
# Submission to the Australian Energy Regulator Service Target Performance Incentive Scheme for Transmission Network Service Providers

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## GLOSSARY

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| **AER** | Australian Energy Regulator |
| **EUAA** | Energy Users Association of Australia |
| **MTPASA** | Medium Term Projected Assessment of System Adequacy |
| **NEM** | National Electricity Market |
| **STPIS** | Service Target Performance Incentive Scheme for Transmission Network Providers |
| **TNSP** | Transmission Network Service Provider |

# 1 INTRODUCTION

The Energy Users' Association of Australia (EUAA) welcomes the opportunity to provide a submission on the Draft Report of the Australian Energy Regulator (AER) *Service Target Performance Incentive Scheme (STPIS) for Transmission Network Service Providers (TNSPs) Draft Report – November 2007.*

The EUAA is a non-profit organization focused entirely on energy issues. Members determine the EUAA's policy and direction; and our activities cover both national and state issues. The membership represents a wide spectrum of end users located in all states. Currently, the EUAA has more than 97 members. These are predominantly large business users of energy with activities across all states and many sectors of the economy. Some are directly connected to the transmission system and all have a strong interest in ensuring that electricity in the National Electricity Market (NEM) is delivered efficiently and effectively.

# 2 SUMMARY AND REVIEW OF ISSUES

This submission responds to some concerns that the EUAA has about the Service Target Performance Incentive Scheme (STPIS) outlined in the draft report. The scope of the response is limited to the market impacts portion of the incentive scheme, as the EUAA has no particular concerns about the existing scheme related to asset reliability.

The EUAA agrees with the need to introduce further arrangements that ensure that TNSPs are influenced, and consider, the market impacts of their asset management arrangements. Assessment of the market impacts of asset management, maintenance and related decisions should form an integral part of the assessment about when these activities should take place. Greater exposure of TNSPs to market impacts would provide appropriate incentives for TNSPs to consider the market impacts of these decisions and would provide appropriate incentives for TNSPs to align transmission operations with energy market conditions.

The AER has provided the EUAA with a further briefing on the design of the STPIS, subsequent to a workshop hosted by the AER on the proposed design of the scheme. In that briefing further detailed design elements of the STPIS were examined, and several additional issues concerning the design of the scheme were explored. As noted above, the EUAA is in broad agreement about the need to provide TNSPs with incentives to consider the affects of their maintenance and associated programs on the electricity market, to enhance theefficiency and effectiveness of the market, and to minimise the price effects of such disruptions on the market. However, the EUAA has some additional concerns in relation to the design of the scheme as follows:

## 2.1 The Asymmetrical Nature of the Proposed Scheme

The proposed scheme provides for a 2% increase in TNSP revenue if there are no large impact constraints arising during a calendar year. There is no provision for revenue reduction if there are many large impact constraints exceeding $10/MWh marginal value. EUAA understands that the rationale for this approach is that the scheme concept is new and unproven. And that it would be unhelpful at this stage to create a large exposure to risk for TNSPs that would be hard to predict given that the market impact scheme has not been tested operationally.

As outlined to the EUAA by the AER, the market impact portion of the proposed scheme provides revenue increases to TNSPs when performance targets are exceeded. However, the scheme as proposed does not impose penalties for TNSPs when performance standards are not met. For incentive arrangements to be effective, they should be symmetrical. If the design of the scheme is asymmetrical, and penalties are not imposed on TNSPs in respect of poor performance, then the incentive for TNSPs to continue to 'raise the bar' in respect of achieving higher performance levels, and maintaining those levels, is diluted. Movement towards best practice and the incentive for TNSPs to improve service levels, or not slip in the delivery of service levels over time is diluted.

Under such a design arrangement where TNSPs are not penalised for a drop-off in performance standards over time, the incentives towards short-term gaming of the system are accentuated, and users are disadvantaged by any upward price impacts that could have been avoided if TNSPs had faced more symmetrical incentives in relation to service standards.

The EUAA considers that the AER should make a commitment to introduction of an asymmetrical scheme. Such a scheme would be designed so that both underperformance and outperformance in service standards have a material financial impact on network service providers.

There are also a number of matters that can be advanced in response to the proposition that the implementation of a new service standards arrangements needs to be cautiously undertaken. For example, in the design of the scheme, the AER could choose to implement:

- A scheme with a 'dead band' where service standards performance within this band is neither penalised nor rewarded. The 'dead band' could initially be quite wide but, over time, could be narrowed as experience with the scheme, and outcomes from the scheme are experienced. This would enable the AER to implement arrangements that are consistent with the 'symmetry' principle referred to above, but allows the design of arrangements, that, at least in the first instance, have dampened financial penalties for TNSPs where service standards performance is below benchmark levels. The AER also has some flexibility in determining the initial benchmarks for the scheme for each TNSP and, in

conjunction with the 'dead band' mechanism, could still retain considerable flexibility in relation to the design of the scheme, whilst maintaining a commitment to introducing symmetrical arrangements.

- A scheme where the penalties and bonuses for service standards performance are not the same. Whilst the EUAA does not consider the implementation of these arrangements to be ideal, the design of a scheme where penalties are imposed at a lower or higher rate than bonuses are awarded is certainly more acceptable than design a scheme that does not include provision for penalties.

Finally, the EUAA has number of comments to make in relation to the administration of the scheme. The EUAA considers that it is a fundamental to the operation of the scheme that the scheme has an expected value of zero. That is, in any one year, on average, TNSPs do not stand to gain from the implementation of the arrangements, but neither do they stand to lose from the imposition of targets that are overly harsh and penalise TNSPs unnecessarily.

The EUAA understands that, previously, TNSPs have considered the bonus payments not in the nature of 'bonuses' but rather in the nature of part of the anticipated budget. The EUAA strongly argues that, as the scheme's name suggests, the focus of the scheme should be on rewarding/penalising TNSPs for improving/reducing service standard performance, relative to recent history, not just rewarding them for maintaining the *status quo* or dling something they should be doing anyway. This would involve end users paying for something they ought to receive as part of their normal TUoS charges. This may well be contrary to the type of scheme that appears to be embraced by some TNSPs. However, this does not obviate the need to focus on the fundamentals of designing a scheme that has a solid foundation and provides appropriate incentives, and is not open to gaming or manipulation from those providers that are subject to it.

## 2.2 Notice of planned Generator outages to all TNSPs

The EUAA also notes that the service standard arrangements outlined by the AER do not appear to provide for TNSPs to adapt to planned generator outages by rescheduling their own outages. It appears that under the proposed arrangements, generators are expected to reschedule their outages according to the TNSP plans. The EUAA considers that in many cases it may be more economic for transmission outages to be driven by generation outage. Such arrangements might ultimately better support the proposed market impact scheme, and contribute to the efficient and effective scheduling of planned disruptions to transmission services.

The scheme as currently proposed appears to have been formulated on the assumption that transmission owners would continue to publish their network outage plans to the market. Generators and customers would, as a result, plan their activities around the network outage plans. In fact, this arrangement may not be efficient, and there should be provision for transmission businesses to adopt a reactive stance and co-ordinate their

outage plans with major generators. Such arrangements are more likely to be economically efficient, and are likely to reduce price volatility in the wholesale market.

Generators currently advise their TNSP of their outage plans but not the market generally. This is sufficient for co-ordination of connection related issues but it does not guarantee effective co-ordination of NEM-wide supply and network management including the impact on major intra-regional and inter-regional constraints, unless the TNSP advises other affected network owners. Scheduled maintenance of generation plant involves many more people and greater resources than scheduled maintenance of transmission assets. Therefore, it may be more economic for generators to publish their plans widely so that TNSPs can adapt their own outages to minimise their exposure to market impacts. This will become more important as the NEM becomes more integrated and the transmission system is used more intensively.

The proposed scheme would also be more effective if generators and large customers were required to advise their outage plans to all TNSPs where their output affects a TNSP flow constraint that could create an adverse impact on customers and TNSPs. The availability of this notification facility is not apparent in the Draft Report.

One of the disadvantages of this requirement is that publication of generator outages may enhance exercise of market power, especially for large units. However, the Medium Term Projection Assessment of System Adequacy (MT PASA) already shows available capacity for each region and it is unlikely that knowing which generator in a region is to be scheduled off may not affect market power significantly as compared to not knowing which generator is to be taken out. This change of policy would need to be investigated to assess the risk of unintended effects on the energy market, but in any event this is worth exploring.

## 2.3 Economic basis for setting parameters

The EUAA considers that the use of historical performance level as the basis for performance benchmarks for market impacts will need to be carefully monitored so that an appropriate economic performance standard is established. Periods of poor performance should not be permitted to degrade the benchmark in future regulatory periods. Performance standards should also reflect the changing role of the transmission system over time, as patterns of load and generation alter.

The Draft Report indicates that AER can amend proposed dispatch interval targets to accord with an “appropriate benchmark or methodology” in section 3.3(i). It appears that explicit requirements to ensure that the targets represent a realistic economic balance between the resources needed by TNSPs and the value of reducing exposure to market impacts are missing. The EUAA concedes that currently there may not be sufficient information to assess where the economic level should be struck, but in principle there are a number of tools that can be used by the AER in establishing and amending benchmarks

over time, so that the a more appropriate balance is struck between costs and benefits. The provisions outlined in the draft report would allow the AER to conduct such analyses to identify appropriate benchmarks.

One of the potential traps in setting benchmark performance levels is that historical levels of performance may not be good indicators of appropriate future benchmarks. This is so because the role of transmission in the NEM is changing and emissions trading, when introduced, is likely to also have significant effects on power flows within the national grid.

The EUAA would expect that the AER will be vigilant on such issues and able to identify when historical performance levels are no longer suitable or where the influence of TNSPs behaviour which affects historical average performance levels becomes counter-productive. As discussed in the EUAA's response to the Issues Paper, periods of poor performance should not degrade the benchmark level for future regulatory periods.

Whilst provision for high historical performance levels raising the performance standard is included in section 3.3(k), there is no provision to adjust for low performance apart from removing statistical outliers. Clause 3.3(k) should allow for adjustment in the event of declining performance affecting the historical average that cannot be justified by economic analysis.