3 November 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Via website: www.aemc.gov.au

Dear John,

Supplementary Submission on Rule Change Proposal: Early Implementation of Market Impact Parameter Proposed

Grid Australia welcomes this opportunity to provide the Commission with a supplementary submission on the proposed Rule change to allow the early introduction of the market impact parameter. The purpose of this supplementary submission is to respond to matters raised in submissions to the Commission's consultation paper[1], and thereby to assist the Commission in formulating its Draft Determination.

As you are aware, the transmission service target performance incentive scheme (the scheme) incorporates two elements:

- The scheme provides incentives for TNSPs to minimise the number and duration of loss of supply events, and to maximise circuit availability; and

- The market impact parameter provides an incentive for TNSPs to minimise the market impact of transmission outages.

As presently drafted, the National Electricity Rules (the Rules) prevent the market impact parameter from being introduced part-way through a regulatory period. As revenue determinations have only recently commenced for some TNSPs, the current Rules have the effect of delaying the introduction of the market impact parameter for a number of years. In April 2009, Grid Australia therefore lodged a Rule change proposal to provide for an earlier introduction of the scheme by inserting a new savings and transitional clause in Chapter 11 of the Rules.

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1 Australian Electricity Market Commission, Rule Change Consultation Paper: National Electricity Amendment (Early Introduction of Market Impact Parameter) Rule 2009, 6 August 2009.

Grid Australia's Rule change proposal noted that no significant design or consultation costs arise from the Rule change as the AER has already established the market impact parameter in accordance with the Rules requirement. However, Grid Australia also noted that some TNSPs may find the implementation costs prohibitive, when compared to the potential benefits from an earlier introduction of the scheme. For this reason, the proposed Rule change provides an option for each TNSP to introduce the scheme earlier than timetabled, but does not mandate an earlier introduction. The Australian Energy Regulator (AER) published its final decision on the second version of the transmission service target performance incentive scheme (the scheme) on 7 March 2008. The second version of the scheme now incorporates two elements:

Grid Australia also highlighted the important regulatory principle that stability is enhanced by strictly limiting the circumstances in which a Revenue Determination may be revisited. In these particular circumstances, however, Grid Australia supported an early introduction of the existing scheme, subject to specific conditions and safeguards that provided protection to customers and TNSPs.

The Commission's consultation paper correctly summarises the Rule change proposal as containing the following main features[2]:

- TNSPs may propose parameters to the AER that would apply under the market impact component of the incentive scheme at least three months prior to the commencement of the regulatory year;

- the AER would make a written determination on the proposal within 30 business days. If the AER rejects the proposed parameters, the AER would determine amended values. If the AER does not provide a response within this time, the parameters proposed by the TNSP would be deemed to be accepted;

- TNSPs would not be obliged to accept the AER's amended values; and

- any amendments to the Revenue Determination as a result of the operation of the market impact component of the incentive scheme would not include any other amendments and would not be retrospective.

The AEMC has received 3 published submissions on the Rule change proposal. Each of these submissions provides supportive comments in relation to the proposal:

> "AEMO considers that no additional burdens should arise for AEMO, from a data provision perspective, from the early implementation of this parameter for all TNSPs."[3]
>
> "[The NGF] support this Rule change as it gives TNSPs the option to apply the MIP [market impact parameter] before the next regulatory period. Under the MIP, TNSPs are

[2] Australian Electricity Market Commission, Rule Change Consultation Paper: National Electricity Amendment (Early Introduction of Market Impact Parameter) Rule 2009, 6 August 2009, page 4.

[3] Australian Energy Market Operator, letter from Terry Grimwade, dated 2 October 2009.

incentivised to reduce the impact of their planned outages. As such, we support the scheme's early implementation."[4]

"The AER recognises that amending one aspect of a revenue determination part way through a regulatory control period may create imbalances in the regulatory framework. Limiting amendments to the revenue determination maintains the integrity of the framework for economic regulation and ensures regulatory certainty. However, in this instance, the AER considers that amending existing revenue determinations to permit the early implementation of the market impact parameter is warranted as there are clear benefits to market participants."[5]

In addition to the supportive comments noted above, the NGF and the AER raise a number of specific queries and concerns regarding the proposed Rule change. Grid Australia's response to these issues is provided in tabular format in the attachment to this covering letter.

In relation to several matters raised by stakeholders, Grid Australia considers it appropriate to suggest drafting changes to the proposed Rule for the Commission's consideration. Grid Australia has therefore also provided a marked-up version of its proposed Rule in the attachment to this letter.

Grid Australia would also like to take this opportunity to suggest a further drafting change to ensure that the market impact parameter can be introduced in a timely and efficient manner.

Based on standard assessment timeframes, the Final Determination on the proposed Rule change, if approved, may not be published until late March 2010. In this event, TNSPs may be unable to satisfy the current draft Rule requirement to submit a proposal 3 months prior to the commencement of the 2010/11 regulatory year (i.e. by 1 April 2010). In these circumstances, the market impact parameter would not be introduced until the 2012 calendar year. Given the potential benefit of introducing the market impact parameter and the general support for the scheme from stakeholders, such an outcome would be contrary to the achievement of the National Electricity Objective and would undermine the purpose of the Rule change.

In order to facilitate the timely introduction of the market impact parameter, Grid Australia proposes that:

- a TNSP should be able to submit a proposal to introduce the market impact parameter at any time; and
- the application of the scheme should commence on the date of the AER's decision to approve the proposed performance target and cap values or such other date as agreed between the AER and the TNSP (with such agreement not to be unreasonably withheld).

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4 The National Generators Forum, letter from Malcolm Roberts, dated 1 October 2009.

5 Australian Energy Regulator, letter from Michelle Groves, dated 29 September 2009.

Grid Australia notes that the scheme already provides for its operation on a pro rata basis where performance is measured over part of a calendar year (for example on a financial year basis)[6]. The changes suggested by Grid Australia can therefore be accommodated readily within the existing scheme. As already noted, Grid Australia considers that these suggested changes would further promote the achievement of the National Electricity Objective.

Grid Australia has also identified that the proposed drafting of Rule 11.6.9A(ii) fails to include reference to the *transitional regulatory control period* in the case of Powerlink that has been included in the drafting 11.6.9A(i). To make the Rule change proposal effective it is essential that this reference be included.

For the reasons set out in Grid Australia's Rule change proposal, Grid Australia strongly commends the proposed Rule change to the AEMC and to stakeholders. We look forward to further opportunities to engage with the AEMC and stakeholders in the finalisation of this Rule change. If you require any further information from Grid Australia, please do not hesitate to contact Simon Appleby in the first instance on 08 8404 7324.

Yours sincerely,

Rainer Korte

Rainer Korte
Chairman
Grid Australia Regulatory Managers Group

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6 Australian Energy Regulator, Electricity Transmission Network Service Providers: Service Target Performance Incentive Scheme, March 2008, p50

Attachment: Grid Australia's response to the matters raised in submission from the NGF and the AER

Reference	Comments from the NGF and AER	Grid Australia's response
NGF, page 2	However, we think that the MIP should: • be improved to include a method that holds TNSPs liable for the severity of market congestion to participants using the transmission system; • be developed to place a share of TNSP regulated revenue at risk (up to 10%) under the STPIS [the service target performance incentive scheme]; and make TNSPS answerable for the severity of market congestion on participants using the transmission system; • promote extra capital spending to ease market constraints in the current regulatory period; • strengthen its link to the contingent project framework in the hope that TNSPs will spend extra capital spending in the current regulatory period; and • provide for AEMO to supply the relevant data inputs for the performance target submitted to the AER by a TNSP.	Grid Australia considers that the NGF's comments are principally directed to the design of the market impact parameter. In contrast, the purpose of the proposed Rule change is to allow for the early introduction of the existing market impact parameter. Amendments to the existing scheme should be undertaken in accordance with clause 1.7 of the STPIS which states that "the AER may amend or replace this scheme from time to time in accordance with clause 6A.7.4(f) of the NER and the transmission consultation procedures." The matters raised by the NGF should be considered in accordance with those provisions. In any event, Grid Australia does not support any proposal to increase a TNSP's liability for market congestion. Any changes in the strength of the incentive would probably need to involve consideration of other Rule obligations to inform the market in advance of planned outages (e.g. Clauses 3.7 and 3.7A). This is because a stronger incentive would encourage TNSPs to be more inclined to give weight to moving outages around at short notice than a weaker incentive. This is also a design consideration that depends on more experience with the incentive scheme than currently exists and would take time to work through. It is likely, however, that the early introduction of the market impact parameter could provide greater incentives for TNSPs to ease market congestion where it is economic to do so through more efficient operation of the transmission system. Grid Australia notes that currently there is no direct link between contingent projects and the market impact parameter. Grid Australia considers that the establishment of such linkage is not a matter that can be considered as part of this Rule change proposal.

Reference	Comments from the NGF and AER	Grid Australia's response
NGF, page 3	TNSPs should have no role in supplying the data required to implement the MIP. The MIP works by mandating a TNSP to put forward a performance target which is equal to the TNSPs' average performance history over the most recent five years. The MIP then measures the number of dispatch intervals where an outage on a TNSP network results in a network outage constraint with a marginal value greater than $10/MWh. We believe that the information used to determine the TNSP average performance history should be provided by AEMO and not by the relevant TNSP.	The NGF's proposal is inconsistent with the provisions of the STPIS. In particular, clause 4.2 sets out the requirements on TNSPs in relation to the target performance for the market impact parameter. In particular, clause 4.2(f), allows for a TNSP to propose reasonable adjustments to performance targets to account for statistical outliers; changes to asset age and ratings; and material changes to an applicable regulatory obligation. The NGF's proposal is inappropriate because it effectively seeks to change the existing scheme, which is again beyond the scope of the Rule change proposal.
AER, page 1.	The AER notes that the proposed rule could raise questions regarding retrospectivity under section 33(1) of Schedule 2 to the National Electricity Law. The AER has no view on this issue, however the AEMC should consider it when assessing Grid Australia's proposal.	Grid Australia's Rule change proposal seeks to operate prospectively, rather than retrospectively. Grid Australia does not consider that issues arise in relation to section 33(1) of Schedule 2 to the National Electricity Law.
AER, page 2.	However, the AER is concerned about the proposed 30 business day assessment timeframe. If a TNSP's proposal was considered as part of a revenue determination under chapter 6A, the AER would have up to 80 business days to assess the proposal before issuing its draft decision. The proposed 30 business day assessment period is less than half the time allowed under chapter 6A. This proposed assessment period will only be adequate if a TNSP provides well documented and validated data which supports its proposal and the AER does not discover significant problems with the data during its assessment.	Grid Australia notes that a revenue determination under Chapter 6A raises a much broader and more complex set of issues compared to the assessment of the performance targets for the market impact parameter. Grid Australia considers that 30 business days is an appropriate time period for assessing the proposed performance targets. It is noted that 30 business days is the required timeframe for the AER's assessment of a contingent project application, in accordance with clause 6A.8.2 of the Rules. Nevertheless, Grid Australia is prepared to accept that the approval period be extended to 40 business days. Grid Australia agrees with the AER that TNSPs should provide well documented and validated data. The proposed Rule change does not require, nor does Grid Australia expect, the AER to approve a proposed performance target that is not well documented and validated. To address this concern, Grid Australia has suggested a modification to the Rule change proposal requiring that the AER notify the proponent of any material deficiency within 15 business days.

Reference	Comments from the NGF and AER	Grid Australia's response
AER, page 3.	There may be unexpected circumstances where the AER is unable to make a decision within the proposed 30 business day timeframe. For example, TNSPs may encounter difficulty in responding to requests for further supporting information which involve complex and technical data issues or we may receive multiple proposals simultaneously. The AER considers that at a minimum the AER would need 40 business days to consider a TNSP's proposal. A longer timeframe would also be necessary if the AER is expected to consult with interested parties before releasing its determination.	Grid Australia considers that extensive consultation is not required to establish a performance target for the market impact parameter. Nevertheless, the TNSP's proposal should be published by the AER, and submissions invited from stakeholders. It is also noted that the calculation methodology for the setting of targets under the scheme has been established through previous consultation. While Grid Australia considers 30 days to be sufficient to allow the AER to make its decision, Grid Australia proposes to modify its Rule change proposal to adopt the 40 day period requested by the AER.
AER, page 3.	The AER is also concerned that clause 11.6.9A(vi) provides TNSPs with the option to reject the AER's amended performance target. This proposal does not apply the scheme in the same way as it would if it was part of a revenue determination. Currently under chapter 6A, a TNSP has to propose a target and cap in its revenue proposal which complies with all of the requirements of the scheme. The AER then assesses this proposal and, if it does not meet the scheme requirements, it can reject it and substitute an alternative. The proposed clause 11.6.9A(vi) is inconsistent with the current regime as it provides TNSPs with an option of electing to accept the AER's amended values. This does not provide TNSPs with a strong incentive to propose well considered targets which comply with the requirements in the scheme. It is also unnecessary as the market impact component is currently a "bonus-only" scheme and therefore there is no major financial risk or consequence for TNSPs if the AER decides to reject and substitute amended values. The largely mechanical assessment criteria in the scheme also limit the risk to TNSPs of an unexpected determination by the AER.	Grid Australia has deliberately drafted the proposed Rule to provide the relevant TNSPs with an <u>option</u> to introduce the market impact parameter earlier than presently allowed for in the Rules. Grid Australia considers it essential that the TNSP is able to preserve its option throughout the AER's assessment process. In contrast to the AER's comments, TNSPs will incur additional operating costs in introducing and responding to the market impact parameter. If an onerous performance target is set by the AER, a TNSP could be substantially disadvantaged from the early introduction of the scheme. Specifically, the TNSP will incur operating costs without any prospect of a financial return through the market impact parameter. In light of the above, Grid Australia considers that a TNSP should be able to withdraw its proposal to introduce the market impact parameter if the AER amends the performance targets in a manner that renders the scheme financially unattractive from the TNSP's perspective. Whilst this approach differs slightly from the way targets may be set under Chapter 6A, this difference is necessary in order to ensure that the TNSP is kept financially whole. Grid Australia does not agree that the Rule change proposal fails to provide TNSPs with a strong incentive to propose well considered targets. On the contrary, the AER's approval of proposed targets is required before the market impact incentive can become operational.

Reference	Comments from the NGF and AER	Grid Australia's response
AER, page 4.	The AER is concerned that this provision operates to allow a TNSP to apply to amend its revenue determination to give effect to the 7 March 2008 version of the scheme even where this version has been superseded. While the AER agrees that the scheme should not be changed through this Rule change proposal, the AER may wish to improve the scheme in the future (following stakeholder consultation) and in these circumstances the proposed rule change should not operate to apply an earlier version of the scheme.	Grid Australia accepts the AER's concerns, and a suggested drafting change to the proposed Rule is provided in this attachment.
AER, pages 4 and 5.	In addition, as the term 'first regulatory control period' is not defined, clause 11.6.9A(i) may operate to allow a TNSP to propose amendments to its revenue determinations in future regulatory control periods. The proposed rule refers to 'transitional regulatory period' and 'first regulatory control period' which are not defined for the purpose of this clause.	Grid Australia notes that "first regulatory control period" is defined and already used in Part E of Chapter 11. The definition in clause 11.6.1 should address the AER's concerns. The term 'transitional regulatory period' applies in relation to Powerlink and is defined clause 11.6.12.
AER, page 4.	Clause 11.6.9A(iii) of the proposed rule states that the AER must accept the proposed performance target or cap values if they comply with the requirements in clause 4.2(b) to 4.2(f) of the scheme. The AER is concerned that this drafting omits a reference to clause 4.2(g) of the scheme. Clause 4.2(g) allows the AER to reject a proposed value where it is inconsistent with the objectives of the scheme. The objectives include that the scheme contributes to the national electricity objective and is consistent with the principles in clause 6A.7.4(b) of the Electricity Rules. The AER considers that 4.2(g) is very important in the operation of the scheme. It ensures that the scheme continues to comply with the requirements in the Electricity Rules and is a key factor which the AER should have regard to when assessing a proposed target or collar value. Proposed clause 11.6.9A should instead refer more generally to the requirements set out in the market impact component of the scheme.	Grid Australia notes that clause 4.2(g) references the scheme objectives, which are set out in clause 1.4. The drafting was not intended to prevent the AER from applying the objectives in clause 1.4, and the AER already has the power to reject a proposed value under the proposed Rule. However, for completeness, a drafting change has been suggested to remove any ambiguity over this point.

Reference	Comments from the NGF and AER	Grid Australia's response
AER, page 4.	The AER also has concerns in relation to the notion of 'deemed acceptance' proposed by Grid Australia. If it fails to make a determination within the required time frame, the AER should not be deemed to have accepted a TNSP's proposal as proposed under clause 11.6.9A. This approach would deviate from the approach taken under chapter 6A of the Electricity Rules and could lead to undesirable outcomes.	Grid Australia has proposed the deemed acceptance provision in order to provide a discipline on the AER to adhere to the approval timetable. Grid Australia notes that the potential benefits from the introduction of the scheme could be lost if there are unnecessary delays in the approval process. Grid Australia does not accept that undesirable consequences would follow from this provision.
AER, page 4.	The proposed rule should clarify whether Transend is able to apply to amend its revenue determination to give effect to the market impact component. While the AER does not oppose the application of the rule change to Transend, the AER is unclear whether the rule as drafted will allow Transend to apply given clause 2.2(a) of the scheme expressly excludes Transend from the market impact component.	Grid Australia's intention is for the Rule change to apply to Transend and a suggested drafting change to address the AER's concerns has been proposed in the attachment to this submission.
AER, page 5.	The AEMC asked whether provisions which permit early implementation of changes to the scheme should be a permanent feature of the regulatory regime. The AER considers that there is merit in this proposal, however it should be within the AER's discretion to allow early introduction of future amendments to the scheme as there may be circumstances where this is not appropriate.	Grid Australia does not support the early implementation of changes becoming a permanent feature of the regulatory regime. Grid Australia's Rule change proposal addresses unusual circumstances that the existing Rules preclude some TNSPs from implementing the market impact parameter for a number of years. As such, the benefits from allowing the early introduction of the market impact parameter outweigh the regulatory principle that determinations should not be revisited. In contrast, where changes are made to an existing scheme, there is a much weaker case in favour of early implementation. In these latter circumstances, it is much preferred that the regulatory determination is allowed to run its course, without amendment. Grid Australia also strongly opposes the AER's suggestion that it should exercise its discretion in determining whether an early introduction of amendments to the scheme should be allowed. Grid Australia considers that this latter proposal is likely to create a degree of regulatory uncertainty for the network businesses, which would be contrary to the basic principles that underpin incentive regulation, and would be contrary to the National Electricity Objective.

Reference	Comments from the NGF and AER	Grid Australia’s response
AER, page 5	The proposed rule only applies to the market impact component of the scheme (as defined in the scheme). This may inadvertently leave out other clauses of the scheme which are essential for the operation of the market impact component, such as information and reporting requirements, compliance auditing, timing of performance and adjustments to the maximum allowed revenue.	Grid Australia considers that the operation of the information and reporting requirements, compliance auditing, timing of performance and adjustments to the maximum allowed revenue will not be inadvertently affected by the proposed Rule change. Grid Australia notes, in particular, that the market impact parameter is only mentioned in clauses 4 and appendix C of the scheme – and therefore the remaining elements of the scheme which are already in operation will continue to operate as intended.

ATTACHMENT: RULE CHANGE PROPOSAL

Grid Australia's draft Rule change proposal is set out below, with marked up changes to address the matters raised by stakeholders and other amendments as noted above.

Insert a new clause 11.6.9A as follows:

11.6.9A Introduction of the market impact component of the service target performance incentive scheme during the first regulatory control period

(i) In accordance with paragraphs (ii) to (vii), the *revenue determination* applying to a *Transmission Network Service Provider* will be amended during the first *regulatory control period*, or during the *transitional regulatory control period* in the case of Powerlink, to give effect to the *market impact component* of the *service target performance incentive scheme* published by the AER on 7 March 2008 or as subsequently revised by the AER in accordance with clause 1.7 of the *service target performance incentive scheme* (the *scheme*).

(ii) A *Transmission Network Service Provider* may propose to the AER a *performance target* (as that term is defined in the *scheme*) and a *cap* (as that term is defined in the *scheme*) in relation to the *market impact component* ~~on~~ of the *scheme* ~~at least three months prior to the commencement of a regulatory year~~. The proposal must address all the matters set out in clause 4.2 of the *scheme*; and it must relate to all the remaining years of the first *regulatory control period* or *transitional regulatory control period* in the case of Powerlink. If, in the reasonable opinion of the AER, the proposal is incomplete in a material respect, the AER must notify the proponent within 15 business days of receiving the proposal. In the notification, the AER must specify the additional information that is required to be submitted by the proponent in an amended proposal.

(iii) Within ~~30~~ 40 business days of receiving the proposal or amended proposal referred to in paragraph (ii), the AER must, subject to clause 4.2(g), ~~either~~ accept the proposed *performance target* and *cap* values if they comply with the requirements of clauses 4.2(b) to 4.2(f) of the *scheme* ~~or the AER must otherwise reject the proposed values~~. If the AER rejects a proposed value, it must determine an amended *performance target* or *cap* value, as the case maybe, that it reasonably considers would comply with the requirements of clauses 4.2(b) to 4.2(f) of the *scheme* and the objectives in clause 1.4 of the *scheme*.

(iv) Within 40 ~~30~~ business days of receiving the proposal or amended proposal referred to in paragraph (ii) the AER must notify the proponent in writing of a determination pursuant to paragraph (iii) and must provide reasons for any determination which rejects any proposed *performance target* or *cap* values.

(v) If the AER fails to comply with (iv) the AER is deemed to have accepted the proposed *performance target* and *cap* values.

(vi) The *Transmission Network Service Provider* may (but is not obliged to) accept the AER's amended values ~~prior to the commencement of the first regulatory year in which the *market impact component* is proposed to apply~~.

(vii) The scheme will commence on:

a. the date of the AER's approval of the proposed *performance target and cap* values; or

b. the date of the TNSP's acceptance of the AER's amended values in accordance with clause (vi); or

c. a date as otherwise agreed between the TNSP and the AER, where such agreement cannot be unreasonably withheld.

(viii) Any amendment of the *revenue determination* that is required as a result of the operation of the *market impact component* must be in accordance with clause 4.3 of the *scheme* (published by the AER on 7 March 2008 or as subsequently revised by the AER in accordance with clause 1.7 of the *service target performance incentive scheme*) and cannot include any other amendments. The application of the *scheme* cannot be retrospective.

(ix) For the avoidance of doubt, this clause 11.6.9A applies to Transend Networks Pty Ltd.