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Sebastian Roberts
General Manager
Regulatory Affairs – Electricity
Australian Competition and Consumer Commission
Level 35, The Tower
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Melbourne VIC 3000

By email: sebastian.roberts@accc.gov.au

Dear Sebastian,

Transend Revenue Cap – Draft Decision

ElectraNet appreciates the opportunity to comment on the ACCC's Transend Revenue Cap Draft Decision of 24 September 2003.

This submission does not seek to comment on the appropriateness or otherwise of Transend's revenue cap, but does highlight a number of important issues arising from the Draft Decision that have broader implications for the regulation of transmission networks; in particular relating to asset valuation, capex, the proposed alternative capex approach, opex efficiency factor and cost of capital.

Asset valuation

ElectraNet notes that the Transend draft decision adopts the jurisdictional asset valuation, but expresses concerns about this valuation in relation to easement compensation costs (land owner costs), easement acquisition costs (route selection, survey, environmental approvals, legal costs) and interest during construction.

These costs are all legitimate costs that must be appropriately recognised in the regulated asset base for TNSP's to recoup and earn a fair and reasonable return on their investments.

The Transend draft decision states:

> *"The ACCC considers that easements should be valued at actual historical costs adjusted for inflation… The ACCC used this approach in its last two revenue cap decisions, for the SA and Vic transmission decisions" (Draft Decision p26).*

This statement is incorrect. In the South Australian revenue cap decision easement compensation costs were not valued at actual cost adjusted for inflation and easement acquisition costs were omitted altogether.

Easement acquisition costs have not generally been included in transmission line valuations, but should be valued separately and recognised in the asset base. Easement acquisition costs are appropriately valued on a replacement cost basis, as they are unrelated to land values.

However, if the ACCC insists on adopting a historic cost approach to easements ElectraNet would support a benchmark approach for easement compensation where historical cost records are unavailable.

Capital expenditure

Capex cannot be sensibly benchmarked between networks or with historical levels of expenditure due to the lumpy nature of capex. The primary drivers for capex are load growth and service standard obligations and these must be met irrespective of capex comparisons.

The challenge faced is to meet the future requirements of the transmission system rather than repeating historical or benchmarked levels of capex.

Alternative approach to capex

ElectraNet notes the inclusion of a proposed more light-handed regulatory approach to non-contestable capex funded by individual network users (eg. prescribed connection assets and funded network augmentations). Costs would be excluded from the capex allowance but allowed as a pass-through.

ElectraNet supports a more light-handed approach but questions how this would work in practice. In our view treatment outside the revenue cap and separate pricing may be preferable to a pass-through under the revenue cap (e.g. the South Australia Electricity Pricing Order included such an arrangement).

However, we question whether the Code as it stands would allow such an approach to be adopted.

If the Commission's proposal is to be considered further then this should be done as part of the review of the Draft Regulatory Principles (DRP).

Operational expenditure efficiency factor

The ACCC's DRP foreshadows that it will consider the use of an incentive mechanism where a TNSP is able to demonstrate management induced efficiency gains. Further the ACCC has stated a preferred position in the current review of the DRP for a more light-handed approach that strengthens the incentives for opex efficiencies.

The application of an imposed 2% efficiency factor in the draft decision is heavy-handed and totally inconsistent with the ACCC's stated position on incentives – especially given that base opex has already been cut below what was assessed as necessary. Application of an efficiency factor imposes efficiency gains and excludes the TNSP from sharing in these gains.

Cost of capital

The draft decision sends very negative signals to investors, in particular the ACCC's proposal to reduce the return on investment by changing the approach to determining equity beta.

The Commission should understand that even floating this idea significantly increases uncertainty and regulatory risk for investors leading to negative impacts on investment.

The regulated rate of return is already only a small margin above the risk free rate.

The recent overseas blackouts serve as a timely reminder of the need to encourage investment in transmission. The blackouts clearly illustrate the substantial impact and cost of widespread failures of the transmission network.

The US has recognised the importance of a reliable transmission grid and is taking steps to attract more investment through providing higher rates of return.

A recent survey of international WACC decisions shows that regulated rates of return in the US are already higher than those in Australia.

The trend to reducing rates of return in ACCC electricity transmission revenue cap decisions must be reversed if Australia is to avoid the problems that have occurred in the US and elsewhere.

Please do not hesitate to contact me on 08 8404 7983 or by email should you wish to discuss any aspect of this submission.

Yours sincerely,

Rainer Korte
NEM DEVELOPMENT AND REGULATION MANAGER