

**Final decision**

**Electricity transmission network service providers**

**Service target performance incentive scheme**

**August 2007**



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# 1 Introduction

The Australian Energy Regulator (AER) is responsible for regulating the revenues of transmission network service providers (TNSPs) in the National Electricity Market (NEM) in accordance with the National Electricity Rules (NER).

In January 2007 the AER issued its first proposed service target performance incentive scheme (first proposed scheme) and invited submissions from interested parties. The AER received seven submissions in response to the first proposed scheme. A further three submissions did not refer specifically to the scheme, but made general comments on all of the first proposed guidelines, models and schemes that may be relevant to the service target performance incentive scheme.

This final decision sets out the AER's service target performance incentive scheme (scheme) and provides the AER's reasons for the scheme. Its preparation satisfies the AER's obligations under clause 6A.20(e) of the NER.

## 1.1 Rule requirements

Under clause 6A.7.4 of the NER, the AER is required to publish the service target performance incentive scheme by 28 September 2007. The scheme must comply with principles prescribed in the NER at clause 6A.7.4(b).

## 1.2 Purpose and objectives of the scheme

The scheme outlines the approach to setting a service target performance incentive within the transmission determination framework. The objectives of the scheme are to:

- contribute to the NEM objective
- be consistent with the principles in the NER
- promote transparency in the information provided by a TNSP and AER decisions
- assist in setting efficient capital and operating expenditure allowances in transmission determinations by balancing the incentive to reduce actual expenditure with the need to maintain and improve reliability for customers.

The scheme will be a stand-alone document. All substantive service standards provisions will, as far as possible, be included in the scheme rather than in some other guideline. The exceptions to this general rule are that:

- general information that must be included in a TNSP's revenue proposal is specified in the submission guidelines
- service standards-related reporting requirements for annual compliance are contained within the information guidelines.

## 2 The reasons for the scheme

The revenue cap form of regulation allows TNSPs to earn up to a maximum allowed revenue (MAR) within a regulatory year. The MAR is based on forecast efficient costs. During the regulatory control period, a TNSP can maximise its profits by reducing its costs below the forecast levels. While cost reductions could occur because of improved efficiency, they could also result from reduced service quality. A TNSP may have an incentive to maximise its profits at the expense of service quality delivered to customers and the market.

The proposed scheme uses an economic mechanism to address this incentive and affect TNSP behaviour to improve customer and market outcomes relating to service performance. The scheme provides financial rewards for improvements in performance standards and penalties when performance standards decline against a performance target.

The proposed scheme promotes the NEM objective and principles set out in the NER by encouraging TNSPs to consider how customers value their actions and how their investment and operational decisions may affect market outcomes. TNSPs are particularly encouraged to improve reliability of the transmission system at the times most valued by transmission network users and on those elements of the transmission system most important to determining spot prices.

This is achieved through the suite of performance parameters applied to TNSPs, the relative weighting of parameters, the level of revenue placed at risk and the performance targets established for each parameter. These factors in the scheme interact to give incentives to TNSPs to improve service performance.



### **3 Issues raised in submissions and the AER response**

The AER received seven submissions on the first proposed scheme. A further three submissions commented on all of the first proposed guidelines, models and schemes issued by the AER in January 2007. These submissions raised general issues that may be relevant to the service target performance incentive scheme. All of the parties who made submissions are listed in appendix A of this document.

This chapter addresses the issues raised in the submissions and the AER decisions on them. Paragraph 3.7 of this decision addresses an additional amendment designed to improve the scheme's operation.

#### **3.1 Non-compliance with NER requirements**

Several submissions considered that, contrary to clause 6A.7.4 (b) of the NER, the scheme does not:

- place incentives on TNSPs to improve reliability at times valued by users and on those elements of the network important for determining spot prices
- take into account other regulatory obligations
- take into account the age and ratings of assets comprising the transmission system.

##### **Movement towards market impact**

Both the Major Energy Users Inc. (MEU) and EnergyAustralia considered that the scheme does not place incentives on TNSPs to improve reliability at times most valued by users or on those elements of the transmission system most important to determining spot prices. The MEU suggested that there must be a review of previous performance and demand on the networks at times of greatest demand and highest regional spot prices.

Similarly, EnergyAustralia submitted that the AER should undertake further analysis to determine what times are valued most by users. This analysis would need to be done on a business-specific basis to account for specific customer preferences and would need to consider the various factors that influence how different users value reliability. EnergyAustralia suggested that demand could be used as a proxy for users' valuation of reliability at certain times.

EnergyAustralia also noted it would be impossible for the AER to design a parameter defining the EnergyAustralia transmission network elements most important to determining spot prices. This is because EnergyAustralia has no constraint equations within National Electricity Market Dispatch Engine (NEMDE) and by definition cannot affect spot prices.

## **Age and ratings of assets**

EnergyAustralia submitted that the scheme does not take account of the age and ratings of TNSPs' assets and that the age profile of networks and system availability would not be expected to remain constant over time because of investment peaks in the 1960s and 1970s. EnergyAustralia also considered that the AER should consider the types of assets comprising a TNSP's network because these could also affect reliability.

## **Scheme interaction with other incentives and regulatory obligations**

EnergyAustralia argued that the AER should review the incentives offered within the regulatory framework. These frameworks include the:

- *ex ante* capital expenditure framework
- contingent project regime
- efficiency carry-over mechanism
- reduction of EnergyAustralia's proposed replacement capital expenditure in the Australian Competition and Consumer Commission's (ACCC) last revenue cap decision.<sup>1</sup>

EnergyAustralia also submitted that the scheme should consider the New South Wales distribution network service provider licence conditions that currently apply to EnergyAustralia and that the performance targets set in the AER scheme should not present a higher hurdle than those set in these licences.

## **AER response**

### ***Movement towards market impact***

Under clause 6A.7.4(b)(1) of the NER the scheme must provide incentives for each TNSP to:

- provide greater reliability of the transmission system at all times when users place greatest value on the reliability of the transmission system
- improve and maintain the reliability of those elements that are most important to determining spot prices.

To meet this requirement, the AER is continuing to develop market impact of transmission congestion (MITC) parameters for incorporation in the scheme.

In the interim, the AER intends to review the parameters applying to each TNSP before their respective revenue determinations. These reviews will ensure that each TNSP is encouraged to improve reliability at the times valued by users and on those elements of the network most important to determining spot prices.

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<sup>1</sup> ACCC, [\*NSW and ACT transmission network revenue cap decision EnergyAustralia 2004–05 to 2008–09\*](#), Canberra, 2005.

This will be achieved by applying (where appropriate) peak period and critical circuit availability sub-parameters to each TNSP. The AER will consult on the definition of peak periods in the circuit availability sub-parameters. Peak periods may be determined by reviewing the levels of demand on a TNSP's network at particular times.

Amendments to the scheme as a result of these reviews will be finalised at least two months before a TNSP is due to lodge its revenue proposal so that they can be applied during the TNSP's next regulatory control period (under clause 6A.7.4(f) of the NER).

The AER is aware that EnergyAustralia has no constraint equations within NEMDE and cannot affect spot prices. For this reason, the AER does not intend to apply any MITC parameters to EnergyAustralia. The AER will work with EnergyAustralia to further develop suitable parameters for application during its next regulatory control period.

The AER will also ensure that the scheme as a whole continues to address the principles in the NER. In New South Wales, this may involve considering the interaction between incentives applying to TransGrid and EnergyAustralia under the scheme.

#### ***Age and ratings of assets***

Under clause 6A.7.4(b)(6) of the NER the scheme should take into account the age and ratings of the assets comprising the relevant transmission system. The AER considers that the scheme ordinarily considers this by setting performance targets, which it generally calculates by averaging the TNSP's actual performance outcomes over the previous five years. Setting targets in this manner takes account of the age and ratings of a particular TNSP's assets because the targets are calculated by reference to the TNSP's existing network.

The AER recognises that investment peaks can mean that long-term performance history may not be an indicator of future performance. However, this risk is minimised under the scheme because performance targets are generally calculated using data from the previous five years.

Nevertheless, in some circumstances the age or ratings of a network may change significantly over a relatively short period. For example, a TNSP may need to revise the ratings of some of its assets, which may result in the overall ratings profile of its network significantly changing from one regulatory control period to the next. In response to this concern, the AER has amended the scheme to allow adjustments to a TNSP's performance targets where:

- there is a significant change in the age and ratings of the assets comprising a TNSP's network in the period used to calculate targets compared to the next regulatory control period
- it is expected that there will be a material impact on a TNSP's performance as a result of this change.

#### ***Interaction of the scheme with other incentives and regulatory obligations***

Clauses 6A.7.4(b)(4) and (5) of the NER provide that the scheme should take into account:

- the regulatory obligations on the TNSP
- any other incentives in the NER that the TNSP has to minimise capital or operating expenditure.

The AER understands that it needs to balance the regulatory frameworks provided in chapter 6A of the NER and will continue to consider other incentives offered within the regulatory framework when making amendments to the scheme (such as the contingent project regime, the efficiency benefit sharing scheme and the *ex ante* capital expenditure framework).

In developing the scheme and the parameters that apply to each TNSP, the AER will consider whether the scheme creates any obligations on TNSPs to act in a manner inconsistent with jurisdictional regulatory obligations. The AER is not aware of any such requirement or incentive in the current scheme.

Furthermore, the AER does not agree with EnergyAustralia’s submission that the scheme cannot or should not present more stringent requirements than the New South Wales licence conditions set by the Minister for Energy. The Australian Energy Market Commission (AEMC) commented in its determination that the jurisdictional standards and regulatory standards in the scheme serve different purposes<sup>2</sup>:

‘The jurisdictional standards seek to ensure that the network operates at a minimum standard in order to preserve the integrity of the system.

Failure to meet these standards would only be expected in extreme circumstances and the penalty would be a loss of licence for the TNSP. Service standards set in an economic regulation framework, on the other hand, are part of an incentive regime that seeks to ensure that the service delivery of the TNSP meets the service level sought by consumers and the market. To encourage TNSPs to achieve this standard financial rewards and penalties are applied so that the interests of a TNSP are aligned with the market.’

The AER agrees that the service target performance incentive scheme and the jurisdictional standards serve two different purposes. The AER does not consider the scheme will encourage EnergyAustralia to act in a manner inconsistent with its licence conditions.

### **AER decision**

The AER has amended clause 2.5 of the scheme to provide that proposed performance targets may be subject to reasonable adjustment for the expected material effects of any changes to the age and ratings of the assets comprising the TNSP’s transmission system.

No further amendments have been made to the scheme in response to these submissions.

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<sup>2</sup> AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule Determination*, Sydney, 2006, pp. 103–04.

## 3.2 Parameters

### Specific definitional issues

Several submissions raised issues with the definitions of particular parameters in the scheme. The MEU argued that the loss of supply measure should capture all loss of supply events (even if only for a second) as the impact of such an event can cause hours of lost production for a generator or customer.

The Essential Services Commission of South Australia (ESCOSA) submitted that all third party system outages should be thoroughly investigated and agreed between the TNSP and the third party. ESCOSA also considered that the scheme should only exclude planned outages when the TNSP gives customers adequate notice. In South Australia this period should be five days so that, if necessary, the distributor (ETSA Utilities) can meet its notification obligations.

Electricity Transmission Network Owners Forum (ETNOF) provided a definition of system minute that it considers is common across TNSPs. ESCOSA queried why the definition of system minute in ElectraNet's definition of the transmission circuit availability parameter in part 2 of appendix B of the scheme is based on peak demand at entry points and unsupplied energy at exit points.

TransGrid proposed amendments to the parameters currently applying to it under part 4 of appendix B of the scheme.

### Market impact of transmission constraints

Two submissions mentioned the development of MITC parameters. ETNOF indicated that it is willing to assist with the further development of MITC parameters while EnergyAustralia considered that any MITC parameters should not apply to it because the National Electricity Market Management Company (NEMMCO) does not deem it a transmission network for NEMMCO wholesale market purposes.

### AER response

#### *Specific definitional issues*

The AER notes that very short outages can have significant impacts on generators and some customers. However, the loss of supply event frequency parameter should not capture all outages regardless of their duration. The loss of supply frequency parameter encourages TNSPs to reduce the number of outages with a reasonably significant duration. The AER does not consider that the parameter should encourage the level of reliability sought by the MEU, because this may result in all users paying for performance improvements that relatively few users require.

The AER notes ESCOSA's concern about the substantiation of third party system outages. The AER will address this issue during future annual compliance reviews and, where possible, will require TNSPs to substantiate all third party exclusions. The AER also notes ESCOSA's concern that planned outages should only be excluded from performance outcomes where ElectraNet has given customers adequate notice of the outage. The AER agrees that parameters that encourage TNSPs to provide adequate

notice are valid and notes that it is currently considering MITC parameters that may address this issue.

As mentioned above, the AER intends to review the parameters that apply to each TNSP before their respective regulatory control periods. In undertaking this review, the AER will aim to apply a consistent definition of system minute across TNSPs and will continue to work with TNSPs to achieve this. The AER will also assess TransGrid's proposed parameters separately and will make any necessary amendments to the scheme at least two months before TransGrid is due to submit its next revenue proposal. The AER will also review the parameters currently applying to Transend and EnergyAustralia under the scheme.

### ***Market impact of transmission constraints***

The AER has released its issues paper<sup>3</sup> on possible MITC parameters. The AER will work with industry to develop MITC parameters and will keep affected businesses informed of its intentions.

The AER is aware that NEMMCO does not treat EnergyAustralia's assets as transmission assets for the purposes of modelling transmission constraints and does not intend to apply any MITC parameters to EnergyAustralia in the future.

### **AER decision**

The AER has not amended the scheme in response to these submissions. However, it will review each TNSP's parameters and finalise any amendments to the scheme at least two months before these businesses are due to lodge their revenue proposals.

## **3.3 Values**

### **Target and value setting**

ETNOF proposed that the scheme permit adjustments to performance targets for the expected effects of increases or decreases in contingent projects and major refurbishments. ETNOF argued that these adjustments are necessary to maintain the primary focus of the scheme on influencing relatively small expenditures and changes in management practices.

Both the ESCOSA and EnergyAustralia submissions highlighted the importance of obtaining accurate and reliable data for setting performance targets. ESCOSA considered that TNSPs should be required to submit an independent audit certificate that the data used to calculate values is accurate, reliable and recorded consistently. EnergyAustralia noted that weightings for new parameters could be set at zero. This would ensure that the TNSP is not exposed to the risk associated with setting performance targets by reference to inadequate data and would allow the AER to gather necessary data over the next regulatory control period.

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<sup>3</sup> AER, [\*Service target performance incentive scheme—Developing incentives based on the market impact of transmission congestion: Issues paper\*](#), Canberra, 2007.

ETNOF also suggested that for the loss of supply event frequency parameter, the scheme should require performance targets, caps and collars be rounded to the nearest integer number where they are calculated to be non-integer numbers. Non-integer performance targets would make it impossible for a TNSP to achieve its performance target exactly for this parameter in any one year.

### **Reaching the efficiency frontier**

ETNOF is concerned that some TNSPs already have high levels of performance and further improvements may not be possible without compromising the NEM objectives and maintenance and reliability obligations under the NER or jurisdictional licence conditions. ETNOF therefore proposed an amendment to the scheme that would permit TNSPs to propose a sound methodology for determining targets where further improvements are inconsistent with prudent and efficient behaviour.

### **AER response**

#### ***Target and value setting***

The AER does not consider that the scheme should allow adjustments to performance targets for the potential effects of contingent projects and major refurbishments. There is currently some flexibility in the scheme to allow adjustments for capex-related works.

However, an adjustment to performance targets to account for contingent projects is not appropriate. Contingent projects are extremely uncertain in nature and it would be difficult (if not impossible) for the AER to calculate an appropriate adjustment when it is unknown whether the project will go ahead. In addition, it is uncertain whether the inclusion of outages associated with contingent projects will affect performance sufficiently to warrant such adjustment.

The AER is also unconvinced that an adjustment for major refurbishments is warranted. While performance may decline during the refurbishment, presumably the TNSP would experience a subsequent improvement in performance because of the refurbishment. The AER considers that adjusting performance targets for major refurbishments may result in users paying for the refurbishment through the TNSP's opex allowances and then paying again under the scheme for improvements in performance through the financial incentive.

In addition, refurbishments are in the general course of operating a transmission network and it is the intention of the scheme that TNSPs manage these types of outages with minimal interruptions to customers. The AER also considers that deciding what constitutes a major as opposed to an ordinary refurbishment would be problematic, and therefore determining an appropriate target adjustment would be difficult.

The AER notes ESCOSA's concerns about the importance of having robust data to set performance targets, but does not consider that TNSPs should be required under the scheme to submit independent audit certificates. The AER addressed this issue in the first proposed submission guidelines, which require TNSPs to provide verifiable data when submitting revenue proposals. The AER will also continue to review data provided by TNSPs during annual compliance. This should encourage improvements in

data collection and reporting systems and ensure greater confidence in the data provided by TNSPs in their revenue proposals.

The AER notes concerns expressed about applying non-integer number values to loss of supply event parameters and has amended the scheme so that values for the loss of supply event frequency parameters are rounded to the nearest whole event. This will provide TNSPs with achievable performance targets for each year of the regulatory control period. Rounding may result in a minor adjustment to the loss of supply event frequency performance targets, however the AER does not consider that this will substantially affect incentives provided to TNSPs.

The scheme permits TNSPs to propose weightings for each applicable parameter and sub-parameter. The AER will consider whether zero weightings for particular parameters are appropriate at each TNSP's revenue determination and on a case-by-case basis. The AER does not intend to place revenue at risk on parameters where there is insufficient data to calculate performance targets and will apply zero weightings to particular parameters to address data concerns where appropriate.

### ***Reaching the efficiency frontier***

The AER considers that the first proposed scheme addressed the efficiency frontier problem described by ETNOF through a number of mechanisms. Under the first proposed scheme, the AER may:

- apply asymmetric caps and collars to a TNSP's particular parameters
- apply greater weightings to parameters on which a TNSP is able to improve its performance
- allow the use of a longer period than the previous regulatory control period to calculate performance targets.

However, the AER recognises that these mechanisms may not completely address the problem raised by ETNOF. A TNSP may reach a level of performance from which it is virtually impossible for it to improve. For example, a TNSP may reach a level of performance where its historical performance for the loss of supply event frequency parameters is consistently zero. The performance target for this parameter would be zero under the first proposed scheme. This would not be an appropriate outcome because it would be impossible to calculate a collar value for the parameter.

The AER also recognises that there may be circumstances where further improvements in performance may not be possible without compromising maintenance and safety requirements under a jurisdictional regulatory obligation.

In response to ETNOF's concern, the AER has amended the scheme to permit a TNSP to propose a reasonable methodology for determining performance targets when:

- the TNSP's historical performance on the particular parameter has been consistently high over at least every year of the previous regulatory control period



- it is unlikely that the TNSP will be able to improve its performance during the next regulatory control period (or that any potential improvement would be marginal), or any further improvements are likely to compromise the TNSP's other regulatory obligations
- where applicable, the TNSP's proposed performance targets (calculated using this methodology) are not a lower threshold than any performance targets that applied to an identical parameter in the previous regulatory control period (regardless of whether those performance targets were calculated under the old *Service standards guidelines* or the service target performance incentive scheme)
- the proposed method is consistent with the objectives of the scheme.

The AER considers these requirements will address the issues raised by ETNOF.

### **AER decision**

The AER has amended clause 2.5 of the scheme to provide that:

- unless a performance deadband is applied, values for loss of supply event frequency parameters must be rounded to the nearest integer number
- the AER may approve a performance target based on a reasonable methodology in particular circumstances.

## **3.4 Revenue at risk and the financial incentive**

### **Level of revenue at risk**

The MEU submitted that the level of revenue at risk should be increased from 1 per cent of the TNSP's MAR and that the NER explicitly allows TNSPs to select the amount of revenue at risk. The MEU considered that if the AER wishes to be conservative, it should allow the TNSP to propose the amount of revenue at risk within a range of 1 to 3 per cent (as 3 per cent is halfway between 1 and 5 per cent).

### **Indexing the financial incentive**

ETNOF submitted that the financial incentive should be indexed to compensate for the time value of money between the regulatory years of the measured performance and the actual year that the financial adjustment is included in the MAR.

### **AER response**

#### ***Level of revenue at risk***

Under clause 6A.7.4(b) of the NER, the scheme must:

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...

The AER does not interpret this clause to mean that the scheme must permit a TNSP to propose the level of revenue at risk.

The AER also reviewed the AEMC's draft and final rule determinations and the rule proposal report.<sup>4</sup> The AER is unable to find anything that suggests the AEMC intended that a TNSP should propose the level of the revenue at risk. The AEMC stated in its final determination that<sup>5</sup>:

'The Commission, in setting an upper limit on the bounds of the risk and reward of the scheme, had the intent of allowing the AER to determine alternative values up to (and including) that limit. However, it is understood that by setting an upper limit, the intent of the AER being able to choose from a variety of values within a specified range was not necessarily clear. Therefore, in order to provide additional clarity in the Rules the Commission has decided to allow the AER to determine the upper and lower bound of the potential risk and reward of the scheme within a range of one per cent to five per cent.'

The level of revenue at risk under the scheme has been retained at 1 per cent of MAR. The AER will consider increasing it from this level after it has fully reviewed the scheme to determine whether it is achieving its intended outcomes. The AER has not been able to undertake this review during this process as there has been insufficient time and data on which it can base an assessment.

However, the AER will consider placing additional revenue at risk for any MITC parameters incorporated into the scheme in the future. The AER is currently reviewing the submissions received in response to its recently released issues paper<sup>6</sup> on possible MITC parameters. The AER plans to publish a further draft scheme incorporating possible MITC parameters and will seek comments from interested parties on these parameters and the level of additional revenue at risk.

In addition, the AER plans to review the parameters that apply to Transend, TransGrid and EnergyAustralia under the current scheme and will provide stakeholders with an opportunity to provide comment on a draft scheme that the AER will publish later in 2007.

### ***Indexing the financial incentive***

The AER considers it was never intended that the scheme would result in adjustments to the MAR in the period used to measure performance. The intention of the scheme is to optimise improvements in a TNSP's performance.

The AER considers that the financial incentive cannot be applied to a TNSP's MAR until the TNSP has finalised its performance report and the AER has completed its annual compliance review. That is, the TNSP does not start accruing the financial incentive from the end of the reporting period. The AER has acted to ensure that the lag

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<sup>4</sup> AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule Determination*, Sydney, 2006; AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Draft Rule Determination*, Sydney, 2006; AEMC, *Review of the Electricity Transmission Revenue and Pricing Rules Rule Proposal Report*, Sydney, 2006.

<sup>5</sup> AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule Determination*, Sydney, 2006, p. 102.

<sup>6</sup> AER, [Service target performance incentive scheme—Developing incentives based on the market impact of transmission congestion: Issues paper](#), Canberra, 2007.

between reporting performance and receipt of the financial incentive is a minimum of six months. For these reasons, and to maintain the relative simplicity of the scheme, the AER considers that it would be inappropriate to index the financial incentive.

### **AER decision**

The AER has not amended the scheme in response to these submissions.

## **3.5 Process for amending the scheme and further consultation**

ETNOF noted that the minimum lead-time of 15 months before a regulatory control period for finalising amendments to the scheme gives a TNSP only two months to account for the amendment in its revenue proposal. ETNOF requested that the AER consider this short timeframe when consulting on and making changes to the scheme.

TransGrid, EnergyAustralia and Transend also noted that if the scheme were finalised in September 2007, they would have insufficient time to propose amendments under the arrangements outlined in the first proposed scheme. Transend and TransGrid requested that the AER consider a transition process that would permit these businesses to submit amendments at the end of November 2007. Similarly ETNOF and EnergyAustralia both indicated that additional consultation on the scheme is required, particularly for businesses subject to revenue determinations beginning in 2008.

The MEU considered that all guidelines should have a specific review date to integrate previous experience and suggested that the AER review all guidelines within two years of their implementation.

### **AER response**

The AER will endeavour to finalise any future amendments to the scheme as quickly as possible and more than two months before a TNSP is due to submit its revenue proposal. However, there may be circumstances in which finalising amendments to the scheme takes longer than expected and the AER reserves its right to finalise amendments up to the time allowed in the NER.

The AER has finalised the scheme earlier than required under the NER and therefore considers that the transition process suggested by TransGrid and Transend is not required. The AER plans to review the parameters that apply to TransGrid, Transend and EnergyAustralia and finalise these amendments at least two months before these businesses are due to submit their revenue proposals on 31 May 2008. The AER is currently working with TransGrid, Transend and EnergyAustralia to develop a process for incorporating and consulting on any necessary amendments to TNSP-specific parameters.

The AER is considering further, the MEU suggestion that all schemes and guidelines be reviewed every two years. The AER anticipates it will review the service target performance incentive scheme before the revenue reset process for Powerlink, which is the next regulatory reset after TransGrid, Transend and EnergyAustralia.

## **AER decision**

The AER has not amended the scheme in response to these submissions.

### **3.6 Other comments**

ETNOF suggested that it would be beneficial to define:

- definition of parameter
- vary a parameter
- element
- value
- standard definition
- definitions and return period.

The APA Group noted that the models, schemes and guidelines were designed with larger, more complex assets in mind, and that the approaches might be irrelevant or redundant for relatively small and straightforward assets such as Murraylink and Directlink.

ENERGEX expressed concern that strict adherence to the AER's overall objective of achieving regulatory consistency across the energy sector will discount the significant differences in the operating environments of distribution businesses compared to transmission businesses.

## **AER response**

The AER agrees with ETNOF that the term return period can be defined under the scheme. The return period concept was explained in ERM Energy's *Report on statistical soundness of selected performance measures*, which was included in the Sinclair Knight Mertz (SKM) Pty Ltd report to the ACCC. ERM Energy explained that<sup>7</sup>:

‘The return period is the average period at which events of greater than a specified size will occur. For example, a Powerlink outage of 1 minute has a return period of 1.8 years. In other words, a 1minute outage will occur, on average, every 1.8 years. In terms of return periods, on average, every 5 years, there will be an outage of 6.3 minutes or greater...’

The AER amended the scheme to include the definition of return period as explained by ERM Energy in its report. However, the AER considers the other terms outlined by ETNOF are used in the NER and should remain undefined, or their meaning is sufficiently clear under the current drafting of the scheme.

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<sup>7</sup> SKM report to the ACCC, *Transmission Network Service Provider (TSNP)—Service Standards: Final Report*, 2003, p.77.

The AER will consider any specific issues raised by APA Group on how the scheme could be made more workable before Directlink and Murraylink's next regulatory control periods. The AER will also consider any specific concerns raised by ENERGEX when developing the service standards regime that will apply to distribution networks.

### **AER decision**

The AER has amended the scheme to include a definition of return period.

## **3.7 Additional amendment—weightings**

After reviewing the first proposed scheme, the AER amended it to provide greater guidance on determining weightings. The AER was concerned that the first proposed scheme may not have provided sufficient detail on the issues that it considered relevant when assessing a TNSP's proposed weightings. Clause 2.7 provides that TNSPs should consider:

- the extent to which its parameters provide incentives to improve reliability at the times of greatest value to users and on those elements of the network most important to determining spot prices
- the availability of accurate and reliable data for determining the values for each parameter
- the scope that the TNSP has to improve its performance as measured by each of its parameters
- the extent to which the parameters applying to the TNSP overlap.

The AER considers that it would generally be appropriate to apply higher weightings to those parameters which are most focused on improving performance at times most valued by users and on those elements of the network most important to determining spot prices. For example, the AER would generally expect that critical- and peak-circuit availability measures would be more heavily weighted than non-critical and off-peak availability measures.

As mentioned above, the AER may consider applying zero weightings to particular parameters where there is insufficient data to calculate meaningful performance targets. Where a parameter is given a zero weighting the TNSP will still be obliged to report its performance against this parameter, and this data may be used to set performance targets in future regulatory control periods.

The AER also considers that in some circumstances it may be appropriate to apply greater weightings to those parameters against which the TNSP has the greatest opportunity to improve its performance. A TNSP should also consider the extent to which its parameters overlap and how this should affect the weighting proposed for each parameter.

**AER decision**

The AER has amended the scheme to provide greater guidance on the factors that TNSPs must consider when proposing weightings.

## Shortened forms

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ERM Energy	Environmental Resources Management Australia Pty Ltd Quality System
ESCOSA	Essential Services Commission of South Australia
ETNOF	Electricity Transmission Network Owners Forum
MAR	maximum allowed revenue
MEU	Major Energy Users Inc.
MITC	market impact of transmission congestion
NEMDE	National Electricity Market Dispatch Engine
NEMMCO	National Electricity Market Management Company
NER	National Electricity Rules
SKM	Sinclair Knight Mertz Pty Ltd
TNSP	transmission network service provider

## **Appendix A—Submissions received**

The following interested parties provided submissions to the AER on the first proposed service target performance incentive scheme

- Alinta
- APA Group
- CitiPower and Powercor
- Electricity Transmission Network Owners Forum
- Energex
- EnergyAustralia
- Essential Services Commission of South Australia
- Major Energy Users Inc.
- Transend
- TransGrid

Copies of submissions made by these parties are available on the AER website ([www.aer.gov.au](http://www.aer.gov.au)).



## **Appendix B—Service target performance incentive scheme**