

1 May 2007

Mr Steve Edwell
Chairman
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Ms Michelle Groves
Chief Executive Officer
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Dear Steve & Michelle,

FIRST PROPOSED GUIDELINES

The AER has issued the first proposed guidelines and accompanying explanatory statements for the following guidelines associated with revenue regulation for electricity transmission businesses.

1. Post-tax revenue model
2. Roll-forward model
3. Efficiency benefit sharing scheme
4. Service Target Performance incentive scheme
5. Submission guidelines
6. Cost allocation guidelines

All of these first proposed guidelines were required by the NER to be issued by the AER by 1 January 2007 and are required to be finalised by 30 September 2007. These guidelines are important documents for all electricity transmission businesses, most particularly because the NER requires transmission businesses to comply with the guidelines.

While ETNOF appreciates the short amount of time the AER had to prepare these first proposed guidelines, ETNOF considers that substantial revisions are required to many of the guidelines in order for them to perform the role ETNOF understands was intended by the Rules – namely to enhance the certainty and efficiency of the process for a revenue determination.

A submission on each of the guidelines has been prepared highlighting ETNOF's concerns with the first proposed guidelines. ETNOF businesses would be happy to provide additional information and discuss our material concerns with the guidelines with AER staff to facilitate an effective outcome.

However, prior to finalising the guidelines, the ETNOF businesses request the AER to conduct a further round of consultation, at a minimum with the businesses subject to revenue determinations, if not more broadly should procedural fairness require it. As our view is that substantial revisions are required to the guidelines ETNOF considers further consultation on the guidelines is essential to producing documents that genuinely enhance the process of revenue determinations.

I would be happy to discuss this matter further with you in person and look forward to your agreement to additional consultation with transmission businesses on this important aspect of revenue determinations.

Yours sincerely,



Gordon Jardine
CHAIRMAN

ELECTRICITY TRANSMISSION NETWORK owners

Service Target Performance Incentive Scheme

Response to AER's First Proposed Guidelines

1 May 2007



Service Target Performance Incentive Scheme

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1. Introduction and Overview

ETNOF generally supports the Proposed Service Target Incentive Scheme (the scheme).

ETNOF recommends that:

- The scheme be developed further such that it provides incentives to a TNSP in situations where the TNSP is performing well and has little or no scope to improve without compromising obligations under the National Electricity Rules or its licence.
- The AER consider the potentially short timeframe between finalisation of an amendment to the scheme and submission of a TNSP's revenue proposal when proposing and consulting on amendments to the scheme.
- ETNOF participates in the AER's Service Standards Working Group when reconvened to consider other transmission parameters. ETNOF notes that a key issue for TNSPs in development of transmission parameters will be their level of control over parameter outcomes and ability to manage the risks associated with proposed parameters.
- The incentive amount be indexed for the time difference between the performance and revenue adjustment.
- The scheme indicates a standard formula for "system minute" and allow for variations in application that have historically been applied from individual TNSPs.

ETNOF also requests the AER to provide an additional round of consultation on the proposed scheme. This will allow further response to the scheme following submissions received by the AER during this round of consultation before the final scheme is published in September 2007.

2. High-level principle issues

2.1 *Continual service performance improvement*

In response to Clause 2.5 (g) of the scheme:

ETNOF broadly supports the AER's approach to the scheme of encouraging continual service performance improvements and agrees with advantages of this approach previously identified by the ACCC.¹

ETNOF suggests that there is a need to develop the scheme further to define its approach in situations where a TNSP is performing at or close to the efficiency frontier. This level is, for all parameters, the level where a TNSP's performance corresponds with efficient delivery of maintenance, efficient delivery of operating and capital works and efficient delivery of major operating projects. In this situation the TNSP has little scope to improve outcomes while remaining consistent with National Electricity Market objectives and not

¹ ACCC, *Statement of principles for the regulation of transmission revenues: Service standards guidelines*, 12 November, 2003 pp4-5.

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compromising its obligations under the National Electricity Rules or licence conditions, such as network reliability or delivery of prudent and efficient works.

ETNOF recognises the intent of the AER in administering the scheme to provide incentives as well as penalties. However, the use of average performance history as the sole determinant for future performance targets means that a TNSP that has little or no scope to improve without compromising its other obligations will consistently attain a neutral or penalty outcome.

In such situations, where a TNSP has little or no scope to improve without compromising its other obligations, there is benefit in providing incentives to maintain good performance, while still retaining some incentives to pursue improvements.

ETNOF therefore submits an amendment to Clause 2.5 (g) as follows:

- (g) Subject to (h) to (j) below, proposed *performance targets* may be determined by one of the following methods, which may be nominated by the TNSP for each *parameter*.
- (1) The TNSP's average performance history over the most recent five years. The data used to calculate the *performance target* must be consistently recorded based on the *parameter* definitions that apply to the TNSP under this *scheme*.
 - (2) Where use of the TNSP's average performance history results in *performance targets* above which further improvement is inconsistent with prudent and efficient behaviour, the TNSP may propose an alternative sound methodology for determining *performance targets* provided it is consistent with the objectives in clause 1.4 of this *scheme*.

ETNOF would be willing to assist with further developments to the scheme to ensure that the scheme continues to effectively meet its objectives in all situations.

2.2 Suitability of amendment process

The AER's minimum lead time of 15 months before a regulatory period for finalisation of an amendment gives a TNSP only 2 months notice to account for the amendment in its revenue reset application. During this time an audit of the TNSP's revenue reset application may also be required by the AER.² This would allow a TNSP a very short timeframe to incorporate amendments to the scheme in its revenue reset application. ETNOF asks that the AER consider this when proposing and consulting on amendments to the scheme.

2.3 Proposed introduction of other transmission parameters

The explanatory statement accompanying the proposed guidelines notes continuing work to devise economic incentive parameters related to market impacts of transmission services.

ETNOF notes the AER's proposal to reconvene the Service Standards Working Group to consider these issues and would be willing to assist with development of other transmission parameters. A key issue for TNSPs in the development of such parameters will be their level of control over parameter outcomes and ability to manage the risks associated with proposed parameters.

² AER, *First Proposed Electricity Transmission Network Service Providers Submission Guidelines*, January 2007.

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2.4 Indexing of Incentives

When calculating the allowed revenue (Appendix C), ETNOF considers that the financial incentive should be indexed to compensate for the time value of money between the regulatory years of the measured performance and the actual year of the financial adjustment being included in the MAR.

2.5 Terminology used in the Guidelines

The AER Guidelines uses and refers to terms for which there is uncertainty as to their definitions and application.

It would be beneficial to include in the glossary:

- the term “definition of a parameter” including identification of material within Appendices A and B that falls under that term;
- the term “vary a parameter” including identification of material within Appendices A and B that the term refers to varying;
- the term “element”;
- the term “value”;
- the term “standard definition” as used in Clause 2.2 (c);
- the term “definitions” as used in Clause 2.4 (a); and
- the term “return period” as used in Appendix A, Parameter 2 including examples of a return period of one year and a return period of two years.

3. Answers to the 5 Specific Questions

Response to Question 1 – *Is the process for requesting an amendment to the scheme suitable?*

The process for a TNSP requesting an amendment to the scheme is suitable.

However, the lead time of 15 months before a regulatory period for finalisation of an amendment gives a TNSP only 2 months notice to account for the amendment in its revenue reset application. During this time an audit of the TNSP's revenue reset application may also be required by the AER.³ This would allow a TNSP a very short timeframe to incorporate amendments to the scheme in its revenue reset application. ETNOF asks that the AER consider this when proposing and consulting on amendments to the scheme.

Response to Question 2 – *What is the current definition of a system minute applied by TNSPs?*

The formula for calculation of system minutes for an event is common across TNSPs, and is:

$$\frac{\sum (\text{MWh unsupplied} \times 60)}{\text{MWpeak demand}}$$

³ AER, *First Proposed Electricity Transmission Network Service Providers Submission Guidelines*, January 2007.

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Response to Question 3 – *Is the definition of system minute included in ElectraNet's definition of loss of supply event frequency (Appendix B) used by other TNSPs?*

There are slight variations in implementation of system minute between TNSPs. It is important to note that these variations are typically due to the operational control systems which are in place in the different TNSPs and have been adopted to most effectively obtain the information required for service standards from the existing operational control systems. The critical issue is the consistent application of the recording and reporting of the system minute calculation by the TNSP (per the formula in the response to Question 2 above). ETNOF suggests that these variations be allowed in the current guidelines similarly to the present administration of inclusions and exclusions.

Response to Question 4 – *Should any amendments be made to the TNSP specific parameter definitions in Appendix B?*

ETNOF does not propose any amendments to the TNSP specific parameter definitions in Appendix B. Individual TNSPs may propose amendments separately.

Response to Question 5 – *Should there be any additional requirements for setting values?*

The scheme provides that performance targets may be adjusted to account for increases or decreases in the volume of capital works. ETNOF supports this approach as changes in capital programs can have a material impact on planned outage requirements.

Similarly, ETNOF suggests that similar adjustments be allowed for increases or decreases relating to:

- contingent projects; and
- major refurbishments.

These adjustments are necessary to maintain the integrity of the scheme. This will assist focus on short to medium term performance measures that can be influenced by relatively small expenditures and changes in asset management practices. ETNOF understands this is the primary aim of the incentive scheme rather than measures that require substantial major expenditure and longer term strategies to be implemented to achieve noticeable change in performance.

It is also noted with concern that in a recent Revenue Cap Draft Decision non-integer performance targets were proposed for loss of supply event frequency parameters. As a fraction of an event cannot occur, this proposal makes it impossible for a TNSP to achieve exactly its performance targets. ETNOF proposes that the scheme state that targets, caps and collars for loss of supply event frequency parameters (and future event-based parameters) must be integer values and, if calculated to be a non-integer number, should be rounded to the nearest integer before application to the scheme.