Major Energy Users Inc.

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Mr Chris Pattas
General Manager
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Australian Energy Regulator
GPO Box 520 Melbourne Vic 3001

By email: Mark.Wilson@aer.gov.au

Dear Mr Pattas

Service Target Performance Incentive Scheme review

The Major Energy Users (MEU) welcomes the opportunity to provide its comments regarding the draft Service Target Performance Incentive Scheme (STPIS).

In its response to the AER Issues Paper on the STPIS the Major Energy Users (MEU) observed that consumers see a well designed STPIS will result in:

> "…less congestion, less price separation between regions, less out-of-merit dispatch and greater uptime of the transmission assets when most needed."

The MEU considers that the draft STPIS will improve TNSP performance in these key aspects.

The MEU also commented that:

> "…rewards [from the STPIS] should be sufficient to drive the service provider to want to improve the service performance, even to the extent that it invests some of the potential reward into achieving the better performance. Where service performance falls, there needs to be a penalty so that there is further incentive for improving performance."

The MEU made these comments because they replicate (as far as possible) the way competitive business operates – increased custom (with associated rewards) is achieved by outperformance and poor performance results in a loss of custom and lower profitability.

The MEU sees that many of the objections raised by the TNSPs by the AER proposals are based on their desire to increase their revenue for the least amount of risk. Unfortunately for consumers, there is no ability to impose on TNSPs the rigors of competition which lead to a need to improve performance just to retain market share. As a result, consumers are expected to make additional payments to achieve improved performance

To a large extent, the AER draft STPIS achieves the benefits of improved performance that consumers value and provide sufficient reward (and penalty) that the TNSPs will desire to improve their performance. The AER has addressed in detail the many aspects that lead to improved performance and attempted to balance these against the resistance the TNSPs have to what they consider increase their risks.

On this basis the MEU supports the draft STPIS and sees that its implementation will lead to better performance by TNSPs but at a significant cost.

Overall, the MEU agrees with the observations made by the AER as it explains its rationale for developing the various elements of the STPIS and for the conclusions that it reaches.

Some concerns regarding the draft decision

1. Duration of unplanned outages. The AER comments

   > "…the duration of an unplanned outage is not important for the [transmission circuit availability] in not important…rather it is the fact that an unplanned outage occurs" (AER Explanatory Document page 21)

   The MEU disagrees. An unplanned outage causes loss of supply to consumers and as a result consumers incur costs. In many cases, the longer the interruption lasts, the greater the cost to the consumer. Also the frequency of unplanned outages also causes considerable cost to some consumers as the restart times for certain plant can last longer than the outage.

   The MEU considers that both the frequency **and the severity** of the outage need to be addressed in the measure.

2. Loss of supply event frequency measures (parameters "x" and "y"). The AER proposal effectively retains the status quo, despite the AER considering there needs to be greater consistency across the STPIS.

   The MEU sees that such measures of frequency of the loss of supply should be benchmarked across TNSPs to drive the outcomes for consumers to reflect best practice. For such benchmarking to occur, the "x" and "y" values need to reflect the degree of meshing of the networks as this would appear to be the reason for there being different values. To this end, the MEU considers that there needs to be some consistency in the "x" and "y" values to reflect the nature of the different TNSP networks.

Reviewing the proposed values for “x” and “y” included for parameter 2 in the Draft STPIS (page 24) there is no consistency at all between the relative values of “x” and “y” for a specific TNSP (eg the ratio between “x” and “y” for SP Ausnet is 1:6, yet for Transend it is 1:10 and for ElectraNet it is 1:4) Equally, there is no relativity between TNSPs (eg, “y” for SP Ausnet – a highly meshed network – is 0.3 yet for ElectraNet – a long skinny network it is 0.2 and for Transend – a mixture of both – it is 1.00.

The MEU considers that the set points of “x” and “y” need to show much more consistency and thereby provide some ability for the AER to benchmark performance between the TNSPs.

3. Capping average outage duration. The AER proposes that the measure of an outage should be capped at 7 days, ie if a duration lasts longer than 7 days then it will be assumed to last only 7 days. This does not reflect the costs to those consumers who suffer a longer outage than 7 days, nor will it reflect the harm a generator has that is constrained off for longer than this period.

   To artificially constrain the duration of any loss of supply to seven days does not reflect the impact on users of the networks and constrains the ability of the AER to benchmark between TNSPs on this measure.

4. Force Majeure (FM). In its Explanatory Document, the AER comments (page 30):

   > “The AER recognises that during force majeure events there is no incentive on TNSPs under the scheme to minimise the time taken to return service to customers due to the existence of standard force majeure exclusions.”

   The MEU agrees with the AER that the inclusion of FM events removes from a TNSP the incentive to bring back supply as soon as possible. Equally, as TNSPs have their revenue set on a revenue cap basis, there is also no incentive to provide service either. The MEU also accepts that an FM event (by definition) is beyond the control of a TNSP.

   From a network user’s viewpoint, their loss of service imposes considerable costs which do not cease merely because there is no network service. Therefore there has to be an incentive on a TNSP to reconnect users as soon as possible. Excluding any incentive (as proposed by the AER) does nothing for users of the network – reporting about the impacts and the efforts of TNSPs merely records the outcomes but does not incentivise a return to full service.

   In a commercial environment, although FM events are generally excluded from performance measures for providers, there is a requirement on the provider to use reasonable endeavours to mitigate the impact of the FM event. The MEU expects that the STPIS to provide some “reasonable endeavours” requirement of TNSPs to reinstall service as quickly as possible.

5. Near miss parameter. The AER comments that it agrees with TNSPs that too many parameters "…can dilute the financial incentive…" (page 31). The MEU recognises that an excessive number of parameters might lead to this outcome, but the number of parameters proposed for the STPIS is quite modest. At the same time, it has to be recognized that there are many causes for the loss of supply and when loss of supply users incur considerable costs.

   The MEU sees that identifying the potential for loss of supply is a forward looking approach to minimizing future loss of supply to users. The decision of the AER to apply a zero weighting for this aspect is an opportunity lost.

6. Market Impact component (MIC). The MEU notes the incentive on a TNSP (due to the program being on a bonus only basis) to load its planned outages into one year (and not incurring any penalty) and to garner a large bonus in the following year because there will be few planned outages. As the AER has rightly identified, this was not the intent of this element of the STPIS While the strategic gaming of the scheme is understood, it is disappointing to see how blatantly the TNSPs manipulated the incentive

   The MEU agrees with the AER that this approach should remove this perverse incentive without having to introduce penalty provisions to counter the bonus possibilities. The AER considers, on reflection, that imposing an asymmetric penalty/bonus scheme (as proposed in its Issues Paper) might not provide the best balance of incentive and outcome. The MEU can see the reasoning behind the AER consideration.

   To address the concern, the AER proposes to use rolling averages (three years for the target and two years for the measure) to overcome this perverse incentive to game the incentive program. Under the new scheme, the target for year N would be the average of years N-4, N-3 and N-2, with the measure being the average of years N-1 and N. The MEU sees that using rolling averages overcomes, to a degree, the incentive to game the scheme and is possibly a better solution overall to imposing a penalty into the scheme.

   The MEU is concerned that using trailing data to set the target so far in the past will not provide an appropriate target for a bonus for the current year, and by not having a common year in both target and measure, there is still potential for gaming the scheme.

   To address the MEU concerns the MEU considers this can be achieved in one of two ways. Firstly, that the target for year N be the average of years N-3, N-2 and N-1, with the measure being the average of N and N-1. Alternatively, the target be the average of years N-4, N-3 and N-2 with the measure being the average of years N-2, N-1 and N.

As noted above, the MEU supports the draft STPIS subject to the comments made above.

The draft STPIS increases the recognition that a bonus has to be earned – it should not be granted merely for continuing to operate the same way as in the past. The competitive market drives the need for continuous improvement just to retain market share and current profits – increased profits have to come as a result of being proactive and taking steps to improve performance.

One of the main criticisms the MEU has with the current STPIS is that it provides a reward for doing little differently to current practice and bonuses are granted just for continuing to perform at current levels. The draft STPIS does impose some requirement (especially the network capability component) to encourage the TNSPs to invest some of the expected bonus from improving service to provide the improved service. The MEU considers that this new parameter is a welcome step forward.

Should you wish to discuss the MEU views expressed in this response in more detail please contact the undersigned at davidheadberry@bigpond.com or on (03) 5962 3225

Yours faithfully

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