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Submitted online: transmissionstpisreview@aer.gov.au

Dear Kris

AER's Transmission STPIS Review issues paper

Transgrid welcomes the opportunity to respond to the Australian Energy Regulator's (**AER**) issues paper on the transmission service target performance incentive scheme (**STPIS**) review. The issues paper initiates the AER's review of the STPIS, specifically the Market Impact Component (**MIC**) and Network Capability Component (**NCC**), for transmission network service providers (**TNSP**) and seeks feedback on ways to refine the STPIS to ensure it is fit for purpose.

As the NSW TNSP, Transgrid must plan for, build, maintain and operate the backbone of this new grid while meeting our obligations to maintain the safety, reliability and security of the transmission system in accordance with the National Electricity Rules (**NER**). The purpose of the STPIS is to provide incentives to TNSPs to improve or maintain a high level of service for the benefit of participants in the National Electricity Market (**NEM**) and end users of electricity.

We support the objectives of STPIS and believe that one of the core responsibilities of TNSPs is to ensure that outages are managed prudently and have minimal impact on consumers. However, we do not believe the current MIC scheme is fit for purpose as it is not achieving the MIC's core objective – that is to incentivise TNSPs to meet consumer expectation. This is because, as the AER has rightly stated, the priorities and challenges facing TNSPs are very different to those which they faced over the last two decades.

Transgrid supports the AER's work to review STPIS and address issues within the scheme. We believe it is important to have an incentive framework that is fit for purpose and works as intended.

As an ENA member, we support the submission made by the ENA. The rest of our submission outlines our views with the MIC and NCC.

MIC

The MIC provides a reward or penalty based on the impact of transmission outages on wholesale market outcomes. The AER states that the MIC is not providing incentives as intended. There are two main problems:

1. Most TNSPs (Ausnet, ElectraNet, Powerlink and Transgrid) are incurring the maximum penalty year after year. When a TNSP incurs the maximum penalty irrespective of its outage management actions, the incentive properties of the MIC do not work as intended.
2. Many of the MIC events now do not have a material impact on spot market prices at the regional reference node.

Transgrid manages its network outages in a manner that minimises the impact on wholesale energy prices in the NEM. Planned outages are necessary in order for TNSPs to complete their maintenance and capital works programs. However, over the past several years there have been changes in the NEM which have resulted in the inability of TNSPs to achieve an incentive outcome above the maximum penalty regardless of their outage management actions.

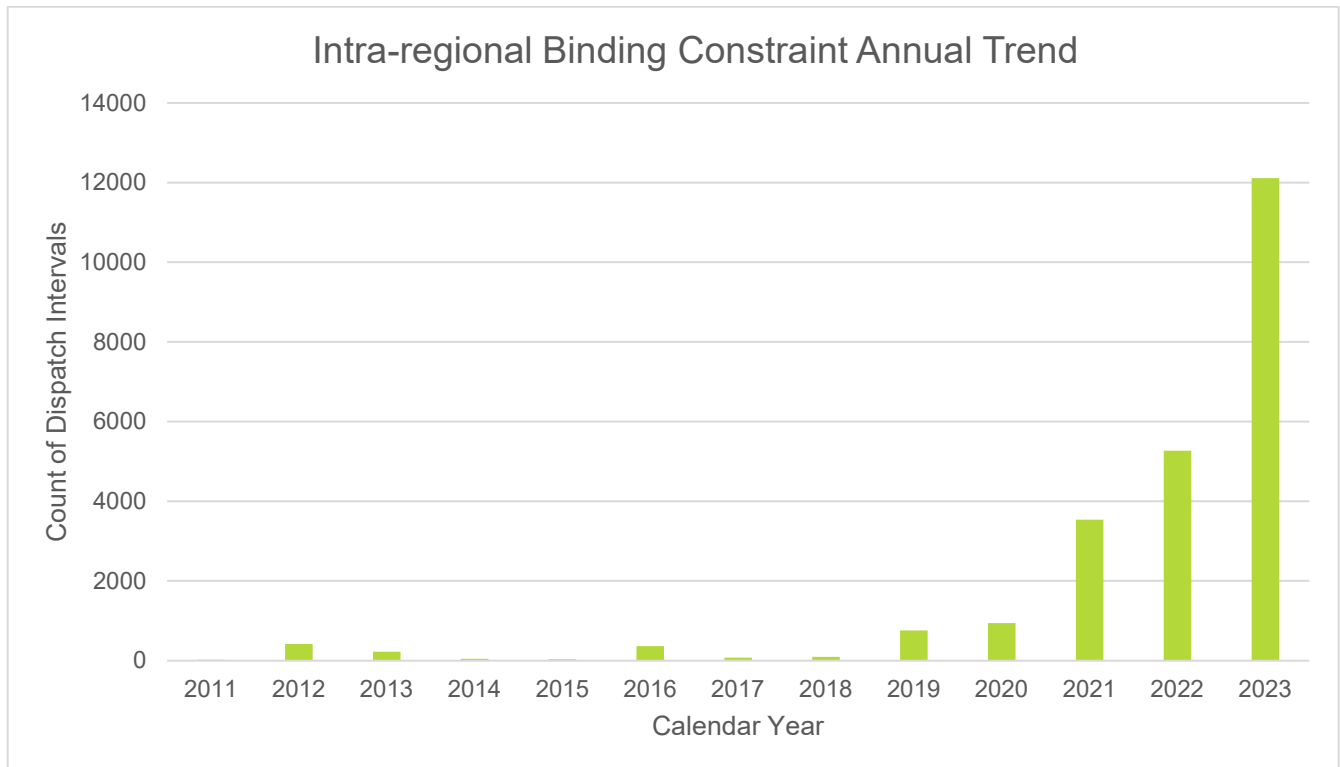
We believe the MIC is not working as intended because:

- The renewable transition and associated changes in generation mix have resulted in substantial increases in the frequency of binding constraints for the same outage today compared to several years ago. This is reflective of the period over which performance targets are based on.
- The scheme is not achieving its intended objective. Over the past 3 years, all TNSPs except for TasNetworks (where there is no significant carbon transition taking place) have incurred the maximum penalty.

There have been several alternative solutions considered by the AER. However, we believe that these alternatives will not solve the fundamental issue of the MIC. Altering the MIC will not improve the scheme due to the fundamentally flawed assumption that historical average market penalty counts form an appropriate basis to project future performance for the purpose of target setting, especially in the current environment of a rapidly changing generation mix. This change is outside the reasonable control of TNSPs.

The alternative solutions include changing the MIC marginal value threshold and better target rewards and penalties. Our views on these two alternative methods are:

- **Changing the MIC marginal value threshold** - An alternative approach which has been proposed by the AER includes changing the MIC marginal value thresholds. We believe that this will not address the fundamental issue of the sharp increase in the occurrence of binding market constraints irrespective of marginal value since 2021. This is primarily due to the increase of generation connections to parts of the network with lower capacity. This is in contrast with the period prior to 2021 where annual increases in market penalty counts were predominantly attributed to increasing marginal values, rather than an increase in the rate of occurrence of binding constraints across all marginal values. The following chart illustrates the rapidly increasing annual count of binding constraints for all marginal values due to Transgrid outages, which are intra-regional (i.e. not limiting an interconnector flow). This increasing trend provides a reflection of binding constraint counts attributable to localised limitations in the network arising from the connection of new generation in parts of the network with lower capacity.



Given this data, we do not believe that altering the MIC marginal value will meet the objectives of the MIC.

- **Target rewards and penalties** - The other alternative approach considered by the AER is attempting to better target rewards and penalties by increasing the selectivity of constraints that count towards the scheme. This does not address the issue of the unsuitability of using historical average annual outage hours to project future performance for target setting, noting that the quantity of planned outages is expected to significantly increase over the coming years and decades to deliver the AEMO Integrated System Plan, as required to progress the transition to renewables.

The current and alternative solutions do not address the core issues with the MIC and therefore do not meet the objectives of the MIC as they:

- Do not provide an incentive to TNSPs to minimise the impact of outages and,
- do not encourage TNSPs to minimise the impact of outages as it has consistently applied a maximise penalty on TNSPs regardless of their outage management strategy.

As such, we believe that a reporting only scheme would be in the best interest of consumers as it will provide visibility to consumers whilst encouraging TNSPs to pursue an outage strategy that minimises impacts to the market and therefore consumers.

RECOMMENDATION: Transgrid encourages the AER to consider the above-mentioned factors and remove penalties and rewards of the MIC and convert it to a reporting only scheme.

NCC

The NCC is designed to fund and provide incentives to increase the efficient capability of existing assets in the network when most needed, while maintaining adequate levels of reliability.

The AER's analysis suggests that the NCC may no longer be relevant given:

- Change in circumstances - The priorities and challenges facing TNSPs today are very different to that when the NCC was introduced in 2012.
- Administrative complexity - The NCC is administratively complex to apply. forecast operating and capital expenditure allowances, and the MAR. This is why AEMO has had a key role in the scheme.

We believe there is benefit in retaining the NCC. NCC projects deliver significant consumer benefits with short payback periods which outweigh the corresponding STPIS incentive paid to TNSPs. We believe the value and benefits to consumers, which includes unlocking extra capacity on the network for new renewable generation to connect, outweighs the costs. Essentially it encourages TNSPs to be proactive in finding innovative solutions to unlock capacity.

Like the other components of STPIS, where TNSPs are encouraged to manage the network to achieve outcomes desirable to consumers, TNSPs should also be encouraged, if they choose to, explore opportunities to increase the efficient capability of existing assets in the network via the NCC.

However, we believe the calculation of the reward compared to the calculation of the penalties under NCC is not consistent. Under the current scheme, penalties are calculated as a percentage of MAR whilst rewards are calculated based on the expenditure of the project. For example, a project that has expenditure in the thousands could attract penalties in the millions if the project is not completed to the requirements of the scheme. On the other hand, the incentive allowance under the current scheme is calculated based on the expenditure estimate for the project (1.5 times). We believe this is not balanced and recommend the AER address this disproportionality.

We understand the AER is scheduled to undertake a review of the RIT-T threshold in July 2024. However, we encourage the AER to consider increasing the \$7 million RIT-T threshold applicable to the NCC. This is to prevent inflationary pressures from constraining the number of projects considered by TNSPs that would ultimately provide consumer a net benefit.

RECOMMENDATION: Transgrid encourages the AER to retain the NCC with the following amendments:

- change the calculations of the penalties to be based on the expenditure of the project rather than a percentage of MAR,
- review the RIT-T threshold for NCC projects and,
- make the scheme optional for TNSPs, either under an opt-in or opt-out arrangement.

We look forward to working with the AER to update STPIS and ensure it is fit for purpose and meets its intended objectives.

If you or your staff require any further information or clarification on this submission, please contact Zainab Dirani at zainab.dirani@transgrid.com.au.

Yours faithfully



Maryanne Graham

Executive General Manager – Corporate and Stakeholder Affairs