



## **Final position**

# **Service target performance incentive scheme for transmission businesses**

## **Early application of version 4**

December 2013

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Inquiries about this document should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne Vic 3001  
Tel: (03) 9290 1444  
Fax: (03) 9290 1457  
Email: [AERInquiry@acr.gov.au](mailto:AERInquiry@acr.gov.au)

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## Executive Summary

The Australian Energy Regulator (AER) is the economic regulator for transmission and distribution services in Australia's national electricity market (NEM). We are an independent statutory authority. Our powers and functions are set out in the National Electricity Law and National Electricity Rules (the Electricity Rules).

Under the Electricity Rules, we create, maintain and administer the service target performance incentive scheme (STPIS) for transmission businesses. The purpose of the STPIS is to provide incentives to transmission businesses to maintain a high level of service for the benefit of participants in the National Electricity Market (NEM) and end users of electricity.

Last year we concluded a comprehensive review of the STPIS for transmission businesses, publishing a 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 an 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 (version 3 did not include the NCC).

In its application to the AER, ElectraNet considered it possible for the AER to grant a transmission business early access to the new NCC introduced under version 4 of STPIS. It considered this possible because of recent Electricity Rules changes made by the Australian Energy Market Commission (AEMC) in the final determination on the AER's Economic Regulation of Network Service Providers rule change proposal (AEMC final rule determination).

On 14 August 2013, we published a draft decision on the early application of version 4 of the STPIS (draft decision) that set out our approach to the application of parts of version 4 to ElectraNet, Powerlink and Murraylink and our proposed preliminary position on the application of the STPIS in the transitional year for TransGrid and Transend. We sought stakeholder submissions on the draft decision. Six stakeholder submissions were received.

In light of issues raised in stakeholder submissions, we reviewed our position and now consider that the Electricity Rules do not provide us the power to apply an amended STPIS (or part thereof) to a transmission business in its current regulatory control period. Consequently, the AER cannot make a decision on the early application of version 4 of the STPIS.

However, our preliminary views in the draft decision, that in principle we support early application of the NCC and/or MIC components of version 4 of the STPIS remain. Subject to considerations of the detail, we would also be supportive of rule change proposals to enable the early application of these components of version 4 of the STPIS to transmission businesses in regulatory control periods that have already commenced.

Our preliminary position on the application of the STPIS to the transitional year for TransGrid and Transend remains unchanged and is supported by the submissions from stakeholders. That is, the MIC of version 4 and the NCC should apply to TransGrid and Transend during their transitional year. The service component of the scheme which currently applies to TransGrid and Transend should continue to apply during their transitional year and the service component of version 4 of the STPIS should apply from the second year of their upcoming regulatory control periods. This preliminary

position will assist in the AER's preparation of the upcoming framework and approach paper for TransGrid and Transend. The framework and approach paper, as required under the transitional rules, will set out the modifications to be made to the application of the STPIS for the transitional regulatory control period for TransGrid and Transend.<sup>1</sup>

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<sup>1</sup> National Electricity Rules, clauses 11.58.3(a)(3) and (g)(1), and 11.58.4(m).

# 1 Early application of version 4 of the STPIS

This chapter sets out our final position on the early application of version 4 of the STPIS to transmission businesses in their current regulatory control period. We consider that the Electricity Rules do not provide the AER with the power to apply version 4 of the STPIS a transmission business in its current regulatory control period. This chapter sets out the reasons.

## 1.1 Background

### Version 4 of the STPIS

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

- the current service component parameters were amended to facilitate measurement of lead indicators of the deterioration of network reliability. The service component was brought into greater alignment between transmission business through standardisation of definitions, exclusion clauses and weightings for parameters.
- the setting of targets and measurement of performance for the market impact component (MIC) was changed to encourage consistency in transmission business 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 (NCC), 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 provide an incentive for transmission businesses' to develop one-off, low cost operational and capital expenditure projects, up to a total of 1 per cent of the proposed MAR per year, to improve the operation and management of its network assets. 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

Our 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 transmission businesses 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 transmission business's performance parameters, were removed as part of the amendments to Chapter 6A.

## Transmission business regulatory control cycle

Transmission businesses 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 - 1 April to 31 March)
- 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 an application to the AER seeking early access to the NCC during its current 2013–2018 regulatory control period. ElectraNet considers the changes to the Electricity Rules in the AEMC's final determination allow transmission businesses to seek the early application of any amended STPIS without a rule change.

### 1.3 AER draft decision

In the draft decision, we agreed with ElectraNet that the changes made in the AEMC's final rule determination meant there was no impediment to the early application of the NCC in their current regulatory period. Furthermore, we considered that there was no impediment under the Electricity Rules, or the scheme, to the application of an amended STPIS during the course of a transmission business' regulatory control period. We considered that we now had the power to determine whether or not the amended STPIS (or part thereof) apply during the current regulatory control period for a transmission business particularly because of the removal of clause 6A.7.4(f). We took the view that this discretion was available to us under the Electricity Rules without the need for an application from a transmission business.

Accordingly, we considered that it was appropriate to take a holistic approach to ElectraNet's request. The draft decision proactively considered whether transmission businesses that have already commenced their regulatory control period ought to adopt the latest version of the STPIS and, if so, what aspects of the scheme are to be applied. In assessing this, we considered whether early application of version 4 of the STPIS would support the achievement of the NEO and if so, whether early application of the scheme could be practically implemented.

We considered in the draft decision that, compared to version 3, version 4 of the STPIS provided greater incentives for transmission businesses to maintain and improve network reliability and capability at times when transmission network users have the greatest reliance on the system reliability and on network elements that are important to determining spot prices. Accordingly the early application of version 4 of the STPIS would promote these benefits and support the achievement of the NEO.

Taking into account the practicalities of early application of version 4, we took the position in the draft decision that:

- ElectraNet and Powerlink would 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 would need to submit a network capability incentive parameter action plan proposal prior to its next regulatory year.
- the MIC of version 4 of the STPIS would apply to ElectraNet, Powerlink and Murraylink from the 2014 calendar year.
- the service component of version 4 of the STPIS would not apply to ElectraNet, Powerlink and Murraylink 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 did not intend to amend Directlink's STPIS.

## 1.4 Stakeholder submissions

We received submissions from AEMO, Powerlink and ElectraNet on the early application of version 4 of the MIC and the NCC.

AEMO noted that one of the key benefits of the NCC was that it drove lower capital expenditure through the efficient use of assets. However, as the expenditure of the transmission business had already been set, this benefit of the NCC may not flow through to customers. To prevent this, Network capability incentive parameter action plan (NCIPAP) projects must be shown to provide net benefits to customers, such as through reduced congestion, improved reliability or deferred investment in the next regulatory control period.

AEMO also noted that the timeframe proposed by the AER to assess the NCIPAP's for ElectraNet and potentially Powerlink, in addition to those from TransGrid and Transend, may make it difficult for AEMO to properly review the priority projects proposed. It requested that the AER inform AEMO as soon as possible of any change to the timeframes proposed in the draft decision.

Powerlink stated that having considered its current business practices, regulatory arrangements and the potential impact on electricity customers, it would seek not to opt-in early to the NCC of version 4 of the STPIS.

Powerlink opposed the early application of the MIC of version 4 from the start of the 2014 calendar year for the following reasons:

- it noted that the STPIS arrangements applicable to its current regulatory period were established under version 3. A fundamental component of version 3 was the requirement that amendments to the STPIS could not apply to a transmission business for a regulatory control period unless it was promulgated no less than 15 months prior to the commencement of that regulatory control period. Accordingly, when version 3 of the STPIS was published on March 2011, there was a reasonable expectation and confidence that these arrangements would apply to Powerlink for the duration of the regulatory control period.
- it considered that it was not good regulatory practice for the AER to use its discretion to require that incentives applicable to an existing regulatory control period be changed within a regulatory period. For a business to respond to an incentive, it is important that the scope of the incentive be known up-front and a business be provided with confidence that the incentive be maintained.



- it stated that the draft position to apply the MIC of version 4 creates a clear inconsistency in the AER's approach to incentives. This arises as the AER has determined expenditure allowances for Powerlink based on one set of incentives but now proposes that Powerlink's actual performance be measured against a different target and be set on a different basis.
- it noted that the AEMC rule determination explicitly excluded Powerlink from the transitional arrangements and did not require them to be subject to the new rules from the commencement of their next regulatory control period. Such a position is in line with the AEMC's view to promote confidence in the regulatory framework and provide regulatory certainty.

ElectraNet supported the AER's draft decision allowing ElectraNet to opt-in to the NCC during its current regulatory control period.

ElectraNet did not support the mandatory early application of the MIC of version 4 from the start of the 2014 calendar year. It considered that mandatory early application of an amended component would undermine the incentive properties of the STPIS and regulatory certainty for transmission businesses. This would also be a departure from the established practice of establishing revenue parameters and incentive arrangements for the applicable regulatory period at the time of the revenue determination. Further, the application of the MIC of version 4 would also be inconsistent with ElectraNet's revenue determination for its current regulatory control period and the AER final decision of version 4 of the STPIS.

However, ElectraNet noted that in seeking the early application of the NCC on a voluntary basis, it was reasonable that other amended components of the STPIS could also be applied. For this reason, it accepted that should it opt-in to the new NCC, the new MIC arrangements should also apply.

## 1.5 AER reasons

Following the concerns raised in Powerlink and ElectraNet's submissions about the early application of version 4 of the MIC, and in particular Powerlink's submission opposing changes to the incentives within a regulatory period, we undertook a reconsideration of our powers to apply a STPIS outside of a regulatory determination. In the course of doing so, we reconsidered the AEMC's final rule determination and the effect of the removal of clause 6A.7.4(f), specifically whether the removal of this provision enabled the AER to now apply a STPIS other than at the time of a revenue determination. We informed each of the affected businesses of the reconsideration we were undertaking and held discussions if requested.

From this review, we have concluded that we do not have the power to apply an amended STPIS (or part thereof) to a transmission business in its current regulatory period. Therefore, it is not appropriate for us to consider the early application of version 4 of the STPIS. The reasons for the change in our position are set out below.

The STPIS which applies to a transmission business in a regulatory control period forms part of its revenue determination for the regulatory control period. In a revenue proposal, a transmission business must include the values that the transmission business proposes are to be attributed to the performance incentive scheme parameters for the purposes of the application to the transmission business of any STPIS (Clause 6A.4.1, Schedule 6A.1). Clause 6A.4.2(a)(5) of the Electricity Rules requires that the AER in making a transmission businesses' revenue determination set out the values of the parameters of the STPIS which applies for the regulatory control period. Furthermore, clause 6A.14.1(iii) of the Electricity Rules specifies that a draft decision or final decision by us on a transmission business revenue determination includes a decision on the values attributed to the STPIS that applies to the transmission business for the regulatory control period. We must approve

the values proposed by a transmission business if they comply with the requirements set out in the STPIS.<sup>2</sup>

Clause 6A.7.4 of the Electricity Rules sets out our powers to make and amend the STPIS, and the principles to which the STPIS should adhere. Prior to the recent amendments to the Electricity Rules that took effect on 29 November 2012, this included a limitation on when an amended STPIS could be applied to a transmission business. The limitation prevented the AER from applying an amended STPIS to a transmission business if the amendment occurred within 15 months of the commencement of the business' regulatory period. As that limitation no longer applies with the removal of clause 6A.7.4(f), the AER could now apply a STPIS that was amended just prior to a commencement period. However, that change to the version of a STPIS applied to a transmission business at the time of the commencement of a regulatory period, did not affect when the AER can apply a STPIS.

Accordingly, the Electricity Rules only provide for the STPIS to be applied to a transmission business in a regulatory control period via the revenue determination process set out in chapter 6A. This is consistent with the AEMC's final rule determination.<sup>3</sup> Our final decision on the values of the STPIS parameters proposed in the revenue proposal or revised revenue proposal forms part of the transmission business' revenue determination for the regulatory control period. These parameter values and the associated underlying version of the STPIS are set for the regulatory control period.

The early application of the MIC of version 4 or the NCC to a transmission business in its current regulatory control period would amount to a change to the version of the STPIS which is specified in the revenue determination to apply to a transmission business and the associated parameters' values. As a consequence, the MIC of version 4 or the NCC could only apply to a transmission business in its current regulatory control period if there was scope in the Electricity Rules to allow for the application of an amended STPIS (or part thereof) during the course of a regulatory period.

We note that there are limited grounds in the Electricity Rules in which a transmission business' revenue determination can be amended during a regulatory period. These are set out in rule 6A.15 of the Electricity Rules. However these grounds, which apply only in certain circumstances, are not applicable here.

## **1.6 AER still supportive in principle of early application**

Despite the conclusion that the Electricity Rules do not provide scope to apply an amended STPIS to transmission businesses in the current regulatory control period, as a matter of policy, our initial view, as reflected in the draft decision document, is that we would support the early application of the MIC of version 4 and the NCC. As stated in our draft decision, we consider the early application of both components would support the achievement of the NEO.

The early application of the MIC of version 4 would bring forward tighter incentives for transmission businesses to ensure outages on their prescribed assets have a limited impact on the wholesale market. This benefits market participants and end users through reduced spot price volatility.

The early application of the NCC would bring forward economically efficient investment outcomes that maximise network capability via low cost projects that are valued by customers or provide improved wholesale market outcomes at low cost. Ideally these improved wholesale market outcomes should ultimately be passed onto consumers through reduced wholesale electricity costs.

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<sup>2</sup> National Electricity Rules, cl. 6.14.3(d)(1).

<sup>3</sup> AEMC, Final Determination - Economic Regulation of Network Service Providers, 29 November 2012, p. 245-7.

We note that the early application of the NCC for transmission business in their current regulatory control period could still be achieved through a rule change. In 2010, the AEMC made a rule change determination to allow transmission businesses early access to the MIC when it was first introduced in version 2 of the STPIS. Given we still consider the early application of the NCC would promote the achievement of the NEO, subject to consideration of the detail, our initial view is for in principle support should a rule change be proposed to allow transmission businesses early access to the NCC.

If a rule change proposal to allow for the early access of the NCC was successful, we agree with the position put by AEMO in this process that, the NCIPAP projects of the transmission business must be shown to provide net benefits to customers, such as through reduced congestion, improved reliability or deferred investment. The STPIS requires that all NCIPAP projects and their priority project improvement targets result in a material benefit.<sup>4</sup>

## 1.7 Final position

**1.1:** The AER has reconsidered its position and concluded that it does not have the power under the Electricity Rules to apply an amended STPIS to a transmission business during the course of a regulatory control period.

**1.2:** The AER considers that as a result it cannot consider the early application of version 4 of the STPIS

**1.3:** The AER affirms the initial view as set out in the draft decision document that the early application of the MIC of version 4 and/or the NCC would support the achievement of the NEO.

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<sup>4</sup> STPIS version 4, cl. 5.2(c).

## 2 Application of the STPIS in the transitional year

This chapter sets out our final preliminary position on the application of the STPIS in the transitional year of TransGrid's and Transend's upcoming regulatory control periods.

### 2.1 Background

#### New Economic Regulation of Network Service Providers rule change

The AEMC's final rule determination amended Chapter 6A to lengthen the determination process (by 4 months) for transmission businesses 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.

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 modify the application of the STPIS through the framework and approach paper to be published in January 2014.<sup>5</sup>

### 2.2 Draft decision

In the draft decision we considered that a preliminary position on the application of the STPIS in the transitional year should be developed as part of our decision on the early application of version 4. This was to ensure that proper consideration was given to the application of the STPIS in the transitional year.

We considered that bringing forward the application of version 4 of the STPIS would 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.

Accounting for the practicalities associated with transitioning to the revised scheme, the draft decision took the following proposed preliminary position on the application of the STPIS in the transitional year:

- the MIC of version 4 would apply to Transend and TransGrid during their transitional year
- the NCC would apply to Transend and TransGrid during their transitional year. This would be subject to confirmation from the transmission businesses and an assurance from AEMO that the assessment timeframes set out in the draft decision can be met. This would allow us to undertake a proper assessment and make a decision on the application's NCIPAP such that the NCC can commence at the start of the transitional year (1 July 2014).
- the existing service component which currently applies to Transend and TransGrid will continue to apply in the transitional year. The service component of version 4 will apply to Transend and TransGrid from the second year of their upcoming regulatory control periods.

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<sup>5</sup> National Electricity Rules, clauses 11.58.3(a)(3) and (g)(1), and 11.58.4(m).

We also requested that TransGrid and Transend confirm that they would provide AEMO with an advanced copy of their capital expenditure proposals so their NCIPAP projects could be appropriately assessed by AEMO and that these projects would not be otherwise included in the capital expenditure in their revenue proposals.

To account for the potential changes in the MAR between the transitional year place holder determination and the revenue determination, the draft decision proposed the following assessment approach for the NCC to TransGrid and Transend in the transitional year:

- 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. There may be a difference in the estimated proposed MAR and the proposed MAR such that additional priority projects can be included. To account for this, the transmission business should include in its NCIPAP additional projects that the AER can include as additional priority projects. For the additional projects, the transmission business 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.
- 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.

## 2.3 Stakeholder submissions

We received submissions from AEMO, Hydro Tasmania, TransGrid and Transend on the application of the STPIS in the transitional year.

AEMO noted it was working collaboratively with transmission businesses to undertake a robust process in accordance with the deadlines proposed in the draft decision. The assessment of Transend's and TransGrid's draft NCIPAPs had already commenced.

Hydro Tasmania welcomed the AER's draft decision to apply the MIC of version 4 to Transend during their transitional year. It considered that the MIC reduced key business risks by making transmission businesses more accountable and incentivising them to minimise planned outages that have the potential to affect the wholesale market outcomes.

Hydro Tasmania noted that, consistent with its earlier submissions to the AER, it continued to support a symmetrical approach to the MIC.

In relation to the NCC, Transend's submission to the draft decision confirmed that:

- the NCC would apply in its transitional year
- it would be able to meet the submission and consultation timeframes pertaining to the NCC outlined in the draft decision
- it would provide AEMO with an advanced version of its capital expenditure profile
- expenditure on projects in the NCIPAP will be excluded from Transend's other capital or operating expenditure in its revenue proposal.

Transend also requested that the AER clarify the timing of NCC incentive payments by providing detailed worked examples equivalent to those it would receive in the next regulatory control period including consideration of the transitional period at the commencement of Transend's 2014-19 regulatory control period.

In relation to the MIC, Transend stated it had substantial concerns regarding the proposed methodology for measuring its annual MIC performance for the periods July 2014 to December 2014 and January 2014 to December 2015. It noted that the draft decision proposed that the performance in the second half of 2014 be measured as the pro-rated average of its average performance count during the 2013 and 2014 calendar years. This was of concern to Transend because it would result in its performance being determined by 18 months of MIC data over which Transend had not been incentivised to manage MIC performance. Similarly, Transend's 2015 calendar year performance would be unduly influenced by 6 months of MIC data over which Transend had not been incentivised to manage its performance.

Transend proposed that its MIC performance in the second half of 2014, and for the 2015 calendar year be measured as its actual MIC performance for those respective periods, and should not be influenced by historical MIC performance data for periods when the incentives did not apply. From the 2016 calendar year, Transend would then have 24 months of MIC data on which to calculate its average performance. This approach would ensure consistency with the approach taken with other transmission businesses at the time of their initial application of the MIC prior to the amendments in version 4 of the STPIS.

Transend supported the draft decision to continue the existing service component in the transitional year.

TransGrid's submission supported the approach in the draft decision on the application of the STPIS in the transitional year. TransGrid noted that it was currently working with AEMO in the preparation of its NCIPAP and should complete it in time to lodge with the transitional revenue proposal. It confirmed that it would provide AEMO with an advanced version of its capital expenditure proposal, and that projects in its NCIPAP will be excluded from capital and operating expenditure forecasts in the revenue proposal.

## **2.4 AER reasons**

For the following reasons, we affirm the preliminary position set out in the draft decision document on the application of the STPIS in the transitional year.

In relation to the NCC, the submissions from AEMO, Transend and TransGrid supported the proposed preliminary position, confirming that they will be able to meet the proposed timeframes in the draft decision. Transend and TransGrid also confirmed that advanced versions of their capital expenditure proposals would be provided to AEMO and that their proposed NCIPAP projects would not be included in their proposed capital or operational expenditure in their revenue proposals.

We note Transend's concerns that application of version 4 of the MIC from the start of their transitional year would result in their performance measure for the 2014 and 2015 calendar years being affected by performance in calendar years where Transend has not been subject to the MIC. However, for the following reasons, we do not consider this would unduly disadvantage Transend.

As Transend has not been subject to the earlier version of the MIC, the initial performance measure of Transend under the MIC of version 4 would be influenced by previous performance in non-incentivised calendar years regardless of when it commences application. Thus, this goes to the design of the amended MIC and is not merely an issue which arises due to the transitional arrangements associated with the new 6/6A arrangements. During the review of the STPIS when it was proposed, no such concerns were raised by Transend as to this aspect of the scheme and we do not consider that it impacts upon their incentives under the MIC. Version 4 of the MIC is a bonus only scheme. Thus, Transend would not be penalised any revenue if its performance measure was negatively impacted by its performance in non-incentivised calendar years.

In addition, in effect Transend is proposing that the MIC of version 2 or 3 apply to it in the transitional year. However, both the MIC of version 2 and 3 specifically exclude the application of the MIC to Transend.

## NCC incentive payment timing

In the draft decision, the AER stated that:<sup>6</sup>

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.

In accordance with this approach, for Transend's 2014–2019 regulatory control period the NCC incentive payments are incorporated into the annual MAR of each regulatory year as follows:

- in 2015, Transend's STPIS incentive adjustment for the 2015–16 regulatory year includes a NCC incentive payment equal to  $0.5 \times 1.5\%$  of its 2014-15 MAR for the period 1 July 2014 to 31 December 2014.
- in 2016, Transend's STPIS incentive adjustment for the 2016-17 regulatory year includes a NCC incentive payment equal to the sum of  $0.5 \times 1.5\%$  of its 2014-15 MAR and  $0.5 \times 1.5\% \times 2015-16$  MAR for the period 1 January 2015 to 31 December 2015.

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<sup>6</sup> AER, Draft decision - service target performance incentive scheme for TNSPs early application of version 4, 14 August 2013, p.18.



- in 2017, Transend's STPIS incentive adjustment for the 2017-18 regulatory year includes a NCC incentive payment equal to the sum of  $0.5 \times 1.5\%$  of its 2015-16 MAR and  $0.5 \times 1.5\% \times 2016-17$  MAR for the period 1 January 2016 to 31 December 2016.
- in 2018, Transend's STPIS incentive adjustment for the 2018-19 regulatory year includes a NCC incentive payment equal to the sum of  $0.5 \times 1.5\%$  of its 2016-17 MAR and  $0.5 \times 1.5\%$  of its 2017-18 MAR for the period 1 January 2017 to 31 December 2017.
- in 2019, Transend's STPIS incentive adjustment for the 2019-2020 regulatory year includes a NCC incentive payment equal to the sum of  $0.5 \times 1.5\%$  of its 2017-18 MAR and  $0.5\% \times 1.5\%$  of its 2018-19 MAR for the period 1 January 2018 to 31 December 2018.
- in 2020, Transend's STPIS incentive adjustment for the 2020-2021 regulatory year includes a NCC incentive payment equal to  $0.5 \times 1.5\%$  of its 2018-19 MAR for the period 1 January 2019 to 30 June 2019 minus any deductions in accordance with clause 5.3 of the STPIS for not achieving the priority project improvement target associated with a priority project.

## 2.5 Final position

**2.1:** The preliminary position for the application of the STPIS in the transitional year is that the NCC and the MIC of version 4 will apply to Transend and TransGrid from the start of the transitional year. The existing service component which currently applies to Transend and TransGrid will continue to apply in their transitional year. The service component of version 4 will apply to Transend and TransGrid from the second year of their upcoming regulatory control periods. The approach to the assessment of Transend's and TransGrid's NCIPAP will follow the assessment approach proposed in the draft decision (summarised in section 2.2 of this final position).

This preliminary position will assist in the AER's preparation of the framework and approach paper. The framework and approach paper, as required under the transitional rules, will set out the modifications to be made to the application of the STPIS for the transitional regulatory control period for TransGrid and Transend.

**2.2:** We have set out the proposed timing of the NCC payments for Transend in its upcoming regulatory control period (assuming it commences application of the NCC in its transitional year).