



# **SOUTH AUSTRALIAN TRANSMISSION REVENUE CAP**

## **COMMENTS ARISING FROM THE ACCC DRAFT DECISION AND PUBLIC FORUM**

October 2002

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The Energy Users' Association of Australia (EUAA) is pleased to have an opportunity to reinforce points made in our presentation at the above public forum last Friday (4 October 2002), and to respond to several key issues raised at the public conference held in Adelaide on Friday 4<sup>th</sup> October 2002. These issues are outlined below.

## **1. Overall reactions**

The EUAA is pleased that the ACCC has pruned ElectraNet's proposals to some extent on returns, Opex and Capex. The initial ambit claims were clearly excessive and deserved close scrutiny. The proposals included in the ACCC's Draft Decision have the potential to improve the outcome for the next regulatory period to some extent.

However, the Draft Decision still results in the imposition of price rises of 25% (nominal) and 11% (real), although this is not immediately transparent from the decision. This is a heavy burden for SA end-users, on top of already very high prices relative to other NEM regions and the recent price rises for retail customers. The issues and comments summarised in this submission seriously question the need for any transmission prices rises over the next regulatory period.

The EUAA believes that the ACCC could, and quite reasonably should, set efficient benchmarks for WACC and Opex that alone would save SA customers \$140-215 million over the next regulatory period. This would deliver more reasonable price changes – somewhere between no real increase and a real price reduction of around 10%.

The EUAA strongly believes the ACCC has not yet adequately scrutinised ElectraNet's claims nor set MAR to include challenging (but achievable) targets for next regulatory period. In addition, the Draft Decision says next to nothing about price impacts for next regulatory period.

## **2. Integration of electricity transmission regulation across the NEM**

The EUAA urges the ACCC to move towards integration of electricity transmission regulation across the NEM. There are two important areas where it can do so in this decision.

These are the application of meaningful Service Standards and performance incentives, and the treatment of the Monash to Robertstown augmentation.

The EUAA has previously voiced its concern about the lack of true national regulation of TNSPs. We are fully aware of the difficulties facing the Commission because of the fragmented jurisdictional arrangements for transmission in the NEM. However, it is the EUAA's firm view that TNSPs should be regulated by the ACCC as a whole NEM transmission network, that is, effectively one single national facility. Practically, this will require the ACCC to 'adjust' the timing of jurisdictional regulatory reviews so that they align at the earliest opportunity, and to establish a single set of uniform service standards and performance incentives. There should also be a single regulatory review process that ensures the most efficient service outcome is delivered to end-users.

## **2.1. Service Standards and performance incentives**

The National Electricity Code requires the ACCC to take service standards into account in setting the revenue cap for ElectraNet (and all other TNSPs). There are good reasons for this as end-users are entitled to know exactly what service they will get for their transmission charges.

The benefits from such an outcome are obvious and clearly demonstrated by the much better outcomes achieved in the UK. In particular, the EUAA notes that the UK regulator Ofgem has recently announced even more changes to improve incentives for the National Grid Corporation (NGC) designed to deliver better outcomes for end-users. In its recent press release Ofgem says:

*Customers, the electricity industry and the National Grid Company (NGC) will all benefit under enhanced system operator incentive arrangements put forward today (17 October 2002).*

*In addition to improving NGC's incentives to control day-to-day operating costs, these incentives will, for the first time, encourage NGC to respond to signals from the market when planning network investments. This will ensure that NGC can respond to changing demand for transmission capacity on a long-term basis and deal with any potential 'bottlenecks' on the system.*

*In order to provide appropriate market signals, NGC will be required to allow market players to buy financially firm, long-term transmission access rights. By purchasing access rights players will be able to ensure that they can input electricity into or take it off the network or be entitled to receive compensation if NGC is unable to deliver the rights.*

*The system operator incentives will allow NGC to earn additional rewards if it invests efficiently and delivers more than the output measures agreed initially to meet customer demand. It will also give NGC incentives to reduce investment if demand is below the initially agreed levels.*

*... These proposals will incentivise NGC to make transmission capacity available in response to actual changing market signals rather than, at present, as a result of planning based on forecasts of future needs.*

*This approach will enhance security of supply because it will encourage NGC to concentrate on strengthening the system where it is most urgently needed and, at the same time, reduce its overall costs, which is good news for customers.*

*The new scheme will bring NGC's incentives in line with those that exist for the Transco, which runs the national gas pipelines.*

EUAA members, and other end-users across the NEM also have a legitimate expectation that TNSPs will be similarly incentivised. This is vital to the future success of the NEM.

Yet the ACCC Draft Decision on ElectraNet meekly defers to SKM's 'work-in-progress' on this matter. Our knowledge of this work is that it is inadequate to sufficiently advance the need for meaningful and performance based service standards for transmission in the NEM and to provide incentives for TNSPs to act so as to optimise outcomes for end-users.

The ACCC must achieve outcomes that place the NEM closer to the UK model, without necessarily replicating that model exactly.

## **2.2. Monash to Robertstown Augmentation**

The EUAA is of the view that the Commission must carefully consider the treatment of expenditure associated with the Monash-Robertstown augmentation and the reaction to this by Transenergie Australia Pty Ltd.

The Commission's draft decision demonstrates that it is well aware of the relevance of augmentation work on this segment of the SA electricity transmission network to the proposal by Transgrid to construct a new regulated interconnector between NSW and SA (SNI).

We note that Transgrid's proposal has passed the required 'regulatory test' and the potential benefits that could be delivered to SA consumers by improved interconnection.

We are also seriously concerned that Transenergie's position on the Monash-Robertstown augmentation could well be heavily influenced by the fact that it has a commercial interest in Murraylink, meaning that it would benefit by frustrating the construction of both SNI and the Monash-Robertstown augmentation. For example, the Commission would be aware that Transenergie has appealed the decision to approve SNI to the National Electricity Tribunal and challenged many aspects of that process, thereby delaying SNI and commercially advantaging Murraylink. The EUAA strongly urges the Commission not to be swayed by self-interested parties, especially if the result is a denial of benefits to end-users.

EUAA's view is that the Commission must find a way to ensure that its final decision does nothing to frustrate construction of a key network element that would deliver considerable benefits to end-users in both the short and long term – while at the same time protecting SA end-users from 'inflated' and 'inefficient' costs that would arise if ElectraNet was allowed to collect revenue for the augmentation and it did not proceed, or it was funded instead by Transgrid.

The Commission should consider providing for 'discretionary' investment on such augmentations, with 'allowances' made for the investment to occur subject to regulatory endorsement prior to commencement of work on the augmentation. If this example were followed, it would even be possible for the Commission to endorse recovery of efficient investment costs for the augmentation by either ElectraNet or Transgrid, depending on which entity is best able to deliver the augmentation at the lowest, most-efficient cost.<sup>1</sup>

## **3. WACC**

The EUAA presentation to the ACCC public conference held in Adelaide included material showing a 'benchmarking' comparison of Return on Equity and Weighted Average Cost of Capital (WACC) prepared by Pareto Associates. This used information presented to the Commission on behalf of BHP-Billiton in relation to GasNet's Victorian gas transmission

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<sup>1</sup> This is, in effect, what happened in Victoria where the Tariff Order allowed, *inter alia*, for augmentation of the transmission network by construction of a new network element from Morwell to Bairnsdale. In this case, the primary 'need' for augmentation was to provide voltage support to Eastern Energy's (now TXU) East Gippsland distribution network (in the short term) and provide additional energy in the longer term. However, rather than a 'conventional' network solution undertaken by GPU PowerNet, Eastern Energy 'found' a more efficient (and lower cost to end-users) solution comprising a small Static VAR compensator and gas-fired power station constructed at Bairnsdale. This solution was ultimately endorsed by the Office of the Regulator-General, allowing Eastern Energy to recover the costs necessary to underwrite investment in assets that were different in scope to that envisioned by the Tariff Order, but which delivered the same services to end-users, but at lower cost.

application and to the Victorian Essential Services Commission on behalf of the Customer Energy Coalition in relation to gas distribution access arrangements.

The EUAA urges the Commission to carefully consider the material contained in these reports. As the Commission will see, the approach taken is to use values of CAPM parameters selected by individual regulators to derive estimates of real, post tax Cost of Debt, Return on Equity (key WACC parameters) and the "Vanilla" WACC. This allows a (nearer) "apples-for-apples" comparison of the outcomes from regulatory decisions than is possible by using numbers derived from different versions of CAPM (as is done by both the ACCC and IPART). The results of this analysis show that Australian regulators have made judgements that are much more varied than those made by UK regulators administering similar 'light-handed', incentive regulation regimes. The analysis also shows Australian regulators have endorsed outcomes that ensure Australia's energy networks will be less 'efficient' (i.e. more costly to end-users) than in either the UK or US.

Two critically important questions for Australian regulators are posed by this analysis and regulators presented with the challenge of answering them:

- What is it about the Australian energy networks that support their judgement that financial markets see these industries as very much less efficient than in either the UK or US?
- If there is a reason for this and supporting evidence (e.g. the Australian economy is seen by financial markets as less efficient), why are capital-intensive Australian firms successfully operating in internationally competitive markets?

In posing these questions, it is noted with disappointment that the Productivity Commission report on the National Access Regime contains virtually no analysis to support the contention that Australian regulators are failing to provide sufficient 'incentives' for utilities to invest. The EUAA agrees with the Productivity Commission that it is important for Australian regulators to ensure that there is adequate investment in energy networks. Inadequate incentives for owners to invest would harm Australia's economic interests and those of end users. But so will an increase in costs due, for example, to excessive returns that diminish the international competitiveness of broader Australian business. The EUAA's view is that this issue is best addressed through regulators undertaking careful analysis and making considered, well-informed and independent decisions focussed on ensuring outcomes that emphasise broad economic benefits rather than ones that protect the long-term interests of existing utility shareholders. The Commission, as Australia's principal economic regulator, has a key role and responsibility here.

There is nothing in the decisions of any Australian regulator – nor in the Productivity Commission report - to explain why return on equity and WACC must be higher for Australian utilities than for utilities in the UK and US.<sup>2</sup> This comment also applies to the ACCC's Draft Decision on ElectraNet.

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<sup>2</sup> Material included in the CEC submission to the ESC shows that 'evidence' presented by NECG in its rebuttal of NERA's report to the ACCC purporting to show that the Australian economy is 'more costly' than the UK and US is misleading. The source data referred to by NECG has been taken from *Expected returns and volatility in 135 countries*, C. Erb, C. Harvey, T. Viskanta, *Journal of Portfolio Management*, Spring 1996, pp. 46-58. The interpretation used by NECG represents theoretical predictions of expected returns for non-market economies from one of three models presented by Erb *et al*. They make no claims that their models accurately predict expected returns in market economies like Australia's. Actual market data for Australia, the US and the UK presented by Erb *et al* show expected returns for Australia (between 1979-1995) slightly below those for the US and UK. That is, the data presented by Erb *et al* suggests financial markets would expect the Australian economy to deliver slightly lower

If the outcomes presented above are the result of overly-cautious regulation, or regulatory error, there is a real possibility that regulators are contributing to a reduction in the competitiveness of the Australian economy, which the EUAA considers is a critical issue for Australia's energy intensive economy. On this basis alone, the EUAA believes it is essential that the Commission consider the implications of the material presented.

The two diagrams below show our estimates of real, post-tax Return on Equity and WACC for ElectraNet. They use the material contained in the submissions referred to above, updated by Pareto to include the Commission's Draft Decision on ElectraNet.<sup>3</sup> Their key conclusions are:

- The main reason for the difference in values of WACC adopted by Australian regulators is because they make the judgement that a value for Market Risk Premium (or Equity Risk Premium) of 6.0% is appropriate – based on analysis of past outcomes. Whereas UK regulators judge a value of 3.5-4.0% to be appropriate – based on analysis showing that the expectations of financial markets have changed compared to historical outcomes (virtually identical information is acknowledged but ignored by Australian regulators).
- The difference in outcomes between Australia and the UK will cost SA consumers around \$60-130M more than if the ACCC had more closely followed the UK approach.

#### **4. The Productivity Commission Report and the WA Supreme Court Appeal Decision**

The presentation made by KPMG to the ACCC public conference includes material referring to the Productivity Commission's Final Report, the Commonwealth Government's response to that report and the WA Supreme Court decision dealing with the 'Epic' Appeal.

The EUAA is of the view that the Commission should rely on its own analysis of these documents, rather than on interpretations put on behalf of ElectraNet. Advice provided to the EUAA suggests that the Productivity Commission should have taken:

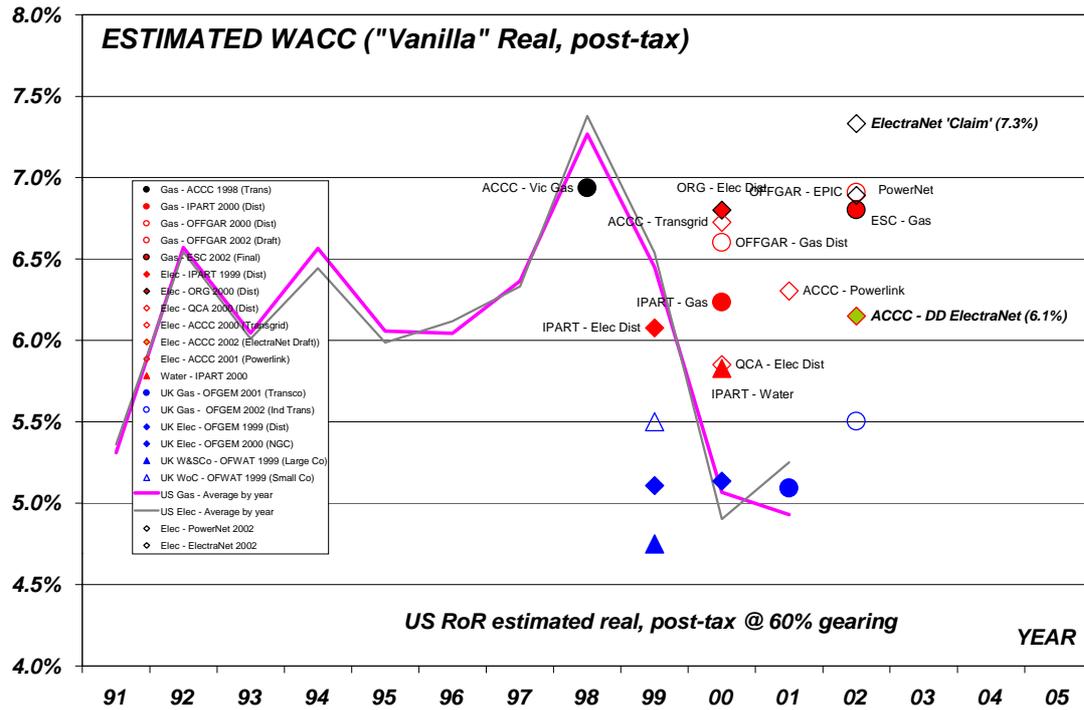
- A more empirically informed approach to its analysis of decisions by Australia's regulators.
- Greater note of the 'practical realities' that regulators face.
- Placed greater weight on the implications of its position on the international competitiveness of Australia's energy using industries.

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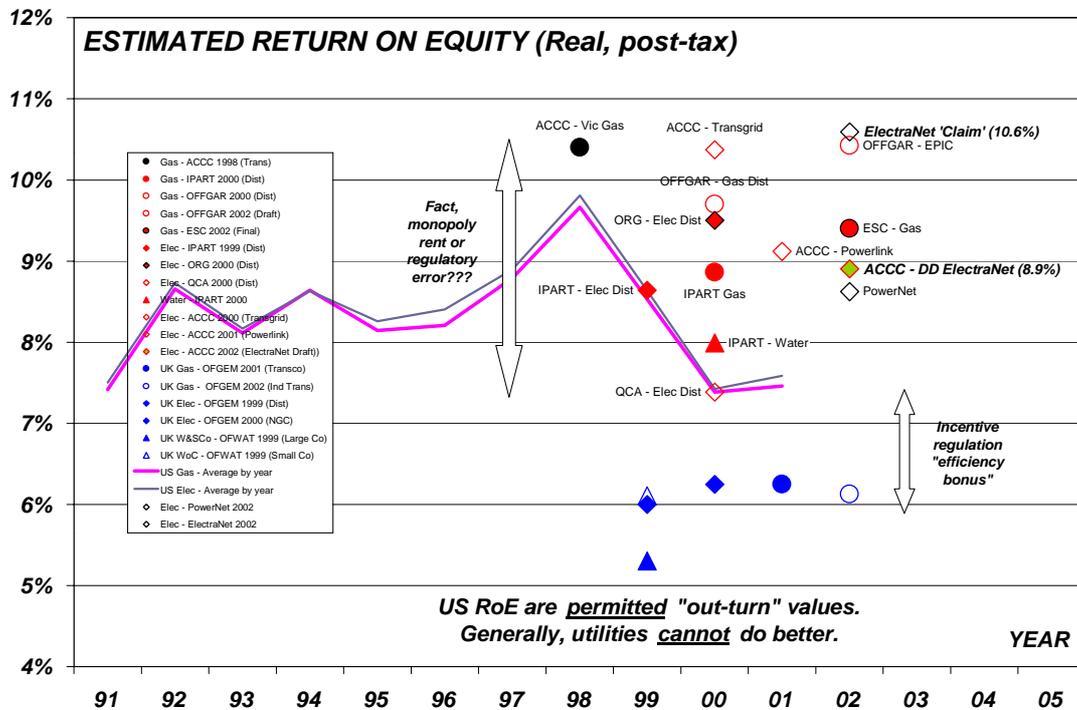
returns than the UK and US economies. To expect anything other than what can be observed requires more (or less) pessimism than the market generally - or access to information the market does not have.

The corollary (using the logic adopted by NECG) is that financial markets would expect Australian utilities to earn slightly lower returns than either UK or US utilities, not higher ones.

<sup>3</sup> The Commission should note that the WACC diagram differs slightly to that presented by the EUAA at the public conference to provide more accurate estimates.



**Figure 1** Real, post-tax “Vanilla” WACC estimated from regulatory decisions in the Australian, UK and US electricity, gas and water industries.



**Figure 2** Real, post-tax Return on Equity estimated from regulatory decisions in the Australian, UK and US electricity, gas and water industries.

The ‘Epic’ decision reinforced that:

- Epic did not achieve what it sought - a direction from the Court that the WA gas regulator must adopt an initial regulatory asset value based on the price paid by Epic for the Dampier to Bunbury gas pipeline;
- Ofgar, the Western Australian gas regulator (and probably all other economic regulators in Australia) have greater discretionary power than exhibited in the Draft Decision;
- The regulator (and probably all other economic regulators in Australia) must take fully into account and explain all factors relevant to their statutory obligations; and
- The fundamental function of economic regulation is to focus on and deliver efficient economic outcomes.

The Court’s focus on aspect of the Gas Code that mean ‘outcomes should replicate effectively competitive markets – not perfectly competitive markets’ provides ample scope (for example) for the Ofgar to come down with a judgement that Epic paid above a fair market price for its assets (given that the WA government specifically did not guarantee future cashflow, did not explicitly specify an opening asset value that the regulator was obliged to adopt, and did specifically state that future prices would be set by the regulator in accordance with the prospective Gas Code - that it was clear even then would promote economic efficiency.

If the WA regulator makes a final judgement that Epic paid more than a ‘fair’ market price for the assets, it could mean that Epic would face the same fate as any investor in actual and effectively competitive markets who pays too much for assets – it would have to accept a write down in investment value to a ‘fair market price’.

The primary issues for the Commission that arise from the Productivity Commission report and the WA Supreme Court judgement is to ensure that it conducts well-informed, rigorous, independent and well-explained regulatory processes; and that it focuses on ensuring that its decisions produce outcomes that are sustainable and in the long-term interests of both end-users and utility investors.

In our view, neither document creates any significant pressure for changing the existing policy settings underpinning economic regulation in Australia, the Commission should provide both more detail and more rigor in explanation supporting its judgements than it has in the past. Specifically, we would expect that the Commission will now have to provide full explanations for its treatment of the proposals we have put in this and our earlier submission.

## **5. Asset valuations**

The EUAA is pleased to see the ACCC has taken a sensible view on the asset revaluation claim made by ElectraNet and rejected ElectraNet’s proposed treatment of easement valuations and other attempts to increase the rolled forward asset values of ElectraNet, such as IDCs and readmission of assets previously ‘optimised’ by the SA government. The ACCC’s decision emphasises that information provided to ElectraNet before it bid to lease the SA transmission assets transparently specified the asset values.

We note in any case, that the ElectraNet assets, with the exception of easements were value using the Depreciated Optimised Replacement Cost (DORC) method, also accepted by the ACCC for regulatory purposes. As we have previously remarked, we oppose the use of this

method which substantially inflates asset value above any reasonable level and exposes transmission users to the resultant inflated prices. DORC values adopted by governments around Australia have already exposed energy users to network prices heavily influenced by assets that are up to 300% above valuations possible for non-regulated companies. ElectraNet's is already and will continue to benefit from this situation.

The approach adopted by the ACCC is, in this instance, also similar to that adopted by UK regulators when addressing this issue. A priority for the UK regulators has been to ensure incentives are created to focus utility operators on achieving efficient future investment, not to maximise revenues on sunk investments made by (supposedly less efficient) owners/operators prior to privatisation. UK regulators explicitly rejected suggestions that pre-privatisation assets should be re-valued in the round of price reviews in 1993-4. In addition, the UK regulators left open the option of assessing the relative efficiency of investment post-privatisation, as an additional incentive for future efficiencies.

## **6. Opex efficiency assessment**

The costs incurred by ElectraNet for operation and maintenance activities account for around one-third of its allowable revenues. They represent a significant source for ElectraNet to achieve 'superior' returns by outperforming the ACCC's 'benchmarks' and also to engage in 'strategic' behaviour through inflated forecasting.

For end-users to access the benefits of improving efficiency, it is essential that the ACCC:

- closely evaluate ElectraNet's performance in the first regulatory period;
- closely scrutinise ElectraNet's forecasts for the coming regulatory period;
- set 'challenging but achievable' performance and revenue benchmarks that sharpen incentives for ElectraNet to pursue further Opex efficiencies; and
- establish an effective arrangement to pass through to end-users efficiencies achieved so far.

The Draft Decision is of limited use in all of the above. Our assessment is that the ACCC has been ineffective in this area and has whimsically assessed ElectraNet's application. This leaves end-users exposed to excessive prices. It also undermines end-user support for the ACCC and its 'incentive' regulation approach.

If this is how the ACCC is to apply 'incentive' regulation, end-users may well be better off supporting a fundamental change in the regulatory approach and a transfer of responsibility away from the ACCC.

The fundamental incentives from regulation are to:

- increase economic efficiency, by allowing utilities to increase returns above regulators' benchmark levels by reducing costs below benchmark levels allowed by regulators; and
- exercise 'strategic' behaviour in forecasts so as to retain and 'claw back' efficiency gains that would otherwise be passed through to end-users, a form of classic monopoly behaviour that regulation is intended to combat or eliminate.

A relevant summary comparison of outcomes of Opex ‘efficiency assessment’ from UK regulators’ decisions in the electricity, gas and water industries is presented in the Customer Energy Coalition submission to the Victorian gas distribution access review. UK regulators are now observing the performance of regulated companies in the third 5-year regulatory period. Ofgem and Ofwat have included analysis and comparisons of forecast and actual OPEX in each of their decisions. Information from those decisions shows:

- Industries always out-performing regulatory benchmarks (proving the fundamental “efficiency” incentives in the regimes do work as intended).
- Industries always providing excessively “conservative” forecasts (proving that regulators do need to scrutinise forecasts closely and not accept them as easily as the ACCC has for ElectraNet).
- Regulators always accept that efficiency will improve – and set ‘challenging’ levels for Opex cost (thereby ensuring that consumers (eventually) gain benefit from improving efficiency). In almost all cases, UK regulators conduct a more rigorous comparative ‘benchmarking analysis’ of past performance than the ACCC has and often set more ‘challenging’ Opex levels for companies judged to be less efficient than their peers (to ‘sharpen’ the incentive to improve efficiency in the next regulatory period).

The diagram below showing actual and forecast Opex for ElectraNet, on the other hand, shows that the ACCC (like almost all other Australian regulators) apparently believe that ElectraNet has achieved significant ‘efficiency’ improvements over the initial regulatory period, that ElectraNet’s forecasts are excessively ‘conservative’, but still proposes to allow ElectraNet a future Opex cost stream well above that achieved in the first regulatory period. Given this, it is impossible for end-users to accept that:

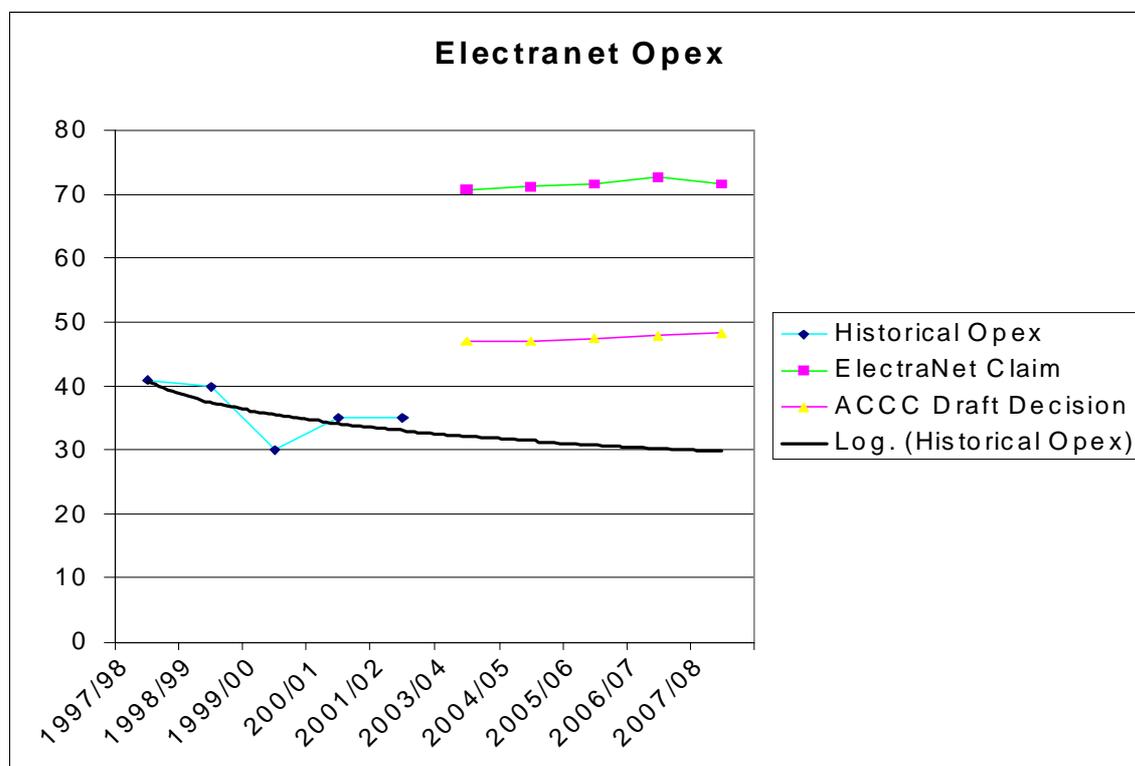


Figure 3 Actual and forecast Opex for ElectraNet SA.

- the ACCC has subjected ElectraNet’s opex to adequate scrutiny; and
- end-users have access to efficiency ‘benefits’ achieved by ElectraNet in the first regulatory period.

Neither has the ACCC conducted any effective or rigorous comparative benchmarking of ElectraNet’s performance relative to other TNSPs in the NEM or elsewhere, thereby disregarding a useful and effective tool adopted by all UK regulators. We have a legitimate expectation that any thorough and effective regulator would do this. Why hasn’t the ACCC?

As an absolute minimum, the EUAA requires the ACCC to re-visit its analysis of Opex and answer the following questions in its Final Decision:

- Why is there such a large gap between ACCC proposal, past opex and trend future opex that amounts to approximately \$15 million pa (ie, more than \$80 million over 5 years)? What justifies this and how will end-users benefit?
- Has ElectraNet optimised its network to minimise opex? Compare this to the SPI PowerNet application. Many aspects of ElectraNet’s operations and its current network configuration, eg the downgrading problems experienced on the Heywood interconnector during storms and the fact that these never exist on the Victorian side, suggest that ElectraNet has failed to optimise the performance of its network and now expects end-users to pay for this through higher opex.
- How is a significant increase in Opex consistent with the large (and increased) Capex program? Normally, an increase in one will offset the other. Yet the ACCC has foolishly neglected this point and proposes to accept ElectraNet dubious argument that expenditure on new capital requires more to be spent on opex!

## **7. Capex efficiency assessment**

Capex forecast proposals adopted by the ACCC provide \$337 million over 5 years (or \$255 million with refurbishment). This is only \$33 million (\$95 million) less than sought by ElectraNet and would lead to a 46% increase in ElectraNet’s closing asset base at the end of the next regulatory period (assuming that ElectraNet actually invested the forecast amount). ElectraNet’s Application itself requested an amount that would have provided an increase in the asset base of only 4% more than this.

This result in itself hardly inspires user confidence in the ACCC’s assessment.

Moreover, the ACCC’s Draft Decision provides no detailed analysis of ElectraNet’s past Capex programs, no attempt to assess their efficiency and no assessment of the ‘efficiency’ of ElectraNet’s future capex proposals.

In our view, this is an indication of sloppy regulatory work and it is totally unacceptable to the EUAA and its members.

The ACCC could learn something about regulatory scrutiny by closely examining the material contained in the CEC submission on the Victorian gas distribution access review. This includes a summary of the analysis and judgements of UK regulators on Capex issues. As with Opex, information in UK regulators’ decisions shows that:

- Industries always out-performing regulatory benchmarks in the early years of the regulatory period (proving that “efficiency” incentives do work as intended).
- Capex increasing in the latter years of each regulatory period.
  - This shows the primary incentives working since it is to be expected that companies would seek to achieve “efficiency” (and increased profitability) by delaying Capex as long as possible.
  - However, if utilities delay investment too long, Opex costs may rise to inefficient levels, or service standards decline. If utilities are able to “shift” projected Capex from one regulatory period to the next, their Capex planning (and asset management) is, most probably, sub-optimal. In either case, costs to end-users are increased significantly.
- Industries always provide excessively “conservative” forecasts (proving that regulators need to closely scrutinise and question their forecasts).
- Regulators accept that efficiency will improve, thereby ensuring that consumers (eventually) gain benefit from improving efficiency.

In the majority of cases, UK regulators rejected or significantly discounted arguments that additional and increasing Capex is required to account for a ‘bow wave’ of investment in the distant past.

The EUAA endorses the ACCC decision to move \$62 million in refurbishments into ElectraNet’s Capex forecasts and dramatically cut interest during construction, but seriously questions whether it has otherwise adequately assessed ElectraNet’s proposal. In particular, the EUAA notes that the ACCC should address the following points in its Final Decision:

- ElectraNet say its Capex is driven by the need to upgrade and replace its “old network” (and to cater for increasing demand). But this equates to the dubious ‘bow wave’ argument, well-known in regulatory gaming. ACCC has not satisfied the EUAA that it has dealt robustly with this matter.
- ESIPC says ElectraNet’s limited project information means it could not determine if the proposals are an optimal solution and notes they have not been through an NEC process.
- Capex seems excessive given that ElectraNet’s network is frequently lightly loaded, except for peaks. Alternatives to expensive network augmentation to meet peaks include DSM, generation and better network management, although there is little if any indication that ElectraNet has acknowledged this and the ACCC Draft Decision shows little inclination to force them or SA energy policy to do this. We believe it is important that the SA transmission system cater for peak requirements to ensure reliable supply and are sympathetic to the need for ElectraNet to do this as part of its licence obligation, but not at any cost.
- It appears from the Draft Decision that \$56m (maybe up to \$180m) would be spent on wind power connection over the next regulatory period. Under current arrangements this would be paid for by all customers through transmission charges notwithstanding that they would be marginal beneficiaries of what is still an expensive form of generation. How is this maximising benefits to customers?

- Moreover, the ACCC Draft Decision on capex makes allowance for substantial expenditure on a raft of new projects. But, this is based on a probabilistic assessment undertaken by ElectraNet itself and not subject to any effective scrutiny by the ACCC. We ask the ACCC to answer the following questions in its final decision. How is allowing Capex for proposals with probability as low as 12% reasonable? Costs of some other large projects seem to have been allocated to all users. If so, why? Why should all SA energy users pay for this, especially if they are not the primary beneficiaries? There seems to be a substantial element of regulatory gaming in these proposals.

The EUAA is inexorably drawn to conclude that the analysis and judgement in the Draft Decision on the crucial matter is inadequate. The Final Decision must include more information, and better analysis of ElectraNet's past performance with Capex spend, and more rigorous examination of its proposals. We challenge the ACCC to do this and fulfil its requirement to safeguard the interests of consumers.

## **8. Other matters – comments on selected supply-side views and issues.**

### ***8.1. Benchmarking of transmission services – The 'explanatory framework' of Benchmark Economics***

The presentation by Benchmark Economics on behalf of ElectraNet at the public conference provides some useful suggestions for Australian regulators.

The EUAA supports the use of independent, rigorous, and internationally valid benchmarks comparisons to assist Australian regulators in making judgements on economic regulatory issues. Indeed, even simple benchmarking can provide useful data to better inform regulatory judgement and the more rigorous approaches adopted by UK regulators demonstrate how this can assist in detecting and quantifying both operational inefficiencies and 'strategic behaviour'. In this way, end-users can benefit from the positive incentives contained in 'light-handed' regulation.

However, apparent difficulties with the Benchmark Economics approach include:

- The work was undertaken for a regulated entity, using information provided by it (and other regulated entities) that has not been subject to independent regulatory oversight or audit.
- While Benchmark Economics claims the work is based on 'established precedents in empirical literature developed in the US, Europe and the UK', no evidence is provided to support this assertion. Nor is any data from these jurisdictions included in the analysis.
- The basis of the 'benchmarking' model appears excessively simplistic. There is no doubt that the Inputs, Outputs and Business conditions listed on Slide 4 are applicable to electricity transmission entities, but the assumption that simple (linear) relations exist between the listed variables is dubious.
- The 'fact' that ElectraNet has more similarities with Western Power and Transend than it does with Powerlink, Powernet and Transgrid is of interest, but if that is the case, it is logical to expect it would also have similar cost/price relationships to the similar entities. The data presented shows it does not.

- There is no explanation that justifies why ElectraNet should be permitted (relatively) higher prices when the data shows its costs are similar to other TNSPs with lower prices. We submit that comparisons contained in the EUAA’s initial submission are more relevant.
- The spread of data in the ‘Economies of Scale’ plot is considerable, and the ‘explanation’ justifying higher costs for Western Power and Powerlink simplistic.
- The claim that “Load Factor drives Opex/MWh” is not supported by credible evidence. Nor is any analysis provided to demonstrate that the observed differences are due entirely to extraneous factors beyond the control of management (which should be a key consideration of regulators before allowing any ‘extra’ revenue). The much more rigorous ‘benchmarking’ analysis undertaken by UK regulators (and reported in their regulatory determinations) shows conclusively that not all entities operate at the same level of efficiency. Indeed, the observed differences in ‘efficiency’ are taken into account when setting challenging, but achievable, revenue/performance targets, with the companies deemed “less efficient” by regulators being set more challenging targets. Similar comments relate to the claim that “Energy density drives network investment”.
- And finally, large industrial end-users may be amused (but more probably aggrieved or angered) by comparisons showing ratios such as Assets/revenue when –
  - their assets are valued at Historical Actual Cost, or Depreciated Actual Cost, or at Current Market Value when regulated utilities are able to assign their assets the (very) much higher DORC values; and
  - their revenues are earned without the ‘luxury’ of being protected by regulators.

Put simply, the comparisons in these slides are of limited use to the ACCC.

## **8.2. *Need to Align Transmission Reviews***

The EUAA has voiced its concern on numerous occasions about the Commission’s approach to regulation of jurisdictional TNSPs. It is our considered view that the Commission must approach regulation of TNSPs on a holistic national basis and treat the whole NEM transmission network as one single national facility. This is vital for the successful operation of the NEM.

Practically, this will require the Commission to use its discretionary powers to align the timing of jurisdictional regulatory reviews at the earliest opportunity, to establish a single set of uniform service standards and performance incentives, and use a single regulatory review process. This process must deliver the most competitively priced and efficient service outcomes to end-users.

The EUAA is fully aware of the difficulties facing the Commission due to the fragmented arrangements currently existing that result in individual assessment of jurisdictional elements of the transmission network. However, the EUAA expects the Commission to use its considerable powers to deliver a better overall process and outcome for end-users.

## **9. What the ACCC should do next**

The material outlined shows areas where the EUAA believes the ACCC must do more in its Final Decision on ElectraNet to protect the interests of end-users. In summary, this means the ACCC should:

- Reassess the WACC decision to make it more realistic in terms of benchmark and justifiable returns.
- Look more closely at opex and capex with a view to further significant pruning, avoiding gaming and taking account of the fact that further efficiencies will almost certainly be achieved during the next regulatory period.
- For capex, also question if ElectraNet's proposals are even achievable (as did Meritec) and make a more reasonable decision on projects where beneficiaries are clear or probabilities low.
- Impose some meaningful service standards for ElectraNet.
- Clearly say what its Final decision means for prices.