Mr Chris Pattas
General Manager
Network Operations and Development Branch
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Dear Chris,

A: Introduction

TRUenergy welcomes the opportunity to comment on the Australian Energy Regulator's (AER) Issues Paper that reviews the "Service Target Performance Incentive Scheme"(STPIS).

The AER's Issues Paper considers a range of issues that relate to the overall performance of the STPIS. Since its inception, the AER has not done any major reviews or made any major changes to the STPIS. As a result, we consider that this review is timely.

The STPIS aims to address the incentives that TNSPs have under the ex-ante revenue-cap to reduce operating costs below forecast levels at the expense of service quality. The scheme is designed to address this incentive by linking TNSPs' performance against service levels measures to their regulated revenues.

The AER Issues Paper covers a broad range of issues that relate to the implementation of the scheme. As part of our response, we do not intend to answer all of the questions that have been raised in the Issues Paper. Therefore, our submission will mainly focus on key issues that impact generators. Nevertheless, we will suggest some changes that improve the way in which the scheme is implemented overall.

B: Key recommendations

TRUenergy proposes the following changes to the STPIS will improve the scheme.
The proposed changes include:

- an increase to at the revenue at risk under the STPIS from 3% to 5%
- making the Market Impact Component (MIC) symmetrical
- adding some "near miss" indicators to the STPIS
- improving the manner in which exclusions are applied to the STPIS
- abolishing the current approach of amending the STPIS
- standardising parameter weights across all TNSPs.

C: Key Issues

1 TRUenergy supports an increase in the revenue at risk in the STPIS from 3% to 5%

TRUenergy supports an increase in the revenue at risk in the STPIS from 3% to 5%.

Currently, we appreciate that 1% of a TNSPs' Maximum Average Revenue (MAR) is at risk under the service component of the STPIS. In addition, we recognise that there is an extra 2% of revenue upside available for TNSPs that achieve their targets under the Market Impact Component (MIC).

We consider that the incentives under the STPIS need to be sharpened. If this change is initiated, then TNSPs will act to improve the service quality they provide on the transmission system. Presently, the ex-ante revenue cap incentivises TNSPs to reduce operating costs below forecast levels at the expense of service quality. In order to deal with this imbalance, we think that the amount of revenue at risk under the STPIS needs to increase.

We realize that the National Electricity Rules (Rules) restrict the maximum increment or decrement of at risk revenue under the STPIS. The revenue at risk under the scheme is restricted to between 1% and 5% of the MAR in any regulatory year. [1] Therefore, we suggest that an appropriate change to the STPIS would involve an increase in:

- the financial bonus or penalty of up to +2/-2% of the MAR under the service component of the scheme
- the financial bonus of up to +3/- 3% of the MAR under the MIC. As such, we request the MIC of the STPIS is made symmetrical.

We recognise that the question of the power of the incentive regime that should apply in monopoly regulation is a complex issue. The question of whether to adopt a low powered regime or move to a much higher powered regime is a difficult balance to get right. Currently, the concern that we have regarding the

[1] Under the National Electricity Rules, the principles which the STPIS should comply with are to:

(3) ensure that the maximum revenue increment or decrement as a result of the operation of the service target performance incentive scheme will fall within a range that is between 1% and 5% of the maximum allowed revenue for the relevant regulatory year;

incentive scheme applied by the AER under the ex-ante- revenue cap is that the benefits of a TNSP under spending its operating costs relative to its forecast levels are likely to exceed its costs. This is especially true given the benign nature of the STPIS. The most effective way to change this is to strengthen the incentive under the STPIS.

2 TRUenergy supports making the MIC symmetrical

TRUenergy considers that the financial incentive of the MIC should be symmetrical.

We support this position because:

- a TNSP is likely to pay more attention to performance targets under the MIC if the scheme is applied in a symmetrical way
- the AER has data available to it now to help it assess the performance of a TNSP under the MIC. In the first regulatory period when the STPIS was applied, this was not available. It meant that the AER could not apply the scheme in a symmetrical way. As data is now available on the performance of TNSPs under the scheme, we see no reason why the MIC should not be applied in a symmetric way.
- the AER discovered evidence that suggests TNSPs possess a higher level of control over market impacts that flow from outages that occur on its network. Unfortunately, the AER claims that the high level of control over market impacts flowing from outages appears to have allowed TNSPs to engage in strategic behaviour. This has influenced the outcomes of the scheme. The AER claims that the scheme was designed to encourage TNSPs to modify their behaviour in order to reduce the market impacts of network outages. Unfortunately, the incentive only scheme under the MIC has lead to this strategic behaviour under the scheme. As a result, we believe the scheme should be applied in a symmetrical way to prevent this behaviour.
- the AER notes that the high level of control and the significant proportion of planned outages which contribute to the MIC. It considers that this can give rise to strategic behaviour under the MIC between regulatory periods.

For these reasons, we suggest that the AER should make the MIC symmetrical. A financial penalty under the MIC would sharpen the incentives under the scheme. This would prevent potential strategic behaviour between regulatory periods.

3 TRUenergy supports the addition of some near miss indicators in the STPIS

TRUenergy supports the addition of some "near miss" to the STPIS.

We consider that "lead" indicators will help us trace the effectiveness of the TNSPs maintenance, operations and training practices. In addition, they have a high correlation to the likelihood of an unplanned outage if not undertaken. As a result, we support their inclusion.

We note the AER's observations in the Issues Paper that suggest transmission networks are inherently reliable. They argue interruptions to supply are rare in transmission, but when they do occur they tend to have a widespread impact. They consider that the infrequency to supply events on the transmission networks makes transmission reliability incentive schemes contentious. Because of this, the AER suggests that it would make sense to broaden the performance indicators currently applied under the service component of the STPIS. They believe it would make sense to add some "lead" indicators to the scheme.

4 TRUenergy supports an improvement in the manner in which the service component parameter exclusions are applied in the STPIS

TRUenergy supports an improvement in the manner in which the service component parameter exclusions are applied in the STPIS.

We recognize that there has been some controversy surrounding the way in which exclusions to STPIS have been sought by some TNSPs in the past. In some cases, the AER has allowed SP AusNet to propose additional exclusions as part of its revenue determination. In addition, the AER notes that there has been a lack of clarity in the definitions of some of the exclusions that apply under the scheme. This has made it difficult to assess whether some applications for exclusions meet the definitions in the scheme itself. In some cases, the AER has used technical consultants to determine whether specific events have satisfied the definitions of each TNSP's "exclusions".

As a consequence of this, we believe that it is time to change the way in which exclusions to the STPIS are implemented under the scheme. In this regard, we welcome the AER's investigations into a number of options to the applications of exclusions under an amended scheme. Overall, we consider that any amended scheme should ensure that exclusions are applied consistently in the different jurisdictions. In addition, we support an improvement in the clarity of the definitions that apply to exclusions in an amended STPIS.

5 TRUenergy supports abolishing the current approach of amending the STPIS

TRUenergy agrees there is merit in abolishing the current approach of amending the STPIS.

We note that that the AER's current flexible approach of applying the STPIS allows TNSPs to change any aspect of the scheme up to 22 months before the next regulatory period. In our view, this results in an inconsistent application of the STPIS.

We support the AER's proposed change that would see it undertake periodic reviews of the scheme. This approach would allow it to undertake a detailed review of the STPIS, including the parameters that apply to each TNSP. In addition, it would help ensure that the STPIS was developed in a more consistent manner over time.

6 TRUenergy supports standardising the parameter weights across all TNSPs

TRUenergy suggests that parameter weights should be standardised across TNSPs.

We cannot see that there is an overwhelming reason for why weightings should vary across TNSPs. We note that the AER suggests that the reasons provided by TNSPs why one parameter should be weighted more heavily than another has in some cases resulted in inconsistencies in the relative weightings between TNSPs. The AER notes that some TNSPs have allocated a greater weighting to the large loss of supply event frequency sub parameter on the basis that this matches customers expectation with respect to reliability of supply. However, one other TNSP has allocated a greater weighting to the small loss of supply event frequency sub parameter on the basis that large loss of supply events will also be counted as smaller loss of supply events.

We consider that the inconsistent approach to parameter weightings in the different jurisdictions is inappropriate. Therefore, we consider that it would be diligent to make the parameter weights across the TNSPs consistent.

D: Conclusion

TRUenergy looks forward to working with the AER in further developing the STPIS.

We propose that the AER incorporate the following changes to the MIC that include:

- an increase to at risk revenue under the STPIS from 3% to 5%
- making the Market Impact Component (MIC) symmetrical
- adding some "near miss" indicators to the STPIS
- improving the manner in which exclusions are applied to the STPIS
- abolishing the current approach of amending the STPIS
- standardising parameter weights across all TNSPs.

Importantly, if the AER decides to adopt the near miss indicators that have been suggested in this paper, then it is likely that the parameter specific weightings may be diluted to a point where they are too weak. In order to deal with this issue, we consider that it is important to increase the aggregate incentive or the at risk revenue as suggested in this paper under the STPIS.

We thank AER for the opportunity to comment on this Issues paper. If you have any enquiries regarding this submission, please feel free to contact Mr. Con Noutso - Regulatory Manager at TRUenergy on Tel: 03 8628 1240.

Regards

Con Noutso
Regulatory Manager
TRUenergy