

Our Ref: C2005/2020
Contact Officer: Liz Wood
Contact Phone: 9230 9109

6 April 2006

Mr N Ficca
Managing Director
SP AusNet
PO Box 222
COLLINS STREET WEST VIC 8007

Dear Mr Ficca

SERVICE STANDARDS REVIEW FOR 2005

I write to inform you of the outcome of the Australian Energy Regulator's (AER) review of SP AusNet's performance against its service standards incentive scheme for the 2005 calendar year.

Resulting from its review of SP AusNet's performance report for 2005, the AER has no objection to SP AusNet using a service standards factor (S factor) of 0.094497% for the 2005 calendar year, and consequently including a performance incentive of \$272,700 in its maximum allowed revenue (MAR) for the financial year 2006-07.

In conducting its review, the AER considered SP AusNet's revenue cap decision (11 December 2002), SP AusNet's performance report for 2005 (31 January 2006), the AER's Service Standards Guidelines (12 November 2003) and Sinclair Knight Merz's (SKM) report (21 March 2006).

As part of this review, the AER considered the issue of SP AusNet's treatment of exclusions, in particular those relating to third-party outages. In its 2005 report, SP AusNet proposed the exclusion of all third-party events from its performance data. The revenue decision states (at page 103) that in relation to such outage events:

SPI PowerNet may be able to plan or influence the third-party event and therefore not all third-party events should be excluded. ... However, such events will be excluded where ... a third-party event is, notwithstanding the observance of good industry practice, beyond the reasonable control of SPI PowerNet.

The AER considers that the third-party events that have been proposed for exclusion in SP AusNet's 2005 report would not be classified as force majeure events as defined in Attachment C to the revenue decision. The approach taken in SP AusNet's 2005 report therefore results in a higher MAR for 2006/07.

However, the AER recognises the following issues regarding how the performance targets in the revenue decision were set. Upon enquiry by the AER, SP AusNet staff identified that the performance targets set out in Attachment D of the revenue decision were based on historical data submitted by SP AusNet through the revenue cap process. The AER's consultant, SKM, has verified that this data incorrectly excluded all third-party events (not just force majeure events) and that no further adjustments were made to rectify this issue. This in turn is likely to have resulted in higher performance targets and thus a lower MAR over the course of the regulatory period.

Given the exclusion of all third-party events from the data used to set the performance targets, the AER considers that SP AusNet's approach of excluding these events from its 2005 data: maintains a consistent comparison of performance data over time; preserves the integrity of the incentive scheme; and is a trade-off between the respective impacts on the MAR.

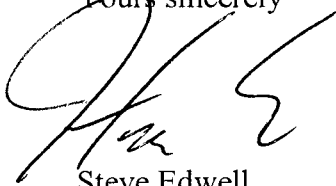
Consequently, at this point in time, the AER does not propose to object to third-party events being treated by SP AusNet as exclusions for the remainder of the regulatory period. For the 2005 period, the exclusion of these events results in a financial incentive of \$272,700.

However, it should be noted that this outcome reflects the particular circumstances of SP AusNet's current revenue cap. The AER considers that, in general, SP AusNet should have incentives to minimise such outages, and that consequently third-party events should only be excluded to the extent that these events are beyond the reasonable control of SP AusNet. The AER intends to consider how best to introduce such incentives at the upcoming revenue cap reset for SP AusNet.

In relation to broader issues regarding the annual service standards compliance audit, due to the tight timeframes of this annual process the AER is considering introducing a standardised reporting template. The template aims to increase the efficiency and thus timeliness of the AER's consideration of these matters. Staff will be consulting with SP AusNet and other TNSPs at the completion of this review regarding the content of these templates.

Finally, I would like to thank SP AusNet staff for their open and active participation throughout this year's review process. Should you have any further enquiries please call Ms Liz Wood (02) 9230 9109.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Steve Edwell', written over a white background.

Steve Edwell
Chairman