano - submission on TNSP STPIS".

Alternatively, submissions can be sent to:

Mr Tom Leuner

General Manager

Wholesale Markets Branch

Australian Energy Regulator

GPO Box 520 Melbourne Vic 3001

Tel: (03) 9290 1444 Fax: (03) 9290 1457

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim, and
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on the AER's website at <http://www.aer.gov.au>. For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy, October 2008 publication also available on the AER's website.

Any enquiries about this explanatory statement, or about lodging submissions, should be directed to AERinquiry@aer.gov.au.