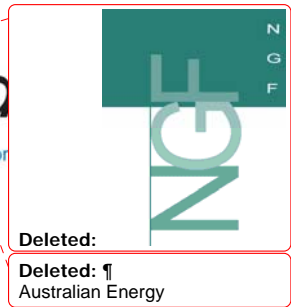




[Australian Energy](#) Regulator
Attention: Market Impact Incentives [Scheme](#)
GPO Box 520J
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[23 August 2007](#)

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By Email: AERInquiry@aer.gov.au

Service Target Performance Incentive Scheme

Developing incentives based on the Market Impact of Transmission Congestion

Issues Paper

The members of the National Generators Forum (NGF) operate the major part of the supply into the National Electricity Market, and hence are the participants in the NEM most directly affected by congestion in the transmission network.

The members of the Energy Retailers Association of Australia (ERAA) provide electricity to over 98% of customers in the NEM and are the first point of contact for end use customers for both Gas and Electricity.

The NGF and ERAA, together the "Market Participants", support the concept of a performance incentive scheme for transmission network service providers.

Over many years the Market Participants have worked with the AER, and prior to that the ACCC, seeking the development and implementation of an effective performance incentive scheme for Transmission Network Service Providers.

We do not expect that a scheme developed immediately will prove satisfactory over the long term. Rather, our expectation is that evolutionary changes will be needed based on the outcomes of earlier attempts. In this spirit we welcome this issues paper by the AER as a valuable step forward in this process.

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Before addressing the detailed questions raised in the issues paper, we will make a general comment on the relationship between the issues for this incentive scheme and issues in the electricity market more generally.

1. General comment in relation to measurement of market impacts

The issues paper raises the idea that generator offers should represent the short run marginal cost of the generation.

We do not accept that this notion is relevant, for reasons of both the market objective and of practical implementation.

Generator offers on this basis cannot satisfy the market objective of providing a sustainable supply at an acceptable level of supply reliability.

On the practical question, a body such as the AER will not be able to ascertain the short term marginal costs for generators.

While rejecting this notion, we do accept that the current market arrangement does not lead to meaningful quantitative measures of the impact of congestion. This is because, with the current energy market settlement process, the incidence of congestion often leads to the breakdown of competitive pressure on the offers of some generators, and in some instances a disconnect between dispatch and settlement prices. The common symptom of this is revised offers at the market floor price.

We suggest that the appropriate question for the AER to consider in terms of the usefulness of measures of impact is whether generator offers remained subject to competitive pressures during the congestion.

We note the possibility that the current review of congestion management by the AEMC could lead to a change in the market settlement process and hence in to effective competition in the presence of network congestion. This could lead to the development useful quantitative measures of the impact of congestion.

If this development proceeds, it could provide a better basis for further development of an incentive scheme.

2. Comments in relation to specific questions raised by the AER

The issues paper raises a number of specific questions on which the AER is seeking responses. These are reproduced below, together with comments by the Market Participants.

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Q1: Is the proposed approach of increasing transparency about line rating methodologies and calculations an appropriate approach to system normal constraints?
Is a financial incentive scheme warranted?

Although line ratings are expressed as exact numbers for operational and contractual reasons, the underlying reality is that there is increasing risk with increasing utilisation. The risk increases rapidly as high utilisation leads to high equipment temperatures. Without some incentive to achieve high utilisation, a TNSP has a natural incentive in the current regime to act conservatively and thus achieve very low risk levels.

In consequence, increased transparency for the rating process is a desirable feature of a service standard regime.

This is particularly true for new assets, because there is now a legacy of ratings set under pre-market conditions, which if now changed to a more conservative level, would raise questions. This protection does not apply to new assets.

Another issue that suggests transparency is needed is the possible use of ambient condition monitoring to increase ratings. TNSPs can avoid overly conservative rating by measurement of ambient conditions, and adjusting ratings accordingly. This improvement requires expenditure, and is unlikely to be utilised to an economic level without an incentive.

In relation to the issues raised above, while transparency may have some benefits, a financial incentive scheme would more clearly apply a countervailing force against the natural tendency to minimise cost and risk.

Q2: If a financial incentive scheme is warranted, what TNSP actions should the scheme target?

A financial incentive scheme should reward

- Increases in rating through measuring ambient conditions,
- Increases in rating through the adoption of short-term ratings, and
- Increases in rating through greater use of seasonal ratings

It would also be desirable, but more difficult, to reward full utilisation up to some prudent level of risk. A level of transparency which allows the practices of different TNSPs to be compared in this aspect would be helpful. Publication of

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line rating policies might be a useful starting point. Timeframes and processes are currently lacking to deliver on previous commitments made in this area.

Q3: Are the criteria proposed for assessing incentive options appropriate? Are there any other criteria that should be used?

The criteria seem generally desirable.

The second criterion, “**Incentive options should relate the economic benefit of the TNSP’s action to the cost**” seems poorly expressed. The cost of TNSP action does not need to be in the incentive scheme as it will be internally assessed within the TNSP against the financial reward or penalty provided by the incentive. The incentive scheme should simply reflect some part of the market effects back to the TNSP (such that the incentive measure in effect acts as the proxy for general economic benefit) so that they can assess the resulting incentive against the cost. This does not require any measure of cost within the performance measure itself.

A further comment which is implicit in the AER discussion, but not emphasised, is that the measure of economic benefit should be defensible, and not based on arbitrary factors, such as the market floor price.

Q4: Is it appropriate to base an incentive on the current TCC measure?

The Market Participants support the preliminary view by the AER that the TCC measure performs poorly in relation to the proposed criteria.

This reflects the weak connection between the measured values and the behavioural changes that the incentive scheme should support. In particular, we see the failure to distinguish between the actions of individual TNSPs as a serious flaw in this approach.

Q5: If not, are there amendments that could be made to the TCC to make it an appropriate measure on which to base an incentive? What could these amendments be?

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The Market Participants have no suggestion in relation to improving the TCC measure, as we regard other proposals as more promising.

Q6: Is it appropriate to base an incentive on the current OCC measure?

The Market Participants accept that the concept of OCC is much closer to capturing the relevant issues than the TCC.

However, given the current energy market settlement process, the measured cost of outages depend critically on whether offers remain subject to competitive pressures during the congestion event. This is variable between different congestion events and hence the quantitative measure as presently defined does not, in reality, provide a useful measure of the cost of congestion due to each outage.

This impediment may, as noted earlier, be greatly reduced if changes to market settlement occur, but at present we cannot support the use of this measure in isolation.

Q7: If not, are there amendments that could be made to the OCC to make it an appropriate measure on which to base an incentive? What could these amendments be?

We do not have any suggested improvements at this time, and as noted above, we believe that the usefulness of this measure will depend not only on the details of its implementation, but also on whether or not the energy market settlement process is altered.

Q8: Is it appropriate to base an incentive on an MCC measure?

The Market Participants are supportive of this approach, but also support the enhancements raised later in the issues paper.

This alternative is misleadingly named, as the marginal cost of a constraint is used only to distinguish between (a) some market effect and (b) no market effect. The proposed measure is based on the aggregate time that an outage constraint related to a TNSP has a non –zero effect on the market.

It does not distinguish between large and small impacts on the market.

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This design choice is understandable given the lack of confidence that AER apparently has in the quantitative measurement of market effect, given the current market settlement process. While a value based measure would ultimately be preferred, we share this lack of confidence in the current measure.

The strengths of the approach proposed are

- It focuses on the effects of outages, which separates the service standard from broad network design issues, and relates it to events that are controllable by a TNSP, albeit that some events are more controllable than others, and
- It does not seek to use quantitative measures of market events. In the long term view this may be seen as a disadvantage, but at the current stage of development of the market the quantitative measurement of market impact may be too vulnerable to challenge to form a useful part of the performance incentive regime.

Q9: If not, are there amendments that could be made to the MCC to make it an appropriate measure on which to base an incentive? What could these amendments be?

The amendments that the Market Participants support are those raised by the AER later in this issues paper and will be dealt with under later questions.

Q10: Should an MCC incentive scheme distinguish between high impact and low impact events?

While it is clearly desirable to distinguish between high impact and low impact events, it is not clear that the current market arrangements reliably provide sufficient information to allow this to be done in a defensible manner.

The measured effect of a constraint depends critically on whether participants are incentivised to rebid to the market floor price in an attempt to maintain volume, because the competitive pressure has been diminished by the congestion. Those constraints for which this occurs will generally have a measured effect several orders of magnitude higher than those where it does not.

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However, the Market Participants have formed the view that those events of congestion that lead to offers at the market floor price would in most cases have led to marginal values above \$10/MWh (or some similar threshold), even if competitive pressure on market offers had continued.

Hence the division into high impact and low impact may be quite accurate, despite some significant issues with measured marginal values.

Q11: Is the proposed threshold of \$10/MW appropriate for distinguishing high impact events? What weighting should be applied to the different thresholds?

We assume that the proposed threshold is \$10/MWh (not MW).

Any such threshold is necessarily arbitrary. The Market Participants are comfortable with this proposed threshold as a starting point, subject to the qualification that it should be reviewed after a period of use to evaluate whether some other choice would have net benefits.

Given this level of threshold, we question whether the low impact events are a necessary inclusion in an incentive scheme.

Q12: Should the incentive scheme provide financial rewards for outage notification?

The Market Participants are supportive of the general approach suggested by AER and would not want the issue of outage notification, which may prove contentious, to delay the implementation of a market-based incentive scheme. This said, The Market Participants support the concept of rewards for outage notification.

Q13: If so should the incentive place greater weight on the notification of the outage or the impact of the outage? Are the proposed weightings applied to various notification periods in table 4 appropriate?

As stated above, the Market Participants support the general approach and also support the application of weightings. The fundamental issue here is the tension between certainty, on the one hand, and minimal market impact on the other.

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On one view, outages should be notified whenever possible, with participants then allowed to trade around their view of the effect of each outage, and the

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outage should proceed regardless of market effects, unless security would be threatened.

The alternative view is that the timing of outages should be adjusted by the TNSP as the event approaches, with the aim of minimising market impact.

An incentive scheme based on solely on measured market effects will tend to induce the latter behaviour, as each TNSP seeks to minimise the market impact of its outages.

However, this outcome may disadvantage market participants who have made trading decisions on the basis of forecast outages.

These alternative views have been expressed in extreme terms for the purpose of explanation, but the weighting system proposed by the AER allows some degree of compromise between these competing objectives.

The Market Participants consider that, on balance, the advantages of certainty of outage timing will frequently outweigh the benefits that might be achieved by late changes in outage times.

A strong weighting towards early notice is expected to give benefits though increased attention by TNSPs to outage planning and also greater attention to preventative maintenance to minimise the risk of needing outages at short notice.

A particular issue that arises with strong weighting to early notice of outages is the appropriate treatment of outages that arise from unexpected requirements. Some of these may be totally unforeseeable, such as the case of malicious damage to TNSP assets. There will however be a wide spectrum of causes which may be claimed as unexpected. At the other end of the spectrum are outages required at short notice due to failure to perform preventative maintenance.

In our view, truly unforeseeable needs for outage will be rare, and there will be little impact from taking notice times as the basis for weighting, without consideration of mitigating factors, at least initially. This would simplify implementation, but could be changed later if were found to create material disadvantage.

While supporting rewards for outage notification, there are two related concerns that we wish to raise here.

The first concern is that even where participants have advance notice of a network element outage, the effects of that outage remain significantly uncertain, and the means available to mitigate the risk, even if the risk were well defined, are in some cases very limited. The AER may wish to consider whether the

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planning of an outage, and advising the market, is sufficient, or alternatively whether the notice of an outage should be accompanied with a statement of the expected effects on the network and hence on participants.

The second concern is that the existence of rewards for early notification of outages may provide an undesirable incentive for a TNSP to notify excessive outage numbers or durations to provide insurance against unplanned outage requirements.

We do not propose that the initial implementation of the incentive scheme should be complicated by measures to protect from this potential for undesirable incentives. But we do suggest that the AER should monitor the incidence of planned outage being cancelled, or completed significantly earlier than planned, which could indicate a tendency to “precautionary planning” and hence unnecessary indications of risk supplied to participants.

Individual Market Participants have a range of views on the appropriate relative weighting of certainty versus minimal market impact. Hence we do not propose any specific value here, although individual members may do so separately.

Q14: Is it appropriate to refine the existing service standards incentive scheme drawing on the MITC data?

It needs to be recognised that the two types of incentive measures serve different purposes. The existing regime addresses reliability (ie asset availability) whereas the new measures are designed to target economic impact (ie service delivery to the market).

The Market Participants see little benefit from the existing service standards that would not be better achieved by the proposed new service standards. We therefore do not see any particular merit in refinement of these existing standards, but are not opposed to their retention if required for other purposes..

Q15: Is an incentive of up to 1% appropriate, or should the scheme be higher or lower

The Market Participants consider that initially the service standards based on market impact should provide for reward or penalty at least 1% of revenue.

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The possibility of more powerful incentives should be considered when the scheme has been evaluated and further developed on the basis of experience.

We suggest that if any elements of the existing service regime are retained, the reward or penalty should be additional to the 1% based on market impact.

Q16: Should baseline performance be based on past performance? If so is the AER's proposal of using the last three years as a base case appropriate? If not, what alternative would be appropriate? Should the incentive be symmetric?

The Market Participants recognise the risk that baselines based on past performance may reward poor performance in the past with lenient standards into the future.

Against this there is likely to be a difficulty is separating past poor performance from some higher level of difficulty, perhaps related to terrain traversed by transmission lines.

Given this difficulty, we accept baselines based on past performance as the best measure available at this stage. In time, it may be possible to introduce more sophisticated benchmarking measures.

We support the concept of symmetrical incentives as a starting point. The possibility of non-symmetrical measures might usefully be considered at a later time following further development of the incentive scheme.

Q17: Should an MITC based incentive scheme supplement or replace the existing scheme?

Ideally, we believe that the new measures discussed here should replace the existing scheme. However we do not oppose the retention of part or all of the existing scheme if required to serve other objectives.

However, as noted above, we suggest that if any part of the existing scheme is retained, its rewards or penalties should be additional to 1% based on market impacts, recognising that the two suites of measures serve different purposes.

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3. Conclusion

The NGF and ERAA trust the comments on the issues paper will assist the AER in their consideration of improvements to the market impact incentive scheme for TNSPs.

If you would require clarification of any of the points raised in this submission please contact Mr. Tony Callan, NGF representative on (02) 92852712, or Mr. Alex Cruickshank, ERAA representative, on (03) 8633 6026.

Yours sincerely,

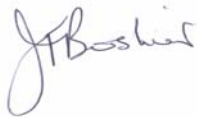
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