11 March 2022

Ms Clare Savage
Chair
Australian Energy Regulator
17 / 2 Lonsdale Street
Melbourne VIC 3000

Dear Ms Savage,

**AER Review of Incentive Schemes**

The transmission members of Energy Networks Australia (ENA) provide this submission to the Australian Energy Regulator's (AER's) review of incentive schemes (the review).

The focus of this submission is the transmission Service Target Performance Incentive Scheme (STPIS), particularly the Market Impact Component (MIC). The MIC provides an incentive for TNSPs to manage network outages to minimise their impacts on wholesale market prices. The MIC has delivered significant customer benefits since its application to transmission businesses from 2009. A continuation of this incentive will facilitate the continued delivery of these benefits however the current MIC is not fit-for-purpose.

While the AER has indicated it does not intend to review the transmission STPIS as part of its current review we want to make clear our views regarding the need to urgently review the operation of the transmission STPIS. These include:

- Why the transmission STPIS needs to be reviewed.
- Acknowledgement of the recent flexibility shown by the AER in the operation of the scheme; and
- Some elements we consider should be included in a review of the transmission STPIS.

ENA has provided a separate submission outlining members' views regarding the other incentive schemes currently included within the scope of its review, being the Efficiency Benefit Sharing Scheme (EBSS), Capital Expenditure Sharing Scheme (CESS) and the Service Target Performance Incentive Scheme (STPIS) for distribution. Transmission businesses support that submission from the broader ENA membership.

## Need to Review the Transmission STPIS

For the past two years transmission businesses have consistently called for a review of the transmission STPIS, particularly the MIC.

The current design of the transmission STPIS is no longer fit-for-purpose. It reflects an earlier industry paradigm, where relatively slow change in the usage of the transmission network allowed transmission businesses to reasonably forecast when transmission capacity was of most value to network users and to plan network outages around these times[1].

In contrast, the rapid pace of the energy transition will see almost the entire fleet of pre-2020 generators retire within the next 20 years to be replaced largely by Variable Renewable Energy (VRE) sources. This rapid turnover is increasing the operational complexity of the power system and is resulting in greater, and more widespread, congestion across the transmission network[2].

The target setting arrangements under the MIC use seven years of historical data to set performance targets that apply for each year of the relevant five year regulatory period. In our experience the historical data used to set future targets now bears no relationship to the current state of the power system, much less the needs over the next five years.

Information presented to the AER in February 2020 showed that in the case of Powerlink for example the number of affected dispatch intervals measured by the MIC increased in 2019 by 127 times the average of the previous four year period as a result of rapid changes in generation mix and location. AusNet Services has experienced a similar step change in dispatch intervals counted under the MIC driven by the closure of thermal power generation and rapid uptake of renewable generation. These trends will increase into the future.

There is therefore a risk that the incentive scheme will not drive behaviours to deliver outcomes that align with customers' expectations. Given the rapid and large scale changes that have occurred on the power system, and that are expected to continue to occur over the medium to long-term, a backward-looking target setting approach no longer meets the current needs much less those of the future. The current scheme design is no longer valid and should not be maintained.

## Recent Developments

We acknowledge the AER has recently taken some steps to address this issue in its Final Decision for AusNet Services. The AER has recognised that many of the new forms of congestion on the network, particularly congestion that arises from the operation of semi-dispatched renewable generators, is legitimately beyond the control of transmission businesses, and has clarified that this is excluded from the operation of the MIC. We understand the AER will also apply this clarification around exclusions to the forthcoming

[1] Powerlink Queensland, 2023-27 Revised Revenue Proposal, November 2021, p34.
[2] Transgrid, Revenue Proposal 2023-28, p48.

Powerlink Final Decision (April 2022) and expect it will also in its assessment of the recently lodged Revenue Proposals from ElectraNet and Transgrid.

While we appreciate the flexibility shown by the AER to adapt to the realities of a rapidly changing power system, we nevertheless see this as only an interim measure, pending a more thorough review of the transmission STPIS. A case of easing the symptoms, rather than addressing the underlying cause.

## Elements of a Future Transmission STPIS Review

We encourage the AER to undertake a review of the transmission STPIS, with a particular focus on the MIC, at the earliest opportunity. Some items that could be within the scope of a review include:

### *The Behaviour to be Incentivised*

When the MIC was first introduced in 2008, there was some debate as to whether market participants preferred that transmission businesses:

1. schedule network outages well in advance and then stick to that schedule regardless of the market impact, thus allowing market participants to confidently trade around the outages (i.e. place greatest value on certainty); or
2. dynamically respond to emerging congestion and actively re-schedule outages (i.e. place greatest value on flexibility).

The MIC currently places greater weight on the second objective above. Given the significant changes occurring on the power system it may be opportune to revisit these, and other, key design choices.

### *Flexibility within the Scheme*

The current design of the transmission STPIS has the key elements, such as parameter definitions and exclusions, hard-wired into the scheme such that they can only be revised through a formal review of the scheme by the AER. While this approach promotes regulatory stability and certainty, it may not provide the appropriate balance given the significance and pace of the changes occurring outside the scheme. The ability to provide greater flexibility to modify some elements through the revenue determination process may be beneficial.

### *Approach to Target Setting*

The MIC uses seven years of historical data to set targets. To remain consistent with the National Electricity Objective and provide long-term benefits to customers, the rewards or penalties resulting from the scheme should be referable to conscious decisions on the part of a transmission business. They also need to be consistent with the current performance of the power system and not the result of past years' performance, which in recent years has been heavily influenced by weather driven VRE output, whether grid connected or on customer rooftops. The MIC elements of the transmission STPIS in particular need to be reformed to rely less on historical performance, which has lost its relevance to target setting.

## Conclusion

The STPIS as presently designed, particularly the MIC, is no longer fit for purpose in a rapidly changing power system and consequently is not well placed to deliver meaningful benefits for customers.

Transmission businesses look forward to working with the AER and customers on a review of the transmission STPIS. Our focus is to ensure that the transmission STPIS is fit-for-purpose and provides appropriate incentives for transmission businesses that benefit electricity customers.

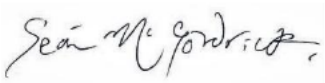
If you have any queries in relation to this submission, please contact [redacted].

Yours sincerely,

**Paul Simshauser**
**Chief Executive Officer**
**Powerlink**



**Brett Redman**
**Chief Executive Officer**
**Transgrid**



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