# ***Comments On***

# ***ACCC Draft Decision On***

# ***ElectraNet SA***

# ***Access Arrangements Applications***

***BY ECCSA***
***OCTOBER 2002***

## ***Introduction***

The Electricity Consumers Coalition of South Australia (ECCSA) is a major energy end-user group formed with the specific purpose of reducing the current unreasonably high price for electricity to all consumers in South Australia. Its members are Adelaide Brighton, Holden, Mitsubishi, OneSteel, WMC, Amcor, Kimberly Clark, Mobil Refining Aust. and Pasminco.

ECCSA welcomes the opportunity to provide its views on the draft decision (dated 11 September 2002) by ACCC on ElectraNet SA's revenue cap application. These comments follow on from the submissions already made by ECCSA to the ElectraNet application, the ECCSA views regarding easements and an ECCSA response to the comments by the ACCC consultants (Meritec) and by ElectraNet in response to earlier submissions from interested parties.

This response from ECCSA, as well as addressing the draft decision, also encompasses points raised at the public pre-decision conference held in Adelaide on 4 October 2002.

In broad terms, ECCSA sees the ACCC's draft decision as proposing to:-

- Reduce the WACC applicable to ElectraNet's assets.
- Reject the ambit claims for easements.
- Allow ElectraNet to introduce a large Capex program without adequate substantiation.
- Reduce the Opex requested, but at a level higher than the current level.
- Introduce the concept of benchmark performance standards with a penalty/bonus arrangement.

The net result of the ACCC's draft decision is to leave unchanged South Australia's position as having the most expensive transmission tariff in Australia's National Electricity Market.

## ***Information disclosure and Benchmarking***

ECCSA notes that the ACCC's draft decision does in fact provide more information than either ElectraNet or Meritec provided during this regulatory review. This additional information has assisted consumers to assess the reasonableness (or otherwise) of the conclusions reached by the ACCC in its draft decision. However, it must be noted that the amount of information

provided from all sources still falls far short of that needed by consumers to verify that the amounts being granted do represent the “fair and reasonable” costs appropriate to the ElectraNet activities.

Both the ACCC and ElectraNet aver that ElectraNet assets bear some relation to electricity distribution when compared to the other Australian transmission businesses and, on this basis, ElectraNet should be granted concessions when comparisons are made with other transmission companies. However, neither party actually reflects on whether such comparisons actually sustain the concessions claimed. It is beholden on ElectraNet to actually carry out and demonstrate that the same benchmarks for distribution businesses really do support the need for the implied concessions. ECCSA has done some preliminary work in this area and contends that using benchmarking from distribution businesses may actually require some downward adjustments to the amounts that the ACCC draft decision suggests are reasonable and fair.

We do note that despite our requests, there is no attempt to compare ElectraNet’s claimed costs against international benchmarks. As we have noted repeatedly, to continue to benchmark performance against a small number of “competitors” all operating in the same electricity market, is a circular activity, and which ultimately leads nowhere. Our assessment is supported by reference to the uniformity of comments emanating from the inter-State transmission companies, who obviously see commercial value in regulatory ‘uniformity’ applying only amongst themselves. The light-handed regulatory approach noted by the ACCC as their preferred approach requires rigorous benchmarking to replicate the underlying assumption of “competition

In his address to the ACCC forum Mr Ian Stirling of ElectraNet noted that electricity infrastructure companies required an incentive to encourage investment, and that if there is no “head room” above the minimum cost to provide the service supplied, this will also negatively impact on future investment. We note that this attractive scenario does not apply in competitive industries. In particular, Australian industry has been severely and adversely impacted by the Australian government approach to reducing import tariffs. This caused Australian industry to lose any of its “head room” that it may have had. Industry’s response to this major reduction of its protected environment has been to address its costs and the way it does its business. Australian industry has responded well to the exposure to the world’s markets, and as a result is now recognised as performing much better in competing at the world level.

The monopoly infrastructure businesses must be seen in the same light as perhaps Australian industry was seen prior to the tariff reductions of the past decade or more. It requires the invisible hand of competition to be applied to any business for it to reach its optimum operating level. This point has yet to be reached by ElectraNet, and as a result, ElectraNet has not yet attained world’s best practice.

Arising from these comments, throughout the rest of this submission we will refer to the absence of the ACCC applying best practice in assessing its evaluation of the ElectraNet application. It is only by applying best practice to ElectraNet activities that consumers will ever see the benefits flow from the deregulation of the energy supply markets.

## ***Cost of Capital - WACC***

We appreciate the detail that the ACCC has used in its draft decision regarding the derivation of the WACC proposed for ElectraNet. We also note the comments made at the public forum regarding the level of WACC nominated in the draft decision. References to the Conference on WACC, funded and convened by the transmission companies 'collective', should be seen and accepted for what they are.

**A holistic view is needed**

We reiterate the need for the final rate of return to be benchmarked, but it would appear that although the ACCC benchmarked aspects of the internal calculations, it has elected not to benchmark the overall calculation.

During discussions with ECCSA the ACCC was advised of work carried out by Pareto Associates in benchmarking the final WACC. The WACC included in the draft decision is still well above the WACC granted by international regulators, operating in a similar risk and financial environment to that applying in Australia.

Pareto Associates has further developed on this work and it is has been published on the ESC of Victoria website[1], under the ESC review of the gas distribution businesses. This additional body of work further develops the view that the WACC proposed by the ACCC in the draft decision is still far too high and unjustifiably so.

We noted in our presentation at the public forum that the approach to WACC is becoming extraordinarily mechanical. Whilst this helps in regulatory consistency, it does not establish if the results fit within the envelope of international practice. For a regulated business with a high certainty of achieving target cash flows, the WACC must approach a level where the ability of securing further funding for the business is approaching constraint. The results of the recent GasNet float do not indicate that this point has been reached.

At the public forum, ElectraNet and others advised that investment in infrastructure would be constrained if a high WACC was not granted. This

[1] ESC Gas Access Review 2002, responses to draft decision, submission 12-2002, 23/8/02, from Customer Energy Coalition

statement runs counter to the other statements made that ElectraNet wishes to inject massive amounts of capex into the business, and noted that the slightly reduced capex permitted by the draft decision would result in failures of the transmission system. International comparisons provide a clear counterpoint to these statements. For example, as Pareto Associates notes, the regulated water businesses in the UK are securing much larger amounts of funding from the financial markets then ElectraNet seeks, at a regulated WACC well below the level suggested by the draft decision.

Nevertheless, the final WACC is a function of the inputs. Because we see the final WACC as still too high, we have investigated elements of the ACCC calculation to identify where errors may cause the high calculation.

**Risk free period**

We concur that the risk free period should replicate the regulatory period. The 5 year bond rate incorporates assessment of the expectations and risks which are likely to occur over the regulatory period. We note the statements that the investment has been made over a longer period, and that the financing of the business needs debt provision of greater than the regulatory period.

What is consistently overlooked is that competitive business returns are benchmarked on shorter periods than the five years (even though they have invested for much longer terms), and they have to seek funding and/or debt turnover in the same way as do regulated businesses.

In analysing the comments by the regulated businesses it would seem that they consistently attempt to use their specific circumstances to argue for an increase in WACC, but argue for the regulator to take a light handed view where interrogation may result in a lower overall return, such as happens in the opex review.

The ACCC is correct to interpret the WACC assessment in isolation of how the regulated businesses may attempt to finance their operations. This view is supported by the Lally report commissioned by the ACCC.

**Equity beta**

The draft decision calculates the equity beta (from an asset beta) and then compares the result for the "Infrastructure and Utilities" category of the ASX from a listing of equity betas provided by the AGSM centre for research[2]. Unfortunately the ASX no longer provides this category having moved to the S&P GICS method of categorisation.

The GICS category for "Utilities" includes electricity generators, gas pipeline companies and two companies having electricity distribution assets. We would point out that for companies having stable cash flow (such as property, food, alcohol and tobacco) are more akin to the electricity transmission business.

[2] Draft Decision table 2.2

These cash flow stable companies have an equity beta at half that suggested is appropriate for ElectraNet. The Pareto Associates analysis of UK regulatory decisions supports that an equity beta for ElectraNet should be of a similar magnitude. We contend that rather than an equity beta of 1.0 being used for the ElectraNet WACC calculation, a figure of 0.5 is more appropriate and comparable to the business type.

**Market (equity) risk premium**

The regulated businesses have consistently argued that an equity risk premium of 6.0 is on the low side of appropriate. However many of the consultants commissioned to evaluate the MRP have been advising the regulated businesses, and there has been a lack of clear independence.

One attempt to provide independence, is to review over a long period, the ASX accumulation index (as a surrogate for competitive industry), compared to CPI and the bond rate. This indicated that over time the difference between the ASX index and the bond rate is of the order of 3-4% points different. Being based on historical data, an assessment such as this should be seen in the light of a backward looking view, although it still provides an indication of what the band width for where an acceptable MRP lies.

The ESC of Victoria commissioned an independent report on the market risk premium from Mercer Consulting to assess a forward looking view of what an equity premium is in regard to investment. Their analysis indicates that the MRP is certainly lower than 6.0 and could well be 3.0, replicating the historical differential between bond rate and the ASX index.

Based on this data we would concur with the view of the ACCC that an MRP of 6.0 is "…on the high side …" (draft decision page 19). We believe that an element of the WACC being comparatively too high is in part related to the ACCC acceptance of a higher than needed MRP, and recommend that it be reduced.

**Asset valuation methodology**

The ACCC has continued the practice of using depreciated optimised replacement cost (DORC) methodology for asset valuation. ECCSA continues to maintain that this is inappropriate and leads to large cash over-recoveries for businesses that are allowed to use this valuation approach.

As the ACCC has carried out some benchmarking of WACC elements from the competitive business environment, it needs to recognise that when comparisons are made, competitive business uses the depreciated actual cost (DAC) for benchmarking its returns. It the ACCC persists in using the DORC values, then it needs to adjust the comparisons of the WACC elements to reflect the overstatement of asset value from using DORC.

**Summary**

There is no doubt that when the WACC is benchmarked on an international basis, it is higher than it needs to be. We believe that the WACC should be in the range of 5.0 and 6.0 for it to be appropriate to the business type that ElectraNet is involved in.

## ***Regulatory Asset Base***

There are two major concerns we have with the Draft Decision, and the associated subsequent discussions, letters and presentations.

**Easements**
We concur with the draft decision with relation to the valuation of easements. There is no doubt that the South Australian Government valued easements at $3.1 million at the time of the sale of the rights to the assets to the new owners of ElectraNet. ElectraNet now wishes to revalue these easements based on notional concepts that can never to be tested in practice.

The South Australian government, in its submission to the ACCC on 5 September 2002, suggests that the easement value of $3.1M is too low, and makes two suggestions:-

1. That easements should be valued on an actual cost basis.
2. That because certain parties consider that easements may have been valued at too low a figure at the time of the sale, ElectraNet should be permitted to value these assets now at a figure based on actual cost, or derived from the recorded costs involved in easement acquisition in Victoria.

We have no problems with the first observation by the South Australian government and we agree that this is a very appropriate way to proceed in the future.

However, we would point out the second observation raises two fundamental issues.

The first issue is that it is inappropriate to revise asset values subsequent to the time of sale when a value was agreed for these assets as part of the sale, particularly when the sale is very recent. This value was the one set by the South Australian government (as required by the Code) as part of its own regulatory review and it subsequently became the one agreed by a willing seller and a willing buyer.

The second issue is the implicit assumption that because the willing buyer now considers that the valuation may have been incorrect at the time of the sale, it is permitted to revisit the valuation and require a change. In other words, it is entitled to a ‘free lunch’.

The ACCC notes in its draft decision (page 46) that:-

> "Under normal circumstances, the Commission would have used the $3.1m as the value jurisdictional value of easements. However, given the explicit written qualifications by the South Australian Treasury and Finance Department the Commission may have to exercise the discretion to consider other options."

This statement implies that because the willing seller may desire to change its view on asset valuation after the event of the sale, the ACCC is required to follow such an instruction. This is not so. The ACCC is required to apply only the valuation agreed between the seller and the buyer, and not some other notional amount advised by the seller subsequent to the sale (for whatever reason) that the seller may consider is appropriate in their later review.

There is no doubt that should the South Australian government have been recommending a reduction to the easement value, ElectraNet would be rejecting the post sale advice on the basis that the assets had been sold at an agreed price.

The ACCC notes that it may need to be considerate of the fact that the South Australian government was under time pressure with regard to valuing easements (draft decision page 46)

> "The South Australian authorities stated that they were unable to apply the DRP owing to inadequate time. Hence it is reasonable to suggest that they would have valued easements on the basis suggested by the DRP, if they had the time."

This statement clearly overlooks the fact that the Electricity Pricing Order was published in October 1999, when easements were valued at $3.1M. The sale took place nearly two years later. If the South Australian government was of the view that easements were undervalued, it had ample time to adjust this whilst the assets were under its control. It did not do this, thus clearly discounting the comments made subsequent to the sale that it had insufficient time to modify the valuation.

The ACCC goes on to say (draft decision pages 46 and 47):-

> "In the DRP the Commission stated that a consistent approach to easement valuation would be to provide compensation for actual amounts paid. The Commission therefore asked ElectraNet to submit actual amounts paid for easements. But ElectraNet claimed that it was impossible get the figures."

The new owners must have carried out a "due diligence" assessment of the assets included in the sale process – to do less would imply incompetence by

the team bidding for the assets. This due diligence did not reveal that the easement value should be higher than that stated by the South Australian government. Therefore, it is not impossible for ElectraNet to supply the figure requested by the ACCC. ElectraNet paid $3.1M for all of the easements that it holds. This was the value placed on easements in the sale process, and by ElectraNet proceeding with the purchase ElectraNet has tacitly confirmed this is the true value of its current easements. Thus, it is clear that ElectraNet has already advised the ACCC as to the actual cost of the acquisition of the easements – that the acquisition cost to ElectraNet is in fact the amount they have actually paid, that is a value of $3.1M.

Later on page 47 of the draft decision the ACCC comments:-

> "As noted above the Commission believes that the easements presented are inconsistent with the Commission's DRP. In the absence of any other valuation the Commission prefers to use the jurisdictional value of $3.1m rolled forward."

It should be noted that the ACCC is required to use the jurisdictional value placed on the assets, which include easements. The ACCC is required to apply the jurisdictional value assessed for easements. Anything else is in contravention of the National Electricity Code and clearly open to appeal.

The issue of the easement value is quite clear. In its role as the previous regulator, the South Australian government valued its transmission easements at $3.1M and included this value for setting tariffs through the Electricity Pricing Order. This valuation fulfils the requirement of the Electricity Code for subsequent asset value setting by the ACCC. The South Australian government subsequently sold the easements as part of the overall sale of rights to the new owners of ElectraNet, for a value of $3.1M, setting a clear and agreed commercial value on these assets.

As both the previous regulatory value and the commercial value are coincident, the ACCC has no need to exercise any discretion with regard to easement value. In any case, under what provision of the Code would the ACCC rely upon to enable it to exercise discretion in this area? Further the ACCC must not place any greater weight to the subsequent advice from the South Australian government (other than in its role as one Interested Party and no more), than it does to other submissions on this review.

**The GST spike**

In our review of the draft decision by the ACCC we note there is no reference to the impact of the GST spike in calculating the present day value of the asset base, and there was no observation or commentary by the ACCC as to why they have ignored the GST spike issue. We have observed that ElectraNet has applied the full CPI as part of its revaluation of the RAB and this practise is continued by the ACCC (draft decision table 3.5). The introduction of the GST

RABxWACC" element is about 50% of the total revenue. As GasNet is required to add GST to its bills, if the GST spike effect is left in the "RABxWACC" calculation then it is effectively charging customers GST at a premium above the basic GST. The best way to eliminate this "double dip" is to eliminate the GST effect in the RAB.

The ACCC has failed to recognise that it is the very inclusion of a GST inflated RAB into the return calculation that causes the problem. The "RABxWACC" calculation is a surrogate for actual returns earned by competitive companies which are required by law to exclude the inclusion of any GST benefit. By the inclusion of the GST spike in the "RABxWACC" calculation, the ACCC is permitting the regulated business to benefit from the introduction of the GST.

**Summary**
In the draft decision, the ACCC has valued easements at the correct amount, and should not change this. The exclusion of the past IDC is also correct. However the inflation adjustment method followed is incorrect and must exclude the impact of the GST spike in the CPI figure.

## ***Capex***

**Minor capex**
ElectraNet and others commented at the public forum that the approach taken by the ACCC to remove minor capex (refurbishment) from the opex line and transfer it to the capex line of the total revenue equation is incorrect. In the comments, ElectraNet and others averred there needs to be a different approach taken between refurbishment and capital works. We agree that both are quite separate, and can be accounted for separately. However, we are of the view that capex used for refurbishment is capex and should be treated that way in the regulatory review.

ECCSA notes that the decision to "expense" capital purchases has always been vexed. To overcome this, the Australian Taxation Office has developed strict guidelines on what can or cannot be expensed in any one year. As ElectraNet is bound by the ATO rules with regard to its statutory accounts, we would recommend that the ATO rules applying to capex and what can be expensed should apply to the cut off for amounts the ACCC allows for capex and expensed capital. This approach then allows ElectraNet to maintain one set of accounts rather than the two (taxation and regulatory) implied by ElectraNet if it should use a different cut off between capex and expensed capital.

We understand this is the approach the ACCC has taken in the draft decision and ECCSA supports this.

**Major capex**

ECCSA agrees that ElectraNet needs to expend on capital items to ensure reliability of the network, to accommodate demand growth, to comply with Codes of good practice and the Electricity Code. ESIPC notes that the projects included in the probabilistic assessment have benefits to the ElectraNet system, but they have not carried out any cost benefit analysis to assess whether all of the projects will pass the regulatory tests[3].

> "Given the high level nature of the analysis and the limited project information available at this time, the Planning Council has made no attempt to determine if the project proposed by ElectraNet SA is an optimal solution to an identified network deficiency. The process has simply been one of noting where a listed project appears likely to address a deficiency identified by the scenario analysis. The Planning Council notes that, in any event, the NEC requires each project in excess of $1M to undergo a public, consultative process."

As we stated in our submissions, we are unable to assess whether the amount claimed by ElectraNet is appropriate, sensible or feasible due to its elected approach of assessing capex needs on a probabilistic approach. Neither does ECCSA see a probabilistic approach as appropriate in assessing future capex needs. The ESIPC assessment supports our view that any of the capex proposed by ElectraNet needs to be proven to comply with the regulatory tests.

The approach taken by ElectraNet does create significant challenges to consumers, the regulator and to ElectraNet itself. In normal circumstances service providers are required to detail the capex program they have in mind, quantify what benefits will flow, the cost of each activity and the timing of each. This creates certainty in the minds of consumers and of regulators that the future projects have an acceptable cost benefit (comply with the regulatory tests), and timing. For the business it means that the capex has received regulatory approval and gives a high degree of certainty to getting the capex rolled into the RAB.

ElectraNet elected not to do this, and instead has requested a very large amount of money to be spent over a range of non-specifically committed projects – the "probabilistic" approach. This creates uncertainty for all concerned. More significantly, there is no way anyone, let alone the ACCC, can attest to the investments as being efficient. Inefficient and over-investment are both economically distorting.

[3] Planning Council Review of ElectraNet SA's Capital Expenditure, posted on ACCC website

The ACCC has stated that despite some misgivings about the ability of ElectraNet to manage the large capex program, they will include the bulk of the capex requested into the revenue equation and then review in five years' time whether the capex spent was in fact prudent and economically sound. This places significant risks on both ElectraNet and consumers and places the ACCC in an unenviable position at the next reset.

As we stated at the public forum

> "We are concerned that if the approved capex is not spent, or demonstrably fails the regulatory tests, consumers will be disadvantaged and will have to wait to the next reset for restitution. But will that restitution recognize the use of our money ElectraNet has had for the period.
>
> For example in the unlikely event that all of the capex granted is not spent, or does not pass the tests, then ElectraNet will have been given the use of these capex funds embedded in the allowed revenue for the five year period. If these funds were invested by ElectraNet this would give them an interest return of over $6m for the first year, about $13M in the second year, reaching nearly $35M in the final year of the regulatory period. In total ElectraNet would have gained interest on the unused capex funds of up to $100M over the period. This is unacceptable."

We note that ElectraNet recognises the risk to consumers of a capex under-run by accepting there may be a capex claw back at the end of the regulatory period. Consumers would prefer to not to have ElectraNet acting as a bank and would rather have the benefit of capex under-run reflected immediately in tariff reductions.

To counter the detriments of the probabilistic approach noted above but retain the flexibility that the approach provides ElectraNet, we proposed at the public forum that the following approach be used.

1. The amounts of capex approved by the ACCC in the draft decision should be included in the RAB calculation. This amount is not to be exceeded in any one year unless the prior approval of certain carryover from the previous year can be substantiated to the ACCC satisfaction.
2. Annually ElectraNet gain formal ACCC approval of the actual amounts of capex spent on projects that meet the regulatory tests, and this approved amount reconciled to the nominal amount approved.
3. If there is an under-run of capex in any one year, then the under-run is to be deducted from the nominal RAB and the allowable revenue for the following year be adjusted.

4. This approach will require annual adjustments to the revenue cap (and hence tariffs) but they can be treated as "negative pass through events" just as the approved revenue is adjusted six monthly as other pass through costs are accommodated

We accept that this approach will add some degree of uncertainty in tariffs, but reductions in tariffs are more welcome to consumers than increases. However of greater importance this approach reduces risks to all parties at the minor expense of an annual review of actual capex incurred.

**Summary**
ElectraNet is proposing to carry out a massive capex program. There is significant doubt as to whether all the projects included in the probabilistic assessment will comply with the regulatory tests. Consumers have raised very valid concerns at the approach proposed by ElectraNet and these have been echoed to a degree by the ACCC and its consultants.

Because there is the lack of a detailed program for capex injection, there is considerable doubt as to the efficacy and appropriateness of the capex requested. The amount of the capex claimed in relation to the RAB is very high. If the ACCC permits ElectraNet to embark on the capex program allowed in the draft decision, it must be accompanied by appropriate controls. ECCSA has proposed controls which are not overly intrusive, give consumers a degree of protection and provide a degree of certainty to ElectraNet.

## ***Operating and maintenance expenditure (Opex)***

**Comparing ElectraNet to competitive business**
At the public forum ECCSA commented that:-

> "Much is said about Australia having an incentive based regime for regulated businesses. By allowing ElectraNet to maintain its current level of opex does not impose any incentive on them to find ways to improve performance. In competitive industry the cost of produce falls in real terms (for instance compare the reduction in the cost and the improved quality of cars and computers over the years).
>
> ECCSA members are continually being forced by competitive pressures to reduce their costs in order to stay in business – to continue with the same market share. What the ACCC has done with its opex approval is permit ElectraNet to maintain its current lifestyle without imposing any financial pressure to permanently reduce its costs of operations."

ElectraNet has maintained that they need increased opex to maintain the assets they so recently purchased. The proposed opex in the draft decision has been stated by the ACCC to be equivalent to past opex, inflated by CPI.

However the information provided by past annual reports and submissions to SAIIR to substantiate performance bonuses, backed up by the benchmarking provided on its comparators, indicates that the amount for opex $43M pa proposed by the ACCC is significantly above even average performance.

Competitive pressures are needed on regulated businesses for them to reach best practice. We believe that the opex allowance should start at past levels and be automatically reduced on an annual basis by at least the CPI to replicate true competitive pressures.

Failure to provide an impetus for improved cost performance will not drive regulated businesses to achieve the performance needed of businesses exposed to the world markets.

**Benchmarking supplied**

A key purpose of international benchmarking is to avoid the circularity of benchmarking by comparing only against a few (local) benchmarks. In our previous submission we refer to the importance of international benchmarks. Generally the ACCC acknowledges the desirability of international benchmarking as part of assessing reasonable opex levels. However, beyond Meritec inserting its own New Zealand benchmark, ACCC does nothing to require ElectraNet to provide any international benchmark cost comparisons. The ACCC fails to explain why international benchmarking is not required in for comparison of ElectraNet's opex.

The ACCC comments that Meritec was unable to compare individual cost items in ElectraNet's opex forecast with its historical figures and therefore has to rely on a holistic approach and rely on opex trends (draft decision page 93). Because of this there is no provision of any in-depth analysis to demonstrate that ElectraNet is subject to rigorous "competition by comparison" which is the key tool of regulators following the "light handed" approach. The ACCC must explain why it does not require this rigorous comparison feature for its review.

**Issues affecting opex**

There are a number of aspects where ElectraNet and the ACCC consider opex as applying to ElectraNet needs to be increased due to the "unique" features of

1. The substantial capex program. The ACCC notes (draft decision page 103) that on balance the large capex program will marginally increase opex. The ACCC does not explain why this should happen, but ECCSA notes that form the limited amount of information ElectraNet provides from its probabilistic approach to capex, that this assertion cannot be sustained. ElectraNet makes much of the need to replace assets and to enlarge assets to accommodate growth. By replacing new with old, must significantly reduce opex. It is noted that there may be some limited new lines installed or duplication, the increase in opex is

marginal. There is no quantification to support the assertion that opex will increase.

2. The "distribution like" features of ElectraNet. ElectraNet opines that its system has features which make it more like a distribution network than other transmission assets. As noted in the section "Information disclosure and Benchmarking" ECCSA has carried out preliminary comparative benchmarking from Victoria's distribution assets (particularly the rural businesses) and the results of this work do not support the contention that ElectraNet should enjoy higher opex due to its distribution like features. In fact it would appear on balance that such comparison could lead to the conclusion that ElectraNet has advantages over its transmission comparators because of this factor, which would indicate that the opex proposed by the ACCC is too high.
3. Low load factor. ElectraNet opines that its low load factor results in higher opex. Whilst the RAB is affected by a low load factor, intuitively the consistent low loading on assets should result in less stress resulting in longer life and less attention.

**Comparisons from ACCC draft decision table 5.4**

Table 5.4 appears to be an outworking from the ACCC. This information was not included in earlier information made available to interested parties.

This table provides a number of benchmark calculations, measuring ElectraNet's claims, the Meritec proposals and the benchmarks from the three other States operating in the NEM. From this we can develop an assessment of the how each of the benchmarks compares with the average.

| $'000 | NEM Average[4] | Meritec | ElectraNet |
|---|---|---|---|
| opex/km | 7.7 | 99% | 129% |
| opex/ss | 1020 | 61% | 80% |
| opex/RAB | 3.6 | 134% | 175% |
| opex/MW peak | 10.2 | 146% | 190% |
| opex/Gwh | 2 | 178% | 233% |

What this table shows is that the claims for opex by ElectraNet exceed the averages in all but one instance, averaging over all benchmarks an average

[4] This number is the arithmetic average of the Meritec, PowerNet, TransGrid and PowerLink benchmarks from table 5.4

exceedance[5] of 160%. In contrast a similar comparison shows the Meritec proposal for opex results in an average exceedance of 123%. Even allowing ElectraNet some opex latitude due to any detriments from its unique features, the Meritec assessment (on which the ACCC proposal is based) still provides ElectraNet considerably more opex than benchmarking studies indicate.

Table 5.6 in the draft decision appears to show that the ACCC proposes to increase the Meritec recommendations, as there is no explanation provided for the difference between the ACCC proposal and the sum of the Meritec proposal and the grid support amount.

**Summary**

We note that the ACCC is of the view[6] that:-

> "Generally, from the analysis provided above it can be seen that the amount of opex requested by ElectraNet is high especially compared to other TNSPs and ElectraNet's historical opex. Even the opex levels recommended by Meritec seem to be on the high side given the results of benchmarking and historical analysis."

ECCSA concurs with this assessment. However, the ACCC goes on to say:-

> "… the Commission, … considers a figure of $43m (excluding grid support) to be an appropriate opex allowance (see table 5.6). This figure is consistent with the recommendation of Meritec. The Commission however notes that $43m is significantly higher than the amount reported to SAIIR by ElectraNet and that by most measures appears to be higher than those of other TNSPs in Australia. Therefore, the Commission will re-examine the opex allowance before its final decision."

ECCSA is firmly of the view that there is little in the arguments provided by ElectraNet to substantiate its claims for increases. The work carried out by Meritec was greatly affected by its inability[7]

> "… to compare individual cost items in ElectraNet's opex forecast with its historical figures, due to a lack of detailed breakdown of costs. Meritec also stated that a line-by-line comparison of individual cost items among TNSPs was not useful because of the differences among networks. Therefore Meritec took a holistic approach and analysed ElectraNet's total opex and trend."

By not being able to compare costs at a detailed level for whatever reason, this leaves the ACCC relying purely on benchmarking to assess opex costs. The

[5] In this case average exceedance is measured by the arithmetic average of all the individual exceedances

[6] ACCC Draft Decision on ElectraNet page 108

[7] ibid page 93

benchmarking work consistently highlights that the ACCC proposed opex is too high by some 10%.

If this amount is left in the approved revenue, this gives ElectraNet some $4M pa (or $20m over the period) of monopoly rent. This monopoly rent adds about $0.35/Mwh to the average transmission tariff

## ***Service standards***

ECCSA notes with pleasure the addition of a service standards requirement to the draft decision. This clearly follows on from the transmission service standards program being run concurrently by the ACCC.

We recognise that the inclusion of the service standards now provides the essential balance required of the regulatory bargain (that of a certain funding for a certain achievement).

At the public forum ElectraNet commented that these service standards create a form of double jeopardy for them, as they also have a service standard to meet under their licence through ESCoSA, formally SAIIR.

As we understand the issue, the current performance incentive scheme is linked to the EPO which expires on 31 December 2002. The SAIIR in its Transmission Code provides incentives for minutes off supply, number of interruptions and an opex cost incentive. Where there is some point of commonality with current standards and the proposed standards, we do not believe that ElectraNet should be exposed to double jeopardy (although this also exposes it to double benefit).

We recommend that the penalty/bonus applying under the new standards be adjusted to expose ElectraNet to either an ACCC standard or to the SAIIR standard if this does not conflict with the ACCC standard. However if the SAIIR standard requires better performance than that proposed by the ACCC, then the higher standard should also apply.

Implementation of high standards of service is integral to moving towards firm supply across interconnects and away from the Electricity Code target of “best endeavours”. We believe that the ACCC proposal is a good step in the right direction and should be strongly endorsed

## ***Conclusions and Recommendations***

We believe that the ACCC’s draft decision goes some way to addressing the concerns we raised in our initial submission. Further we have reviewed the comments made at the public forum and see that little was added by those

representing the transmission businesses to justify the ACCC moving from the proposal implicit in the draft decision.

On review we believe that the ACCC's Draft Decision proposes:-

1. A WACC which is too high. Our analysis indicates a WACC of between 5.0 and 6.0 would result from applying more appropriate values for intermediate elements of the calculation.

2. A RAB which excludes the impact of the GST spike and when this is removed will reduce the RAB by some $50M.

3. The correct value for easements of $3.1M. We do not consider the ACCC has any discretion to move from this value.

4. A capex value that is extraordinarily high. However in the absence of detailed capex proposals, we recommend that the ACCC apply controls on the capex, such as annual reviews and adjustments to the RAB to reflect actual capital expenditure rather than leave the adjustment to the end of the regulatory period.

5. An opex which although significantly reduced from the amount claimed by ElectraNet, is still too high when compared to past opex, opex declared to the previous regulator to claim benefits, and when benchmarked to other electricity businesses. We believe that the opex should be at least 10% lower than that proposed in the draft decision.

As a footnote we must make an observation regarding the presentation alleging that there must be sea change to the regulatory environment arising from the WA Supreme Court decision regarding Offgar and Epic, and the release of the draft report from the Productivity Commission. ECCSA has reviewed both of these documents and we have reached a conclusion different to that presented at the forum.

In summary, we see that these documents have clarified the regulator's role, requiring the regulator to be more overt in:-

- Explaining in detail the bases on which it has exercised regulatory judgment, ensuring that it explains fully its views on each of the factors it is required to assess, and that it clearly and fully explains why it has elected to take one position over another, especially when there are conflicting objectives.

- Ensuring that each of the objectives embodied in Codes or legislation is addressed, particularly paying attention to and

balancing the conflicting objectives of both consumers and service providers.

In this regard, we note there are some aspects of the draft decision on which the ACCC has not fully examined the issues and/or explained its reasons for taking a particular view.