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Our Ref: C2005/2020
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3 May 2006

Mr Kym Tothill
General Manager
Corporate Development
TransGrid
PO Box A1000
Sydney South NSW 2001

Dear Mr Tothill

Service standards review for 2005

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

In its performance report submitted 3 February 2006, TransGrid proposed a service standards factor (s factor) of 0.720081 per cent for the 2005 calendar year, and a financial incentive adjustment of \$3 200 290 to its maximum allowed revenue (MAR) for the financial year 2006-07.

On the basis of this year's review, the AER considers that TransGrid's s factor for the 2005 calendar year is 0.698833 per cent, and that the financial incentive to be included in TransGrid's MAR for 2006-07 is \$3 114 950.

In coming to this view, the AER considered TransGrid's revenue cap decision (11 December 2002), TransGrid's performance report for 2005 (3 February 2006), the AER's Service Standards Guidelines (12 November 2003), TransGrid's letter (17 March 2006) and SKM's final audit report (24 March 2006).

The differences between TransGrid's and the AER's proposed s factor and financial incentive is discussed below.

Treatment of exclusions

While the AER recognises TransGrid's arguments, the AER, based on advice from SKM, considers that the outages relating to third party events resulting from sewer works (June to October 2005) and road works (25 July 2005) do not meet the definition of a third party or force majeure exclusion as set out in the guidelines.

The events have not been treated as third party exclusions as the outages did not relate to an 'electrical' third party system (such as intertrip signals or generator outage). The AER considers that not all outages resulting from third party activities should be excluded from the incentive regime, and that TNSPs should have incentives to take appropriate action to prevent outages and mitigate the impact of any outages resulting from third party activities where possible.

The events have also not been treated as force majeure exclusions. Given the nature of the work being undertaken, the AER considers that the resulting outages were not 'unforeseeable' by TransGrid, nor was the impact of the outages 'extraordinary, uncontrollable and not manageable' by TransGrid.

The AER estimates that the inclusion of these events reduces TransGrid's proposed s factor by 0.021248 percentage points from that proposed by TransGrid. The AER notes that outages relating to sewer works (June to October 2005) were capped to 14 days (336 hours).

Inflation rate

The AER recognises that a minor discrepancy exists between the financial incentive proposed by the AER and that proposed by Transend.

This discrepancy is due to the AER's practice of adjusting the annual revenue used in calculating the service standards financial incentive for actual inflation which is aligned to the period concerned. This is distinct from the practice of using lagged inflation data from the period immediately preceding the March to March period.

The financial incentive adjustment to the MAR for 2006-07 calculated by the AER uses consumer price index (CPI) data released on 26 April 2006 by the Australian Bureau of Statistics.

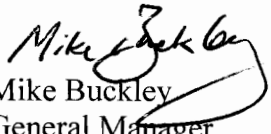
Other issues

During this year's compliance review SKM also assessed TransGrid's reporting systems. SKM noted that these reporting systems are largely manual and subject to human error. While it is noted that TransGrid is developing a new recording system to be implemented within three years, SKM made some recommendations regarding simple changes which could be made to improve TransGrid's present reporting systems. These changes are listed on page 7 of SKM's final audit report dated 24 March 2006. The AER hopes that TransGrid will give due consideration to these recommendations and will implement them where appropriate.

In relation to broader issues regarding the annual service standards compliance audit, the AER is considering introducing a standardised reporting template. The template aims to increase the efficiency and timeliness of the AER's consideration of these matters. Staff will be consulting TransGrid and other TNSPs on the content of these templates.

I would like to thank TransGrid 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


Mike Buckley
General Manager
Network Regulation North