AEMC

RULE CHANGE

Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (Early Implementation of Market Impact Parameters) Rule 2009

Rule Proponent

Grid Australia

Commissioners

Tamblyn
Henderson

10 December 2009

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For and on behalf of the Australian Energy Market Commission

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Citation

AEMC 2009, *Early Implementation of Market Impact Parameters*, Draft Rule Determination, 10 December 2009, Sydney

About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market and elements of the natural gas market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council of Energy as requested, or on AEMC's initiative.

Contents

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	see AEMC
draft Rule	AEMC, *Draft National Electricity Amendment (Early Implementation of Market Impact Parameters) Rule 2009*, 10 December 2009, Sydney, (also the draft Rule to be made)
the incentive scheme	The service target performance incentive scheme for TNSPs as developed and published by the AER in accordance with clause 6A.7.4 of the Rules
MAR	Maximum Allowed Revenue
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Electricity Rules (also Rules)
NGF	National Generators Forum
Rules	National Electricity Rules
TNSP	Transmission Network Service Provider

Summary

On 30 April 2009, the Australian Energy Market Commission (Commission) received a Rule change request from Grid Australia. The Rule change request related to Clause 6A.7.4 of the National Electricity Rules (Rules), which requires the Australian Energy Regulator (AER) to publish a service target performance incentive scheme (the incentive scheme) that applies to transmission network service providers (TNSPs).

The Rules provide that any amendment or replacement of the incentive scheme will not apply to a TNSP in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the incentive scheme coming into operation. The Rule change request proposed to insert savings and transitional provisions in Chapter 11 of the Rules to allow one component of the incentive scheme, the market impact component, to be implemented earlier.

Commission's draft Rule determination

Under section 99 of the National Electricity Law (NEL), the Commission has determined to make this draft Rule determination and the draft National Electricity Amendment (Early Implementation of Market Impact Parameters) Rule 2009 (the draft Rule). The Commission has exercised its power under section 99 of the NEL to make the draft Rule a proposed more preferable Rule.

The Commission is satisfied that the draft Rule meets the Rule making test and will, or is likely to, better contribute to the achievement of the national electricity objective (NEO) than the Rule proposed in the Rule change request. In making this assessment, the impacts of the draft Rule on economic efficiency and good regulatory practice were taken into account.

The draft Rule will, or is likely to, better contribute to the NEO as it would promote economic efficiency while maintaining good regulatory practice. Economic efficiency is promoted as the market impact component of the incentive scheme provides incentive to TNSPs to maximise the availability of the transmission network, which would contribute to better price and quality of service outcomes to customers. The draft Rule maintains good regulatory practice as the early implementation of market impact parameters would not be a mandatory requirement for TNSPs. The early implementation application and assessment process would be governed by a clear and transparent process.

Making a submission or request for a hearing

Stakeholders are invited to make a written submission on the draft Rule determination and draft Rule by 5pm, 29 January 2010.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 5pm, 17 December 2009.

Submissions and requests for a hearing are required to be lodged electronically via the AEMC website (www.aemc.gov.au) or in hardcopy by mail to:

Australian Energy Market Commission
AEMC Submissions
PO Box A2449
SYDNEY SOUTH NSW 1235

All submissions and requests for a hearing should cite the reference "ERC0093".

1 Introduction

1.1 Grid Australia's Rule change request

On 30 April 2009, the Australian Energy Market Commission (Commission) received a Rule change request from Grid Australia. The Rule change request related to Clause 6A.7.4 of the National Electricity Rules (Rules), which requires the Australian Energy Regulator (AER) to publish a service target performance incentive scheme (the incentive scheme) that applies to transmission network service providers (TNSPs).

The Rules provide that any amendment or replacement of the incentive scheme will not apply to a TNSP in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement to the incentive scheme coming into operation.[1] The Rule change request proposed to insert savings and transitional provisions in Chapter 11 of the Rules to allow one component of the incentive scheme, the market impact component, to be implemented earlier.

1.2 Background

Clause 6A.7.4 of the Rules requires the AER to publish the incentive scheme and was introduced in 2006 as a part of the amendments to the Rules following the Commission's Review of Electricity Transmission Revenue and Pricing Rules.[2]

Incentive schemes are part of the overall economic regulatory regime defined in Chapter 6A of the Rules. They are designed to operate alongside the revenue cap form of regulation, which allows TNSPs to earn up to a maximum allowed revenue (MAR) each regulatory year. Under this framework, TNSPs can maximise their profits by reducing their costs below the forecast levels. Cost reductions could be achieved through improved efficiency, however, they could also potentially result from reduced service quality.

The aim of the incentive scheme is to link regulated revenues to the TNSPs' performance in order to ensure that cost reductions do not come at the expense of reduce service quality. The incentive scheme provides incentives for TNSPs to improve their performance by rewarding them when performance standards increase and penalising them when performance standards decline. That is, the TNSPs' MAR would be adjusted in accordance with the provisions in the incentive scheme to reflect the TNSPs' performance in each calendar year.

The AER published its final decision on the incentive scheme in March 2008.[3] The final scheme includes two components:

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[1] Clause 6A.7.4(f) of the Rules.

[2] AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*, Rule Determination, 16 November 2006, Sydney.

- a service component which provides incentives for TNSPs to minimise the number and duration of loss of supply events, and to maximise circuit availability (implemented through the application of "performance incentive parameters"); and

- a market impact component which provides incentives for TNSPs to minimise the market impact of transmission outages (implemented through the application of "market impact parameters").[4]

The financial incentive available under the market impact component is calculated by comparing a TNSP's performance in a calendar year against its market impact parameters. The financial incentive available will fall within a range of 0 to 2 percent of the TNSP's MAR.[5]

Clause 6A.7.4(f) of the Rules provide that any amendment or replacement of the incentive scheme will not apply to a TNSP in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement to the incentive scheme coming into operation. In effect, the final incentive scheme will not be introduced for most TNSPs until 2012 and onwards.

The draft Rule to be made (draft Rule), if made, would apply to all TNSPs. However, in effect, it would only apply to SP AusNet, ElectraNet, Powerlink, Murraylink and Directlink as:[6]

- TransGrid has already implemented the final incentive scheme, which comprises of both the service component and the market impact component; and

- Transend and EnergyAustralia are exempted from the market impact component of the incentive scheme.[7]

If all TNSPs successfully apply to bring forward the market impact component and perform such that the payments under the incentive scheme were maximised, the draft Rule would make available to TNSPs collectively additional revenue of approximately $90m. This estimate is based on determining the number of years that each TNSP would be able to "bring forward" the market impact component of the incentive scheme and assuming that each TNSP reaches the maximum two per cent

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[3] AER, *Electricity transmission network service providers – Service target performance scheme*, Final, March 2008.

[4] A TNSP's performance would be measured against the market impact parameters. The market impact parameters would be calculated for each TNSP based on the number of dispatch intervals where an outage on a TNSP's network resulted in a network outage constraint with a marginal value greater than $10/MWh over the previous five years. The TNSP's performance in the current calendar year would then be compared against the parameters to determine any applicable incentive. This is set out in Appendix C of the incentive scheme.

[5] AER 2008, op cit, p. 11.

[6] SP AusNet and ElectraNet have implemented the initial scheme, which has the service component only.

[7] AER 2008, op cit, p. 3.

incentive in each year the market impact component is brought forward. Additional details on this analysis is set out in Appendix A of this draft Rule determination.

1.3 Description of the Rule change request

The Rule change proposed by Grid Australia is to insert new provisions in Chapter 11 of the Rules which would provide for the market impact component of the incentive scheme to be implemented earlier than currently provided.

The main features of Grid Australia's proposal were that:

- TNSPs may apply to the AER to amend the revenue determination that applies for the current regulatory control period to give effect to the market impact component of the incentive scheme;
- the TNSP may propose to the AER the parameters 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 must either accept or reject the proposed values within 30 business days. If the AER rejects the proposed values, it must determine amended values;
- if the AER does not make a determination within 30 business days, it is deemed to have accepted the values proposed by the TNSP; and
- the TNSP may (but is not obliged to) accept the AER's amended values.

In its submission to the first round of consultation on the Rule change request, Grid Australia proposed a number of amendments to the Rule change.[8] The proposed amendments included:

- a provision for the AER to notify the TNSP to request for additional information, if required;
- the AER would make a written determination within 40 business days (instead of 30 business days); and
- the start of the market impact parameters could be brought forward to start at any time (subject to conditions) rather than the start of the next regulatory year.

1.4 Draft Rule to be made

Under section 91A of the National Electricity Law (NEL), the Commission may make a Rule (a more preferable Rule) that is different from the Rule proposed in the Rule change request if the Commission considers that the more preferable Rule will, or is likely to, better contribute to the achievement of the National Electricity Objective (NEO). Section 91A of the NEL states:

[8] Grid Australia, submission to the first round of consultation, 3 November 2009.

> The AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the national electricity objective.

The Commission has exercised its power under section 99 of the NEL to make the draft Rule a proposed more preferable Rule. The draft Rule provides a process to allow TNSPs to apply for the earlier implementation of market impact parameters but differs from the Rule proposed by Grid Australia. The differences between the draft Rule and Grid Australia's proposal are summarised in the following table:

Table 1.1 Comparison of draft Rule and Grid Australia's proposal

Grid Australia's proposal	Draft Rule
A TNSP would lodge an application to the AER at least three months prior to the commencement of the regulatory year.	A TNSP would lodge an application at least four months prior to the requested commencement date of the market impact component.
No specific provisions for the AER to request additional information.	The AER would conduct a preliminary examination of any application and the TNSP would be able to resubmit a proposal if it did not comply with the relevant requirements.
No specific consultation requirements were provided.	The AER would be required to conduct a public consultation.
The AER would be required to make a determination within 30 business days.	The AER would be required to make a determination at least one month prior to the commencement of the market impact component.
If the AER did not make a determination with 30 business days, it is deemed to have accepted the TNSP's proposed parameters.	The AER would be required to make a determination. There are no provisions for deemed acceptance.
The TNSP would not be obliged to accept the AER's amended values.	TNSPs would not have the option to reject any amended values.
Any early implementation will commence from the start of the next regulatory year.	The TNSP can apply for the early implementation to commence at any subject to meeting the timeframes under the application process.

1.5 Consultation on the draft Rule determination

Stakeholders are invited to make a written submission on the Commission's draft Rule determination and draft Rules by **Friday, 29 January 2010**. The Commission will have regard to all submissions lodged within the specified time period but may not be able to afford late submissions the same level of consideration. To ensure the Commission is able to give full consideration to each submission, parties are encouraged to lodge their submissions by this date.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on Rule change proposals.[9] The Commission publishes all submissions on its website subject to a claim of confidentiality.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than Thursday, 17 December 2009.

All enquiries on this Rule change should be addressed to Anita Lai on (02) 8296 7800.

Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code "ERC0093". The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within three business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
AEMC Submissions
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0093.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

[9] This guideline is available on the Commission's website.

If this confirmation letter is not received within three business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

2 Draft Rule Determination

2.1 Draft Rule determination

In accordance with section 99 of the NEL, the Commission has determined to make this draft Rule determination and the draft National Electricity Amendment (Early Implementation of Market Impact Parameters) Rule 2009 (draft Rule). The draft Rule is a proposed more preferable Rule.

2.2 Commission's considerations

In making the draft Rule, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule;
- whether the proposed Rule will, or is likely to, contribute to the achievement of the national electricity objective (NEO);
- the Rule change request;
- submissions received during the first round of consultation;
- any relevant Ministerial Council of Energy (MCE) statements of policy principles;[10] and
- revenue and pricing principles.[11]

2.3 Commission's power to make the Rule

The Commission may make a Rule with respect to certain matters as set out in section 34 and, more specifically, Schedule 1 of the NEL. In this case, the draft Rule is a matter on which the Commission may make a Rule as it falls under section 34(1)((a)(iii), which is the regulation of "the activities of persons (including Registered participants) participating in the national electricity market or involved in the operation of the national electricity system".

The draft Rule also falls under the following subject matters under Schedule 1 of the NEL:

Item 15:	the regulation of revenues earned or that may be earned by owners, controllers or operators of transmission systems from

[10] For this Rule change there are no relevant MCE statements of policy principles.

[11] Under section 7A of the NEL, the AEMC must take into account the revenue and pricing principles in making a Rule for or with respect to any matter or thing specified in items 15 to 24 and 25 to 26J of Schedule 1 of the NEL.

the provision by them of services that are the subject of a transmission determination;

Item 20: the economic framework, mechanisms or methodologies to be applied or determined by the AER for the purpose of items 15 and 16 including (without limitation) the economic framework, mechanisms or methodologies to be applied or determined by the AER for the derivation of the revenue (whether maximum allowable revenue or otherwise) or prices to be applied by the AER in making a transmission determination; and

Item 23: incentives for regulated transmission system operators to make efficient operating and investment decisions including, where applicable, service performance incentive schemes.

In exercising its Rule making powers, the Commission must also ensure that any Rules made are consistent with the provisions of the NEL. In making this draft Rule, the requirements of section 33 of Schedule 2 of the NEL on the saving of operation of repealed Law, Regulation or Rule provisions were taken into consideration. Specifically clause 33(1)(b) and (c), which state:

> [The repeal, amendment or expiry of a provision of this Law, the Regulations or the Rules does not –]
>
> (b) affect the previous operation of the provision or anything suffered, done or begun under the provision; or
>
> (c) affect a right, privilege or liability acquired, accrued or incurred under the provision;

The Commission is satisfied that the draft Rule does not contravene the provisions of section 33 of Schedule 1 of the NEL in relation to retrospective application of Rules. The draft Rule, if made, would not impact any existing rights or obligations. Importantly, if the implementation timeframe for the market impact parameters were brought forward, the market impact parameters would apply prospectively. The analysis and reasoning on this matter is provided in additional detail in Appendix A of this draft Rule determination.

2.4 The Rule making test and the National Electricity Objective

The Commission, in accordance with section 88(1) of the NEL, may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO.

The NEO is set out in section 7 of the NEL as follows:

> The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic efficiencies), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

2.4.1 Commission's assessment of the proposed Rule against the NEO

The Commission is satisfied that the draft Rule will, or is likely to, contribute to the achievement of the NEO as the draft Rule promotes economic efficiency and good regulatory practice, giving consideration to regulatory certainty and the overall regulatory framework. The Commission's considerations are outlined in the section and additional details on the analysis of the Rule change request are provided in Appendix A of this draft Rule determination.

Economic efficiency

Incentive schemes are included in the regulatory framework to promote efficiency under monopoly conditions. The market impact component addresses productive efficiency by seeking to reward TNSPs for maximising available network capacity when it is of most value to customers. For example, when demand in the NEM is high, the network could become congested. Congestion may prevent the cheapest generation from being dispatched and more expensive generation would need to be used. Additional network capacity at these times could reduce the need to dispatch higher-cost generation, thereby promoting more efficient outcomes.

Generators would also be impacted by transmission congestion and outages due to the risk that would be placed on their ability to dispatch generation. Generators would need to bear in mind dispatch risk when they decide on how to contract their output. Greater certainty around dispatch risk can support more efficient contracting by generators, which would potentially lead to lower costs to consumers.

The market impact component works by encouraging TNSPs to increase availability of the network during times that is of greater value to the market. It achieves this by measuring the TNSPs' performance during times where congestion on the network has resulted in spot prices above a defined level.[12] TNSPs would then be rewarded under the incentive scheme where their performance has improved from one year to the next. This potential reward creates an incentive for TNSPs to adopt operational and maintenance practices to increase the availability of the network and decrease

[12] The market impact parameters are currently calculated in relation to network outage constraints with a marginal value greater than $10/MWh. AER 2008, op cit, p.45.

incidences of congestion that are more efficient from the perspective of the market. The incentive scheme seeks to align private and market interests. Maximising network availability provides two benefits which would contribute to better price and quality of service outcomes to consumers:

- the need to dispatch higher-cost generation would be reduced; and
- the risks to each generator in managing its ability to dispatch into the network would be reduced, which would reduce the cost of business to manage these risks.

The draft Rule would bring forward the market impact component of the incentive scheme and, by doing so, allows potential benefits to be realised sooner. Taking this into account, the Commission is satisfied that the draft Rule contributes to promoting economic efficiency.

Regulatory certainty

Regulatory certainty is important as it would promote efficient decision making by allowing market participants to understand and predict the impact of the regulatory framework on business and operational decisions. The Commission assessed whether the incremental increase in the flexibility of the regulatory framework provided by the draft Rule would impact regulatory certainty.

The proposed process under the draft Rule provides a clearly defined framework that would maintain regulatory certainty by providing clarity to TNSPs and ensuring the AER fulfil its regulatory functions in a transparent and consistent manner. The draft Rule provides the opportunity for the AER to conduct a thorough review of any proposals and also include the requirement for consultation with stakeholders on any proposals received.

The draft Rule provides an option for TNSPs to seek early implementation of the market impact component; where the early implementation would not be a mandatory requirement. This would provide confidence to TNSPs as TNSPs would be able to assess whether to make an application based on each TNSP's specific business requirements and readiness to participate in the incentive scheme early.

Although the draft Rule provides an incremental increase in the flexibility of the regulatory framework, the provisions would be bound by a clearly defined process. The early implementation of market impact parameters would also be optional. For these reasons, the Commission considers the draft Rule would not decrease the level of regulatory certainty.

Impacts on other aspects of the incentives framework

The Commission assessed whether implementing one component of the incentive scheme now (rather than at the start of the next regulatory period) would impact the overall incentive framework. Any impact on other aspects of the framework, may impact market participants' existing obligations and anticipated business and operational outcomes.

The operation of the market impact component does not rely on, nor significantly impact, the operation of other aspects of the incentive framework. For this reason, the Commission considers the draft Rule providing for the option to implement the market impact parameters early, during an existing regulatory control period, would not have any material impacts on the overall incentive framework.

Safety and security of the NEM

The Commission does not consider the draft Rule is likely to affect the safety and security of the NEM.

2.5 More preferable Rule

Under section 91A of the NEL, the Commission may make a Rule (a more preferable Rule) that is different from the Rule proposed in the Rule change request if the Commission considers the more preferable Rule will, or is likely to, better contribute to the achievement of the NEO.

The Commission has exercised its power under section 99 of the NEL to make the draft Rule a proposed more preferable Rule. The draft Rule captures the intent of the original Rule change request by providing a process to allow TNSPs to apply for the early implementation of market impact parameters. However, it differs from the Rule proposed by Grid Australia in a number of aspects.

Grid Australia's proposal provided a process for a TNSP to make an application to the AER to request for the early implementation of market impact parameters. A 30 business day period was defined within which the AER would make a determination. Grid Australia's proposal also outlined that the TNSP's application would be deemed to be accepted by the AER if it did not make a determination within 30 business days and, that if the AER did amend the parameter values proposed, the TNSP would not be required to accept the amendment.

The draft Rule differs from that proposed by Grid Australia by setting out a more balanced application process, which is based on the existing requirements under Chapter 6A of the Rules. The draft Rule provides for the AER to conduct a preliminary examination of any applications from TNSPs. If following the preliminary examination, the AER believes the application did not comply with the necessary requirements, TNSPs would have the ability to resubmit their application. The draft Rule also has the requirement for the AER to conduct a public consultation on the application. The provisions for "deemed acceptance" have been removed and, if the AER determines to amend the values in the TNSP's proposal, the TNSP would not have the option to reject the amended values.

The Commission is satisfied that the draft Rule would better contribute to the achievement of the NEO, compared to the proposal outlined in the Rule change request. In the Commission's view, the process proposed in the original Rule change request for assessing the proposed market impact parameters was inconsistent with the existing provisions and favoured the TNSPs. The process under the draft Rule is more rigorous, which reduces the ability of transmission businesses to benefit from information asymmetry, hence, allows benefits for consumers to be better captured.

Additional analysis and reasoning is provided in Appendix A of this draft Rule determination.

2.6 Revenue and pricing principles

In accordance with section 88B of the NEL, the Commission must take into account the revenue and pricing principles set out in section 7A of the NEL in making a Rule for, or with respect to, any matter specified in items 15 to 24 and 25 to 26J of Schedule 1 of the NEL. As the Rule change request relates to the regulatory framework governing transmission revenue and pricing, meeting the requirements of section 88B, the Commission has taken into account the revenue and pricing principles in making this draft Rule determination and draft Rule.

2.6.1 Commission's assessment of revenue and pricing principles

The Commission considers that the draft Rule is consistent with the revenue and pricing principles as it provides a clear and transparent process to bring forward a component of the incentive scheme, which promotes economic efficiency. Applying for the earlier implementation of the market impact parameters is optional and the clearly defined application process would allow TNSPs to assess and manage any regulatory and commercial risks.

A Analysis of the Rule Change

This Appendix sets out the Commission's assessment and analysis of the Rule change request, including consideration of issues raised in stakeholder submissions.

A.1 Background

The Commission conducted a review of the Rules governing the regulation of electricity transmission revenue and pricing in 2005 and 2006. The revenue regulation aspects of the review was completed in November 2006 with the publication of the transmission revenue Rule and Rule determination.[13] The revenue Rule provides a balanced regulatory framework with appropriate incentives for efficient network investment and operation. This included forming an incentive framework to include incentives for efficient capital expenditure, efficient operating expenditure, maintaining service standards and the management of uncertain project costs and timing.

In developing the incentive framework, the Commission noted that the joint application of multiple incentive mechanisms would require a degree of flexibility and experimentation to produce optimal outcomes over time. To this end, the Rules provide discretion to the AER, with appropriate guidance, to develop the service target performance incentive scheme (incentive scheme) as set out under clause 6A.7.4 of the Rules. The Rules outline the broad features of the incentive scheme and provide a set of principles that the AER is to comply with in developing the incentive scheme. The Rules also require the AER to consult with stakeholders during its development processes.

The AER published the first service target performance incentive scheme (the initial scheme) in August 2007. The initial scheme focused on network availability and reliability and contained only the "service component". Concurrent to the development of the initial scheme the AER also developed performance parameters based on the market impact of transmission congestion, which led to the publication of an amended draft of the incentive scheme in November 2007 that included a market impact component. A final version of the incentive scheme was then published in March 2008.

The Rules provide that any amendments to the incentive scheme would not apply in respect of a regulatory control period that has commenced before, or that will commence within 15 months of the amendment coming into operation.[14] That is, in effect, the incentive scheme published by the AER in March 2008 will not apply to a TNSP until the next regulatory control period that commences 15 months

[13] AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*, 16 November 2006; and AEMC, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*, Rule Determination, 16 November 2006.

[14] Clause 6A7.4(f) of the Rules.

thereafter.[15] In effect, the final incentive scheme will not be introduced for most TNSPs until 2012 onwards.[16]

A.1.1 Grid Australia's Rule change request

On 30 April 2009, the Commission received a Rule change request from Grid Australia.[17] The request proposed to insert new provisions in Chapter 11 of the Rules which would provide for the market impact component of the incentive scheme under Rule 6A.7.4 to be implemented earlier than currently provided. The main features of the Rule proposed in the Rule change request were that:

- 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 30 business days, the parameters proposed by the TNSP would be deemed to be accepted;
- TNSPs would not be obliged to accept the AER's amended values.

In its submission to the first round of consultation on the Rule change request, Grid Australia proposed a number of amendments to the Rule change.[18] The proposed amendments included:

- a provision for the AER to notify the TNSP to request for additional information, if required;
- the AER would make a written determination within 40 business days (instead of 30 business days); and
- the start of the market impact parameters could be brought forward to start at any time (subject to conditions) rather than the start of the next regulatory year.

A.1.2 More preferable Rule

Under section 91A of the NEL, the Commission may make a Rule (a more preferable Rule) that is different from the Rule proposed in the Rule change request if the

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15 Clause 6A.7.4(f) and AER 2008, op cit, p. 3.

16 The next regulatory control period starts for each TNSP on 1 July 2012 for Powerlink; 1 July 2013 for ElectraNet and 1 April 2014 for SP AusNet.

17 A copy of the Rule change request is available on the Commission's website at www.aemc.gov.au.

18 Grid Australia's submission, op cit.

Commission is satisfied the more preferable Rule will, or is likely to, better contribute to the achievement of the NEO.

The Commission has exercised its power under section 99 of the NEL to make the draft Rule a proposed more preferable Rule. The Commission considers that the draft Rule will better contribute to the achievement of the NEO, compared to the proposal outlined in the Rule change request, as it would provide greater transparency and increased consistency with current processes under the Rules. The process under the draft Rules is more rigorous, which reduces the ability of transmission businesses to benefit from information asymmetry, hence, allows benefits for consumers to be better captured.

The Commission's analysis on the relevant issues is outlined in this Appendix as follows. A comparison of the differences between the draft Rules and the original Rule change request is set out in Chapter 1 of this draft Rule determination.

A.1.3 Potential impact of the proposed Rule

The financial incentive available under the market impact component is calculated by comparing a TNSP's performance in a calendar year against its market impact parameters. The financial incentive available will fall within a range of 0 to 2 percent of the TNSP's MAR for each calendar year.[19]

The draft Rule, if made, would apply to all TNSPs. However, in effect, it would only apply to SP AusNet, ElectraNet, Powerlink, Murraylink and Directlink as:

- TransGrid has already implemented the final incentive scheme, which comprises of both the service component and the market impact component; and

- Transend and EnergyAustralia are exempted from the market impact component of the incentive scheme.[20]

If all TNSPs successfully apply to bring forward the market impact component and perform such that the payments under the incentive scheme were maximised, the draft Rule would make available to TNSPs collectively additional revenue of approximately $90m. This estimate is based on determining the number of years that each TNSP would be able to "bring forward" the market impact component of the incentive scheme and assuming that each TNSP earns the maximum two per cent incentive in each year the market impact component was brought forward. Estimated values are set out in the table below.

[19] AER 2008, op cit, p. 11.

[20] Ibid, p. 3.

Table A.1 Estimated financial impact of early implementation of the market impact component

	Effective date of market impact component with Rule change	Effective date of market impact component without Rule change	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	TNSP total ($ m) ‡
			(2% MAR, $ m)*‡					
Powerlink	Future date subject to successful application to AER†	1 July 2012	14.7	16.3				31.0
ElectraNet		1 July 2013	5.2	5.7	6.1			17.0
SP AusNet		1 April 2014	9.7	10.1	10.5	10.8		41.1
Murraylink		1 July 2013	0.3	0.3	0.3			0.8
Directlink		1 July 2015	0.3	0.3	0.3	0.3	0.3	1.3
Total								91.1

*To allow for comparison, values in the table are calculated based on regulatory years. It is noted that the actual incentive payments would be calculated based on calendar years. Nominal, smoothed MAR values were used. No adjustments were made for the X-factor.

†Calculations based on the assumption that all TNSPs successfully apply for the early implementation of the market impact parameters to start on 1 July 2010.

‡Figures have been rounded.

A.2 Promoting the National Electricity Objective

The NEO guides the Rule making process to ensure that the regulatory regime in place facilitates efficient investment in, and operation of, the NEM, which then promotes competition and the long term interest of consumers.

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic efficiencies), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

The NEO is set out in section 7 of the NEL as follows:

> The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

The Rule change request seeks to bring forward the start date of the market impact component of the incentive scheme for TNSPs. In making this draft Rule determination, the Commission has assessed whether bringing forward the market impact component would promote the NEO in terms of whether the Rule change request would facilitate efficient investment in, and operation of, transmission networks and, hence, promote competition and efficiency in the electricity market.

The assessment of the draft Rule against the NEO examines whether the draft Rule better promotes the NEO, compared to the Rule proposed in the Rule change request, in terms of economic efficiency and good regulatory practice. The Commission also considered the impact of the processes requirements under the draft Rules on the NEO.

A.2.1 Economic Efficiency

TNSPs are currently subject to the revenue cap form of regulation, where TNSPs may maximise their profits by reducing costs below forecast levels. TNSPs may achieve cost reductions through improved efficiency, however, cost reductions could potentially also result from reduced service quality. Consistent with the NEO, the aim of the incentive scheme is to protect, and promote the improvement of, service standards by linking the TNSPs' revenue to their performance.

The market impact component of the incentive scheme is designed to link service standard incentives to market outcomes and, by doing so, influence the TNSPs' operational decisions and behaviour to reduce the economic impacts of congestion on the transmission network, by ensuring that the network is available at times that are of greater value to the market. Congestion on the transmission network can have two obviously relevant impacts:

- dispatch efficiency; and
- generators' ability to manage dispatch risk.

Reduced availability or outages on the transmission network could prevent the lowest priced generation from being dispatched, which would result in productive inefficiency. As lower priced generation is displaced by more expensive generation, consumers would pay higher prices for electricity. For example, when demand in the NEM is high, the network could become congested. Congestion may prevent the cheapest generation from being dispatched and more expensive generation would need to be used. Additional network capacity at these times could reduce the need to dispatch higher-cost generation and promote more efficient outcomes.

Generators would also be impacted by transmission congestion and outages due to the risks placed on their ability to dispatch generation. Generators would need to bear in mind dispatch risk when they decide on how to contract their output. Greater certainty around dispatch risk can support more efficient contracting by generators, which would potentially lead to lower costs to consumers.

Commission's considerations and reasoning

The Commission considers that the draft Rule promotes economic efficiency as it would bring forward the implementation of an incentive scheme that has been developed under the Rules as a means of rewarding TNSPs if their behaviour supports more efficient outcomes.

The market impact component of the incentive scheme is designed to influence the TNSPs' operational decisions and behaviour to decrease the economic impacts of congestion on the transmission network. That is, reduced availability or outages on the transmission network could prevent the lowest priced generation from being dispatched, which would result in productive inefficiency, leading to higher electricity prices and greater risks to generation businesses.

The market impact component works by encouraging TNSPs to increase availability of the network during times that is of greater value to the market. It achieves this by measuring the TNSPs' performance during times where congestion on the network has resulted in spot prices above a defined level.[21] TNSPs would then be rewarded under the incentive scheme where their performance has improved from one year to the next. This potential reward creates an incentive for TNSPs to adopt more efficient operational and maintenance practices to increase the availability of the network and decrease incidences of congestion. Maximising network availability provides two benefits which would contribute to better price and quality of service outcomes to consumers:

- the need to dispatch higher-cost generation would be reduced; and
- the risks to each generator in managing its ability to dispatch into the network would be reduced, which would reduce the cost of business to manage these risks.

The draft Rule would bring forward the market impact component of the incentive scheme and, by doing so, allows potential benefits under the incentive scheme to be realised sooner. Taking this into account, the Commission is satisfied that the draft Rule better contributes to promoting economic efficiency.

A.2.2 Good regulatory practice

Good regulatory practice refers to the means by which regulatory arrangements are designed and operated to provide a framework under which market participants can have confidence in the regulatory processes and decisions. This confidence provides the environment within which effective and efficient decisions may be made by businesses and regulators. In assessing whether the draft Rule promotes good regulatory practice, the Commission has considered the impacts of the draft Rule on regulatory certainty and the overall regulatory framework.

A.2.2.1 Regulatory certainty

The frameworks for regulatory processes and decision making should be based on consistent principles to allow TNSPs to plan and respond to changes in market requirements, while allowing the regulator sufficient discretion and flexibility to perform its role effectively. Frameworks that deliver these outcomes can be

[21] The market impact parameters are currently calculated in relation to network outage constraints with a marginal value greater than $10/MWh. AER 2008, op cit, p. 45.

characterised as providing regulatory certainty. Regulatory certainty promotes the NEO as it provides confidence in stakeholders' planning and decision making processes. In assessing this Rule change request, the Commission considered whether the level of regulatory certainty would be maintained given the incremental increase in the flexibility of the framework that would allow the implementation of the market impact component of the incentive scheme to be brought forward.

A lack of regulatory certainty would dilute the potential effects of incentive schemes and reduce the confidence of market participants and potential investors. Incentive regulation is based on renumerating TNSPs in respect of their forecast costs over the regulatory control period. As TNSPs would be able to capture a proportion of the benefits of any unanticipated cost reductions (or in the case of the market impact component, by reducing the impact of outages on the spot market), TNSPs would be encouraged to make cost savings with the expectation of receiving an incentive payment. However, if TNSPs anitcipated incentive payments may be subject to change, they would not have any incentive to take any action.

Regulatory certainty was also a consideration at the time the incentive scheme provisions were established.[22] As discussed in the revenue Rule determination, a definitive timetable for the regulatory process was considered necessary to improve the certainty, transparency and timeliness of regulatory processes. The Commission had set out specific timelines and transitional requirements for the implementation of Chapter 6A of the Rules. No specific consideration was given at that time to the possibility of initiating one component of the incentive scheme at an earlier time.

Commission's considerations and reasoning

The Commission considers that the draft Rule, if made, would not impact regulatory certainty as it seeks to bring forward the start date of a component of an incentive scheme that would, in any case, be implemented. By maintaining the level of regulatory certainty, the ability for market participants to make confident decisions would not be affected. This would allow decisions to be made efficiently, which would promote the efficient investment in, and operations of, the transmission systems.

The incentive scheme has been developed by the AER in accordance with the clear and transparent requirements under the Rules, which includes consultation with stakeholders. The draft Rule would not impact the operation of the incentive scheme.

The draft Rule provides an option for TNSP to seek early implementation of the market impact component; where the early implementation would not be a mandatory requirement. This would provide confidence to TNSPs as they would be able to make an assessment on whether to make an application based on each TNSP's specific business requirements and readiness to participate in the incentive scheme early.

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[22] AEMC 2006, op cit.

The process under the draft Rule provides an application and assessment process that is consistent with the current provisions in relation to submitting information under the revenue determination process. The proposed process would maintain regulatory certainty by providing clarity to TNSPs and ensuring the AER fulfilled its regulatory functions in a transparent and consistent manner. The draft Rule provides the opportunity for the AER to conduct a thorough review of any proposal and also includes the requirement for consultation with stakeholders on any proposals received.

A.2.2.2 Impacts on the overall incentive framework

In making the Rule Determination for the Economic Regulation of Transmission Services, the Commission noted that the provisions were established to provide a range of incentive mechanisms that worked harmoniously together to provide an overall suit of incentive properties that delivered efficient and desired production and service outcomes.[23] In assessing this Rule change request, the Commission has considered whether one component of the overall framework could work effectively if it is applied at a different time to other components.

The component parts of the incentive framework included incentives for efficient capital and operating expenditure. There were also provisions for the management of uncertain project costs and timing. The incentive scheme being considered in this draft Rule determination relate to maintaining appropriate service standards.

Commission's considerations and reasoning

The Commission considers that the draft Rule would not adversely impact the overall incentive framework as the different mechanisms in place address specific components of the revenue framework. The market impact component seeks to provide incentives for TNSPs to adopt more efficient transmission operating and maintenance practices and more efficiently use existing transmission infrastructure.

The market impact component operates by setting performance targets for each TNSP, giving consideration to market impacts of the its historical performance. The aim is to provide incentives to ensure that the network is available at times that is of greater value to the market. The operation of the market impact component does not impact other incentive provisions under the regulatory framework such as the incentives for operating and capital expenditure. Incentives for operating and capital expenditure are captured by other mechanisms under the Rules such as those relating to the treatment of operational savings and the regulatory asset base.

The design of the market impact component of the incentive scheme provides that any financial gain a TNSP would receive would be proportionate to the benefits provided to the market. Any incentive payments to TNSPs would be calculated based on how a TNSP has managed its operations to reduce the potential for outages that adversely affect (increase) spot prices.

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[23] ibid, p. 95.

The operation of the market impact component does not rely on, nor significantly impact, the operation of other aspects of the incentive framework. For this reason, the draft Rule which provides for the option to implement the market impact parameters early, during an existing regulatory control period, would not have any material impacts on the overall incentive framework.

In considering the impact of the draft Rule on the overall incentive framework, the Commission also considered the case of Powerlink where Powerlink is currently subject to a "transitional regulatory control period". Powerlink's transitional revenue determination was made pursuant to the old Chapter 6 of the Rules as its last revenue reset concurred with the Commission's review of the revenue Rules. As the market impact component is a part of the incentive scheme under Chapter 6A of the Rules, the question was raised as to whether Powerlink should be able to bring forward the implementation of the market impact component given that it is currently subject to the transitional revenue determination.

In the development of Chapter 6A of the Rules, through specific savings and transitional provisions, the Commission had ensured that Powerlink was neither in a better or worse position than other TNSPs as a result of the application of a transitional regulatory control period.[24] The savings and transitional provisions provided that the same principles under Chapter 6A of the Rules would apply to Powerlink. Taking these factors into consideration, the Commission considers that the provision to allow the market implementation parameters to be implemented earlier should apply to Powerlink.

A.2.3 Retrospectivity considerations

To maintain good regulatory practice and consistency with the principles of promoting efficient investment under the NEO, amendments to the regulatory framework should not have retrospective application. Retrospective amendments would create uncertainty and undermine the regulatory framework by rewarding or penalising decisions that have already been made. In assessing this Rule change request, the Commission has considered whether it is consistent with the provisions relating to retrospectivity under section 33 of Schedule 2 of the NEL.

Commission's considerations and reasoning

The Commission considers that the draft Rule, if made, would not have retrospective application and therefore is consistent with the provisions relating to retrospectivity under clause 33(1) of Schedule 2 of the NEL.

The draft Rule relates to the implementation timeframe of an incentive scheme that has yet to come into operation, which would not affect the application or operation of the other components of the incentive scheme.

The draft Rule provides for a change to be made during the current regulatory control period, which potentially could affect decisions that have already been made

[24] AEMC 2006, op. cit. p. 126.

by market participants. For example, planned maintenance decisions may need to be adjusted in light of the market impact component being introduced. However, this risk is minimised by making it optional for TNSPs to apply for the earlier implementation of the market impact component.

In addition, if the implementation timeframe was brought forward, the market impact parameters would apply prospectively.

A.2.4 Process requirements

To provide for the early implementation of the market impact component of the incentive scheme, an appropriate process would need to be established to provide for TNSPs to make applications and the AER to assess the applications. The draft Rule has been developed giving consideration to maintaining consistency with the current provisions under the Rules. The Commission's assessment and analysis of various aspects of the implementation process are set out below.

A.2.4.1 Consultation and timeframe requirements

The current arrangements under the Rules require a TNSP to submit the parameter values for the incentive scheme as a part of the revenue reset process, including parameter values for the market impact and service components of the incentive scheme.[25] This initial submission would be made 13 months prior to the start of the next regulatory control period.[26] The AER would have the opportunity to conduct a preliminary assessment of the TNSPs applications.[27] If the application did not comply with the relevant requirements, the TNSPs would have the opportunity to amend and resubmit their application.[28] The AER would then publish the TNSP's revenue proposal and invite written submissions.[29]

In its Rule change request, Grid Australia suggested that a TNSP would submit an application to the AER three months prior to the start of the regulatory year and the AER would make a determination within 30 business days. No specific provisions for consultation were included.

Commission's considerations and reasoning

Under the current provisions of the Rules, a TNSP's proposed market impact parameters would be assessed as a part of the revenue determination process that has been designed to protect the interest of consumers. The process under the draft Rule for the assessment of a TNSP's proposed parameters and application for early implementation of the market impact component should be as rigorous as it would have been under the current provisions. Given that there is potentially an additional

[25] Clause 6A.10.1 of the Rules; section 4.2 of the incentive scheme.

[26] Clause 6A.10.1(a)(1) of the Rules.

[27] Clause 6A.11.1 of the Rules.

[28] Ibid.

[29] Clause 6A.11.3 of the Rules.

$90m that could be gained by TNSPs, an equivalently rigorous process should be adopted, if practical, to ensure that the interest of consumers would be protected and promoted. As the revenue determination process encompasses a much broader scope, the draft Rule, in comparison, provides a condensed and simplified process.

Consultation on the TNSPs proposals

The draft Rule requires the AER to consult on a TNSP's proposed parameter values. Under the current provisions, the proposed parameter values, as a part of a TNSP's revenue proposal, would be subject to consultation. The consultation process increases transparency and allows all stakeholders the opportunity to participate in the market. However, as noted by the AER in its submission on the Rule change request, the process for setting the market impact parameters would be based on publicly available data and a "largely mechanical" process.[30] On balance, the Commission considers that a shortened consultation timeframe of 10 business days would be appropriate (as compared to a 30 business day consultation period under the revenue reset process).

The AER would be required to publish on its website, and make available for inspection at is public offices, the applications received from TNSPs and the invitations for submissions. Although under the revenue determination process the AER would publish invitations for written submissions in a newspaper circulating generally throughout Australia, the draft Rule does not include this requirement.[31] Given the process under the draft Rule is limited in scope compared to the revenue determination process and the process for setting the market impact parameters would be largely mechanical, a simplified notification would be appropriate. In addition, stakeholders would be able to subscribe to the AER website to be advised of any updates.

AER's assessment of proposals

The draft Rule provides the AER with the ability to assess each proposal received and determine the appropriate parameters that should be applied giving consideration to the requirements as defined under the incentive scheme. This provides a balance to the information asymmetry that may exist between businesses and the AER. In addition, the draft Rule does not specify a number of days within which the AER must make a determination. The draft Rule provides an overall three month timeframe whereby a TNSP would be required to make an application at least four months prior the requested start date of the market impact component and the AER must make a determination at least one month prior to the start date.

This timeframe under the draft Rule would provide approximately 60 business days within which the AER would conduct a consultation and make a determination. The draft Rule also clarifies the ability for the AER to make a preliminary assessment of any application to ensure that the relevant requirements were met prior to progressing with the application process. In its submission, the AER had noted that

[30] AER, submission to the first round of consultation, 29 September 2009, p. 2.

[31] Clause 6A.11.3(a) of the Rules.

the 30 business days outlined in the Rule change request could be insufficient in some circumstances and that it should have the option to extend the time if it were to consult with interested parties.[32] The Commission considers the draft Rule provides consistency with the existing processes under the Rules and addresses some of the concerns raised by the AER while maintaining a similar timeframe to the original Rule change request.

A.2.4.2 Approval of parameter values

Currently the AER would assesses the proposed parameter values as a part of the revenue reset process and, in accordance with this process, make a determination. However, Grid Australia's Rule change request included the provisions that:

- the TNSP's proposed values would be deemed to be accepted if the AER did not make a determination within 30 business days; and

- the TNSP may, but would not be obliged to, accept any amended values by the AER.

Commission's considerations and reasoning

Consistent with the provisions under Chapter 6A of the Rules, the draft Rule requires the AER to make a determination on the proposed values and does not include provisions for "deemed acceptance". In addition, TNSPs would not have the option to reject any amended values. The draft Rule reduces the ability of TNSPs to benefit from information asymmetry and, hence, benefits for consumers would be better captured.

Grid Australia submitted that the deemed acceptance provision was included in its Rule change request "to provide a discipline on the AER to adhere to the approval timetable".[33] However, the draft Rule provides a specific process and timeframe within which any application would need to be considered, which should provide sufficient discipline on the AER. The Commission considers that the deemed acceptance provision would not provide sufficient incentive to ensure TNSPs' proposals would maximise the potential benefits to consumers. The draft Rule provides the AER to make a determination on the proposed values to ensure the parameters were calculated in accordance with the requirements under the incentive scheme. The rigour built into the assessment process would promote the protection of consumer interests.

Grid Australia submitted that the ability for a TNSP to reject amended values, or withdraw its application, would be important as "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".[34] However, as set out in the incentive scheme,

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32 AER submission, op cit, p. 3.

33 Grid Australia submission, op cit, p. 9.

34 Grid Australia submission, op cit, p. 7.

the AER must accept any proposed values if they comply with the requirements of the scheme.[35] In accordance with the provisions of the incentive scheme, the risks faced by the TNSPs would be minimised as any well-considered proposals that meet the defined requirements would be accepted. TNSPs would be able to make a well-informed decision on whether to make an application for the early implementation, with a clear understanding of how the market impact parameters would be set.

In addition, the financial risks to TNSPs would also be reduced as the market impact component is a "bonus only" provision and, as such, no penalties would apply if a TNSP did not meet its performance targets.

A.2.4.3 Effective date

Currently the Rules, in effect, provide that the incentive scheme would be applied from the start of the next regulatory control period.[36] Grid Australia's Rule change request proposed that the early implementation of the market impact component would be brought forward to the start of the next regulatory year. In its submission on the Rule change request, Grid Australia proposed more flexibility on the start date.[37]

Commission's consideration and reasoning

The draft Rule provides that the early implementation of the market impact parameters may commence at any time as outlined in the TNSP's application and approved by the AER, subject to meeting the timeframe requirements of the application process.

It is noted that the incentive scheme currently provides for the TNSPs' performance against the parameter values to be measured on a calendar year basis. The scheme also provides for the measurements to be adjusted to account for the start and end of the regulatory control period where periods do not span a full calendar year. As the scheme already has provisions for periods of application that do not span a full calendar year, the Commission considers that there would be no benefits to limit the commencement date of the early implementation to the start of the regulatory year.

A.2.4.4 Administrative costs

To request for early implementation of the market impact parameters, TNSPs would need to submit an application, which would then be assessed by the AER. TNSPs and the AER would incur administrative costs in setting up and undertaking these process requirements.

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35 AER Final incentive scheme, op cit, p. 10.

36 Clause 6A.7.4(f) of the Rules, which provides that any amendment or replacement of the incentive scheme would not be applied in respect of a regulatory period that has commenced, or that will commence within 15 months of, the amendment or replacement coming into operation.

37 Grid Australia submission, op cit, p. 12.

Commission's consideration and reasoning

The Commission considers the process requirements under the draft Rules would not add material costs to TNSPs and the AER. The implementation costs in setting up the process requirements for TNSPs to prepare proposals and for the AER to assess them, would be incurred in any case at the next revenue reset. The provisions under the draft Rules would bring forward these implementation costs, which would otherwise be incurred at the next revenue reset.

The administrative costs, to make an application by the TNSP under the draft Rules and for the AER to assess the application, would be additional costs as the parties would go through this process more times if this draft Rule was made. However, once the processes have been set up, based on the information available the Commission understands that the incremental "operational" costs would not be material.

A.2.5 Implementing future changes to the incentive scheme

Under the provisions of the Rules, the incentive scheme can be further developed and amended by the AER, in consultation with stakeholders.[38] If a further amendment were to be made to the incentive scheme, clause 6A.7.4(f) of the Rules would currently require that the amendment would only be implemented in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement coming into operation.

Given the draft Rule determination to permit the early implementation of the market impact parameters, the Commission considered the related question of how subsequent changes to the incentive scheme should be treated.

Commission's considerations and reasoning

The Commission considers that the early implementation should apply to the market impact component of the incentive scheme as published by the AER in March 2008 only. The implementation of any future amendments to the scheme would be subject to clause 6A.7.4(f) of the Rules. Should market participants, including the AER, wish to implement a future amendment of the scheme earlier than that provided for under clause 6A.7.4(f), a Rule change request may be raised.

As discussed above, regulatory certainty is an important consideration. The five year revenue control period provides certainty by setting out a specific timeframe that allows TNSPs to make decisions with a level of certainty. Although the analysis for the draft Rule concluded the draft Rule did not have any negative impacts on regulatory certainty, the analysis was based on the market impact component being a new component to the incentive scheme and that the early implementation would be optional for TNSPs. Bringing forward the start of a provision that some TNSPs

[38] Refer to clause 6A.7.4(f) of the Rules.

would otherwise be precluded from for a number of years, would not impact any existing obligations.[39]

This draft Rule determination does not mandate the early implementation of the market impact component, which goes towards maintain regulatory certainty. The option for TNSPs to apply for early implementation should be applied to any future changes. In the same why that this request for the early implementation of market impact parameters was considered, should TNSPs or the AER wish for a future change to be implemented early, a Rule change request may be raised which would allow any potential impacts to be appropriately assessed at that time.

In making this assessment, the Commission also considered whether the process under the draft Rules should be a generic provision to allow future changes to be implemented earlier on application. However, it is unclear whether the earlier implementation of any other future amendments to the incentive scheme would have a retrospective application by, for example, changing the current application or operation of the incentive scheme. For this reason, a future change may have additional impacts that would need to be assessed.

A.2.6 Service component of the incentive scheme

As outlined above, the incentive scheme comprises the service component and the market impact component. The draft Rule, consistent with the Rule proposed by Grid Australia, refers specifically to the early implementation of the market impact component. In making this draft Rule determination, the Commission considered whether early implementation should apply to the service component as well.

The service component provides incentives for TNSPs to minimise the number and duration of loss of supply events and to maximise circuit availability (as opposed to the market impact component which provides incentives to minimise the market impact of outages). The service component formed the initial scheme (which did not contain the market impact component), which has been implemented for SP AusNet and ElectraNet.

The service component also subjects TNSPs to a potential penalty where the financial incentive that a TNSP may earn falls within a range of plus or minus one percent of the TNSP's MAR for each calendar year.

Commission's considerations and reasoning

The Commission considers that provisions for the early implementation of the service component of the incentive scheme should not be included at this time. The Commission understands the service component parameters are subject to greater complexity and preparing for its implementation would likely require more extensive consultation and consideration by TNSPs and the AER. In this case, it is likely the additional time to prepare and assess an application would likely limit the

[39] This was noted in Grid Australia's submission to the first round of consultation, p. 9.

ability to bring forward the start date. The Commission welcomes any comments from stakeholders on this issue.

Should TNSPs or the AER consider it appropriate to bring forward the implementation of the service component, a Rule change request could be raised to allow the relevant issues to be considered.

A.2.7 Summary of the Commission's assessment against the NEO

The Commission is satisfied that the draft Rule will, or is likely to, better contribute to the achievement of the NEO. In making this assessment, the Commission took into account the impacts of the draft Rule on:

- Economic efficiency – the draft Rule promotes economic efficiency as the market impact component provides incentives to TNSPs to maximise the availability of the transmission network at times of greater value to the market;
- Good regulatory practice – the draft Rule maintains the level of regulatory certainty and does not have any impacts on the operation of other aspects of the incentive framework;
- Retrospectivity – the draft Rule would not have any retrospective application; and
- Process requirements – the process for the application and assessment of parameter values under the draft Rules provides a rigorous process, which protects the interests of consumers.

A.3 Revenue and pricing principles

In accordance with section 88B of the NEL, the Commission must take into account the revenue and pricing principles set out in section 7A of the NEL in making a Rule for, or with respect to, any matter specified in items 15 to 24 and 25 to 26J of Schedule 1 of the NEL. As the Rule change request relates to the regulatory framework governing transmission revenue and pricing, meeting the requirements of section 88B, the Commission has taken into account the revenue and pricing principles in making this draft Rule determination and draft Rule.

A.3.1 Commission's consideration and reasoning

The Commission considers that the draft Rule is consistent with the revenue and pricing principles as it provides a clear and transparent process to bring forward a component of the incentive scheme, which promotes economic efficiency.

The market impact component of the incentive scheme has been designed to increase the availability of that the transmission mission network at times that would be of most value to the market, which would promote the efficient utilisation of investments. Providing for the market impact component to be implemented earlier would allow these potential benefits to be realised sooner.

The provision is not a mandatory requirement, which provides TNSPs the ability to assess their readiness to bring forward the incentive scheme. Together with the clearly defined application process, TNSPs would be able to assess and manage any regulatory and commercial risks.

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B Response to Issues Raised in Submissions

This Appendix provides a summary of the issues raised in submissions received in the first round of consultation on the Rule change request. Submissions were received from the Australian Energy Market Operator (AEMO), the AER, the National Generators Forum (NGF) and Grid Australia.

	Issue	Summary of submission/s	AEMC response/comments
General Issues			
1.	Interaction with the National Electricity law (NEL) and retrospectivity	The AER noted that the proposed Rule could raise questions regarding retrospectivity under section 33(1) of Schedule 2 of the NEL. The AER noted it did not have any views on this issue but would expect the AEMC to consider this when assessing the Rule change request.[39]	The proposed Rule is consistent with the NEL. As discussed in Chapter 2 and section A.5.
2.	Amending the revenue determination part way through a regulatory control period	The AER recognised that limiting amendments to the revenue determination maintains the integrity of the framework for economic regulation. However, in this instance, the AER considers that permitting the early implementation of the market impact parameter is warranted as there are clear benefits to market participants.[40]	The proposed Rule does not have any material impacts on other aspects of the regulatory framework. As discussed in section A.2.2.

[39] AER, submission to the first round of consultation, 29 September 2009, p. 1.

[40] Ibid, p. 2.

	Issue	Summary of submission/s	AEMC response/comments
3.	Should this be a one-off change or should future amendments to the incentive scheme be able to be implemented immediately	The AER submitted that there was merit in the allowing subsequent changes to the incentive scheme to also be implemented early, ahead of the next regulatory control period. However, it noted that it should be provided with some level of discretion to assess when changes may be implemented early.[41] Grid Australia, on the other hand, submitted that this should be a one-off change.[42]	The provisions for early implementation should be a one-off change and apply to the incentive scheme as published in March 2008. As discussed in section A.2.5.
Implementation Process			
4.	Whether the AER should be required to consult before making its determination on the parameter values	The AER submitted that as the process for determining the parameters to apply would be a largely mechanical process, the Rule should explicitly state that the AER does not need to consult before making its determination.[43]	A short consultation period will be required. As discussed in section A.2.4.

[41] Ibid, p. 5.

[42] Grid Australia, submission to the first round of consultation, 3 November 2009, p. 9.

[43] AER submission, op cit, p.2.

	Issue	Summary of submission/s	AEMC response/comments
5.	Period for the AER to make its assessment following an application from a Transmission Network Service Provider (TNSP)	The Rule proposed by Grid Australia provides that the AER must make its assessment in 30 business days. The AER submitted that this would be insufficient and proposes that 40 business days, with an option to extend further if any complex issues were raised, would be more suitable.[44] The AER further noted that if a TNSP's proposal was considered under the revenue determination process, the AER would have up to 80 business days to assess the proposal before issuing its draft assessment.[45]	The proposed Rule defines an overall timeframe that would apply to the process. As discussed in section A.2.4.
6.	Approval of the parameter values	The Rule proposed by Grid Australia provides that the parameter values proposed by a TNSP would be deemed to be accepted by the AER if the AER failed to make a determination with the required timeframe. The AER submitted that it did not support this approach and considered that it would deviate from the approach taken under Chapter 6A of the Rules and could lead to undesirable outcomes.[46]	The proposed Rule requires the AER to make a determination. As discussed in section A.2.4.

44 Ibid, pp. 2-3.

45 Ibid, p. 2.

46 Ibid, p. 3.

	Issue	Summary of submission/s	AEMC response/comments
7.	TNSP's option to reject amended parameter values	The Rule proposed by Grid Australia also provides that a TNSP may reject the AER's amended performance target. The AER submitted that it did not support this as it would be inconsistent with the current regime and would not provide TNSPs with a strong incentive to propose well-considered targets.[47] Grid Australia disagreed with the AER's assessment.[48]	The AER's determination would be applied. As discussed in section A.2.4.
8.	The applicable version of the incentive scheme	The Rule proposed by Grid Australia references the incentive scheme published by the AER on 7 March 2009. The AER submitted it may wish to improve and amend the scheme in the future. The AER also noted that the Rule would need to refer to all the relevant requirements under the incentive scheme such as information and reporting requirements, compliance auditing, timing of performance and adjustments to the maximum allowed revenue.[49]	This has been addressed in the draft Rule where the obligations to comply with the relevant provisions under the incentive scheme have been captured.

[47] Ibid.

[48] Grid Australia's submission, op cit, p. 7.

[49] AER's submission, op cit, p. 4.

	Issue	Summary of submission/s	AEMC response/comments
9.	Application of the incentive scheme to Transend	The AER noted that Transend is explicitly excluded from the market impact component of the incentive scheme and that the Rule should clarify whether Transend is able to apply to amend its revenue determination.[50]	The early implementation provisions should not change the actual provisions of the incentive scheme. As Transend is currently excluded from the incentive scheme, this exclusion would not be changed by the draft Rule. This clarification has been addressed in the draft Rule.
Data Requirements			
10.	Data would be required to calculate the market impact parameters	AEMO noted that it collects and publishes the data necessary to calculate the market impact parameters and considers that no additional burdens should arise for AEMO, from a data perspective, from the early implementation of this parameter for all TNSPs.[51]	The AEMO's processes have been noted.
11.	Collection of the required data and provision to the AER	The NGF submitted that AEMO should supply the relevant data to the AER and that TNSPs should have no role in providing the required data.[52] Grid Australia submitted that the NGF's proposal was inconsistent with the existing scheme.[53]	The Commission considers that TNSPs need to maintain ownership of the application process and need to provide well-considered proposals. As the data would be used by the TNSPs in its calculation of proposed parameter values, it would be inappropriate for another party to be responsible for submitting the data to the AER.

[50] Ibid.

[51] AEMO, submission to the first round of consultation, 2 October 2009, p. 1.

[52] NGF, submission to the first round of consultation, 1 October 2009, p. 3

[53] Grid Australia's submission, op cit, p. 6.

	Issue	Summary of submission/s	AEMC response/comments
Other issues			
12.	Design of the market impact component	The NGF submitted that it supported a change to the market impact parameter that obliges the TNSPs to account for the severity of the impact of congestion on the market. It further noted that while the current provisions offer value, "TNSPs will pay more attention to a scheme that makes them liable for the severity of impact of congestion on the market".[54] The NGF submitted that it supported a change to the provisions "that puts at risk a higher share of a TNSP's regulated revenue (up to 10%) when it fails to achieve its targets under the [incentive scheme] in the next regulatory period".[55] The NGF hoped that the provisions would be strengthened such that linking an expanded market incentive parameter to the contingent project framework might encourage TNSPs to spend extra capital to ease constraints.	The Commission notes the issues raised by the NGF, however these issues relate to the design of the incentive scheme, which would be considered by the AER in its continued development of the scheme. Consideration of these issues is outside the scope of this Rule change.

54 NGF's submission, op cit, p. 2-3.

55 Ibid.