ElectraNet SA
electricity transmission network

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Mr Michael Rawstron
General Manager, Regulatory Affairs - Electricity
ACCC
PO Box 1199
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Dear Michael,

Powerlink Revenue Review Application

The ACCC recently published Powerlink's Revenue Review Application and four consultancy review reports prepared by PB Associates for public comment.

ElectraNet SA does not intend to make extensive comments on these matters at this time. However, we do request that the ACCC take into account the following in its consideration of Powerlink's application.

Benchmarking Comparisons

ElectraNet SA accepts that benchmarking of operating cost efficiency, service standards etc. can be a useful regulatory tool for making performance comparisons. However, we agree with PB Associates that benchmarking is more readily applied to monitoring performance trends, which compare the performance of a company with itself over time. Different network topologies, environmental factors and State determined regulatory frameworks can make direct comparisons of performance between companies misleading. These factors must be properly taken into consideration when comparing the performance of companies.

Operating Cost Efficiency

Powerlink in their Revenue Review Application compared operating cost efficiency on the basis of transmission network asset value (ODRC). PB Associates in their report made opex comparisons on the basis of this and a number of other normalisers. There are a number of issues that must be taken into account in making such comparisons, including:

- Corporate and mandatory charges need to be considered separately from direct network maintenance costs, which may be more readily related to network size or other normalising factors.

- The level of corporate support costs and network operating costs is not directly related to the size of the network. Smaller networks may be disadvantaged if this is not recognised.

- Other components of opex that are unrelated to network size include grid support payments to generators and regulatory licence fees. We support Powerlink's recommendation that these costs be passed through in full and note that these costs are much more significant in some jurisdictions than in others.

- The relative age profiles of the transmission networks under comparison because operational funded refurbishment expenditure is much greater for network assets approaching the end of their technical and economic lives.

In summary, we emphasise the need for care to be taken when making operating cost comparisons.

Asset Replacement

Significant proportions of Australian transmission systems were developed in the 1950's and 1960's. Many of these assets are still in service, but require a disproportionately high level of maintenance and high levels of operationally funded refurbishment expenditure. Given that many of these assets are nearing the end of their technical and economic life, an appropriate allowance must be made in the Regulatory Reset for an increasing level of investment in asset replacement. An average asset life of 40 years represents a minimum capital expenditure on asset replacement of 2.5% of ORC per year over time.

Adjustment to Jurisdictional Asset Valuation

ElectraNet SA supports the adjustment of Powerlink's jurisdictional asset valuation to correct obvious anomalies in the jurisdictional asset valuation such as inappropriate easement valuation and inappropriate allowances for interest during construction.

Indexation of the Regulated Asset Base

On the issue of indexing forward the RAB, the PB Associates report states that "It is likely that over a short period of time, replacement cost movements will be primarily driven by changes in the cost of resource inputs" and "Resource inputs, particularly local plant and labour, will tend to increase with time, more or less in line with CPI".

A composite industry specific index is suggested to capture the impact of replacement cost movements that in the longer term may not be aligned with CPI movements. ElectraNet SA notes the recent significant devaluation of the Australian dollar (relative to countries that manufacture the equipment used in the transmission business) and the recent high escalation in the costs of materials that underpin the valuation of transmission networks.

ElectraNet SA acknowledges that the continued use of CPI to index forward the RAB provides the benefit of a stable long-term indicator that is independently determined

and cannot be manipulated. We cannot support any proposal to not index asset values given the recent upward pressures on the relevant cost drivers.

Capital Expenditure – Treatment of Uncertainty

ElectraNet SA supports the probabilistic approach adopted by Powerlink to deal with significant uncertainty in the future connection of new generation to the Powerlink network.

The treatment of future uncertainty in planning network capital expenditure is an essential feature of applying the building block approach to the regulation of transmission networks.

However, the Powerlink approach to dealing with uncertainty is not the only one and may not be the most appropriate for other networks. The Powerlink approach deals with uncertainty in generation commitments in a high load growth environment. Other networks may face greater uncertainty in relation to other factors such as multiple proposals for interstate connections.

Capital Expenditure – Efficiency Gains

ElectraNet SA agrees with PB Associates that incentive regulation must reward capital expenditure efficiency gains. It is essential that valid claims for capital expenditure efficiency gains be considered on their merits and that the TNSP be allowed to share in these gains consistent with the ACCC Draft Statement of Regulatory Principles.

Cost of Capital

ElectraNet SA agrees with Powerlink and others that asymmetric risk is a very real and growing business risk, which must be compensated in estimating the allowable regulatory rate of return.

It is incorrect to argue that these risks are diversifiable and according to CAPM theory should not be rewarded in an efficient capital market. The CAPM theory is strictly only applicable in a competitive market where participants can freely choose whether to supply or not supply. This is not consistent with the regulatory framework in which transmission networks are operated.

Service Standards

ElectraNet SA is broadly supportive of the more limited set of performance indicators proposed for reporting by PB Associates when compared to the more extensive set of indicators proposed in the ACCC Draft Statement of Regulatory Principles.

The ACCC has indicated in its letter to ElectraNet SA dated 27 April 2001 that the framework resulting from the PB Associates review of Powerlink's regulatory revenue cap with respect to service standards will form the basis of the ACCC's service standards for future regulatory revenue decisions.

We note that the South Australian Transmission Code requires ElectraNet SA to comply with a detailed set of service standards, which include specific exit point reliability standards. ElectraNet SA expects that these exit point reliability standards will form the basis of service standards applied by the ACCC in its revenue review of ElectraNet SA.

We also note the ACCC's intention to undertake consultation on service standards with TNSPs over the coming months and look forward to participating in this consultation.

ElectraNet SA agrees with Powerlink that service standards should be consistent with the general philosophy and principles discussed in Section 4.1 of the PB Associates report. We also believe that Powerlink's statistical approach to service standards, which appears to have been dismissed by PB Associates, may warrant further consideration as part of the proposed consultation on service standards.

Please don't hesitate to contact Rainer Korte on 08 8404 7983 if you would like to discuss any aspect of this submission.

Yours sincerely

(Signed)

Kym Tothill
CHIEF EXECUTIVE OFFICER