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29 September 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear ~~Dr Tamblyn~~ John

Rule change proposal: Early implementation of market impact parameter (AEMC reference ERC0093)

Please find attached the AER's submission on the AEMC's consultation paper for the early implementation of the market impact parameter.

Please contact me if you have any questions in relation to the matters raised in our submission.

Yours sincerely

Michelle Groves
Chief Executive Officer
Australian Energy Regulator

AER Submission

National Electricity Amendment (early implementation of market impact parameter) Rule 2009

Response to Grid Australia rule change proposal and AEMC consultation paper

29 September 2009

Introduction

The Australian Energy Regulator (AER) welcomes the opportunity to respond to Grid Australia's rule change proposal and the Australian Energy Market Commission's (AEMC) consultation paper on the early implementation of the AER's market impact component.

The AER is responsible for economic regulation of electricity network services in the national electricity market (NEM) and is responsible for publishing and implementing the electricity transmission service target performance incentive scheme (the scheme). These roles mean that the AER is well placed to comment on Grid Australia's proposed rule change.

The AER's scheme forms part of the overall economic regulatory regime. It aims to link transmission network service providers' (TNSP) regulated revenues with their performance by rewarding TNSPs when performance standards improve and penalising them when performance standards decline.

The market impact component is a relatively new part of the scheme (which commenced in March 2008). It is currently a "bonus-only" regime which aims to improve transmission service standards by linking TNSP's revenues more directly to market outcomes. The scheme provides a financial incentive for TNSPs to minimise transmission network outages that have an adverse impact on spot market outcomes. The market impact component currently only applies to TransGrid and will apply to other TNSPs from the commencement of their next regulatory control periods.

The AER broadly supports the early introduction of the market impact component; however it has a number of concerns regarding the proposed rule as drafted. This submission sets out the AER's view on Grid Australia's rule change proposal. Attachment A also addresses each of the questions raised in the AEMC's consultation paper.

Interaction with the National Electricity Law

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.

AER support for early implementation

Clause 6A.7.4 (f) of the National Electricity Rules (the Electricity Rules) provides that any amendment to the scheme cannot affect a TNSP in a regulatory control period that has commenced, or that will commence within 15 months of the amendment coming into operation. Given this, the market impact component will apply to most TNSPs from the commencement of their next regulatory control periods.

Grid Australia has proposed an amendment to the Electricity Rules which would allow TNSPs to apply to the AER to amend their existing revenue determinations to give effect to the market impact component of the scheme. This would allow for the early introduction of the market impact component than is currently provided for in the Electricity Rules.

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.

The AER considers that the market impact parameter is likely to promote the efficient operation of the transmission system, which is consistent with the national electricity objective. The market impact component is likely to have a positive affect on spot market outcomes by influencing the operational decisions and behaviour of transmission businesses. While there may be some costs to consumers through additional incentive payments to TNSPs, the AER had regard to these costs when developing the market impact component and considered that the benefits arising under the scheme outweigh any additional costs.

Implementing the market impact parameter

While the AER supports the proposed early introduction of the market impact parameter, it has a number of comments regarding the proposed process and framework for implementing the parameter for each TNSP.

Process for assessing

Grid Australia has proposed a condensed 30 business day assessment process to implement the market impact parameter. This process does not explicitly provide for consultation on a TNSP's proposed values.

Consultation

While consultation is usually an important and necessary step for regulatory decision making, in this case the AER considers that there would be limited benefit from requiring an extensive consultation process. The process for setting performance target and cap values for this component of the scheme is largely mechanical; targets are usually based on public data with defined exclusions and there are clear criteria in the scheme which the AER must refer to when making its decision. Given this, the proposed rule should explicitly state that the AER does not need to consult before making its determination.

30 business day assessment period

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.

The AER, Grid Australia and Australian Energy Market Operator (AEMO) are developing a central repository database which will allow market participants and the AER to obtain performance data for the market impact parameter. While these systems should allow TNSPs and the AER timely access to reliable performance data, these systems may not be completed before TNSPs can apply to the AER to implement the scheme early.

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.

Deemed acceptance by the AER

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.

TNSP's option to reject amended targets

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.

Framework for assessing proposals

Version of the scheme to apply

Clause 11.6.9A(i) of the proposed rule change applies the scheme published by the AER on 7 March 2008. Grid Australia states that it has referred to this version of the scheme so that stakeholders can fully understand the effect of the amendment. It also considers that the key features of the scheme should not be subject to change as part of the current rule change proposal, as the market impact parameter has been determined by the AER following stakeholder consultation.[1]

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 propose rule change should not operate to apply an earlier version of the scheme.

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.

Criteria to assess against

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.

Application to Transend

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.

[1] Grid Australia, *Proposed Rule change: early implementation of market impact parameter*, p. 5.

Permanent feature

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.

Other drafting issues

The AER considers that other aspects of the proposed clause may be problematic and the current drafting requires detailed review to ensure that it operates as intended. For example:

- The proposed rule refers to 'transitional regulatory period' and 'first regulatory control period' which are not defined for the purpose of this clause.

- 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.

Attachment A: Responses to specific questions raised in AEMC consultation paper

Regulatory control period	
What would be the impacts on TNSPs and the AER to make such a change part-way through a regulatory control period? What are some of the issues that would need to be resolved?	The proposed rule change could raise questions regarding retrospectivity under section 33(1) of the Schedule 2 to the National Electricity Law. The AER has no view on this issue at this stage, but considers that this is an issue which the AEMC should consider when assessing the rule change proposal. Putting aside issues regarding retrospectivity and the operation of the National Electricity Law, implementing the market impact parameter part way though a regulatory control period would not place a significant burden on TNSPs or the AER. The AER has been working with Grid Australia and AEMO to develop a central repository database which should assist the AER and TNSPs implement the market impact parameter without significant difficulty.
Would other aspects of the Revenue Determination be affected?	The AER considers that other aspects of the revenue determination will not be significantly affected by the early implementation of the market impact parameter.
Would any imbalances in the current regulatory period / Revenue Determination be created?	The AER notes the AEMC's concerns that amending one aspect of a revenue determination during a period may create unintended 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 the market. The market impact component is likely to facilitate the more efficient operation of the transmission system and may provide benefits to customers through lower spot market prices. The AER also considers that it is unlikely that the early introduction of the market impact parameter will create imbalances in the current revenue determinations. The market impact parameter is primarily aimed at influencing the operational decisions of TNSPs rather than their capital investment decisions, so there is no need for additional allowances to facilitate its introduction. The financial incentive payments made under this component of the scheme can also be recovered through the existing framework for revenue recovery.

What would be the impact on TNSPs if the Rule change proposal was not implemented and / or what would be the net benefits of implementing the Rule change proposal?	The AER considers that there would be no detriment to TNSPs if the rule change proposal was not implemented. However there are significant benefits to both TNSPs and other market participants which could be achieved by implementing the market impact component early. As noted, the market impact component is likely to facilitate more efficient operation of the transmission system and may provide benefits to customers through lower spot market prices.
Should this be a permanent feature to allow any future refinements of the incentive scheme to be implemented within a shorter timeframe?	There may be benefit in implementing future refinements to the incentive scheme within a shorter timeframe. However, there may be circumstances where this is not desirable and therefore the AER should have the discretion to disregard applications to apply amendments to the scheme early.
Data requirements	
Would TNSPs be able to provide the required data in a shortened timeframe?	The AER considers that TNSPs and the AER will have sufficient information to apply the market impact component early. The AER, Grid Australia and AEMO are developing a central repository database which will allow market participants and the AER to obtain performance data for the market impact parameter. This database is part of AEMO's Market Management System and will be accessible to market participants and the AER via the Infoserver. These systems should allow TNSPs and the AER to access reliable performance data which can be used to calculate a performance target for the market impact parameter and determine the financial incentive at the end of each calendar year. The AER hopes to continue to work with Grid Australia and AEMO to finalise the development of the central repository database and ensure that performance data can be provided in a timely fashion. The AER also notes that the proposed amendment gives TNSPs the option to apply the market impact parameter. This will allow TNSPs to delay lodging proposals to apply the scheme until there is sufficient data to calculate a performance target.

What are the factors that the TNSP would need to consider?	Consistent with the approach adopted in chapter 6A, a TNSP should only consider the requirements for performance targets and cap values set out in the market impact component of the scheme. The requirements prescribe a mechanical process for setting a cap and performance target for the market impact parameter. A proposed cap must equal zero dispatch intervals and the performance target must be equal to the TNSP's average performance history (subject to limited adjustments).
Implementation costs	
Would implementation costs that would in any case be incurred be brought forward or would there be additional costs?	The AER considers that there will not be any significant additional costs incurred in introducing the market impact component of the service target performance incentive scheme early. As noted, the AER, Grid Australia and AEMO are currently developing a central repository database to obtain performance data for the market impact parameter. The AER considers that finalising the development of this database will be the most significant cost which the AER and TNSPs will incur to implement the market impact component. However this cost will only be brought forward by the early introduction of the parameter and it is unlikely that there will be any additional implementation costs created by early implementation.
Implementation process	
What are the factors that should be included in the TNSPs proposal?	As noted above a TNSP's proposal should address the same factors that it would need to include if it were submitting a revenue proposal for assessment by the AER under chapter 6A of the Electricity Rules. The TNSP should propose a performance target and cap value which complies with all of the requirements of the scheme and an explanation as to how the proposed values comply with the scheme.
What factors would the AER need to consider in its assessments?	The AER should consider the same factors that it would normally consider if it were assessing the TNSP's proposal under chapter 6A of the Electricity Rules. These factors include the values proposed by the TNSP and the requirements and matters set out in clause 4.2 of the service target performance incentive scheme (including clause 4.2(g) of the scheme).

What specific process steps would be appropriate (including what would be the appropriate timeframes that should apply)?	Grid Australia has proposed a condensed 30 business day assessment process to implement the market impact parameter. This process does not explicitly provide for consultation on a TNSP's proposed values. The process for setting performance target and cap values for this component of the scheme is largely mechanical. Given this, an extensive consultation process is probably not necessary. However the AER is concerned about the proposed 30 business day assessment timeframe. This assessment period is less than half the time allowed for consideration by the AER under chapter 6A and will only be adequate where 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. 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 the AER may receive numerous applications simultaneously. A longer timeframe would also be necessary if the AER is expected to consult with interested parties before releasing its determination. In these circumstances 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. The AER is also concerned that the proposed clause 11.6.9A(vi) provides TNSPs with the option to accept the AER's amended performance target. This proposal 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 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 limits the risk to TNSPs of an unexpected determination by the AER.