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Mr Mike Buckley
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Australian Energy Regulator
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Dear Mr Buckley

ElectraNet Transmission Network Revenue Proposal – 2008/09 to 2012/13

Flinders Power appreciates the opportunity to offer the following comments on the revenue proposal submitted by ElectraNet for the period 1 July 2008 to 30 June 2013, together with the associated negotiating framework and proposed pricing methodology.

At the outset it is acknowledged that a comprehensive proposal has been lodged, and a considerable level of effort has clearly gone into its preparation. The following comments are therefore offered in this context. It is also expected that the AER will be taking its own advice from independent experts through the review process.

1. Revenue Proposal

Capital Expenditure

Greater reliance has been placed on anticipated capital projects in determining the expected capital expenditure allowance. This is supported as an improvement over the previous approach which relied more heavily on probabilistic assessment of potential scenarios, providing only an indicative guide to the expected level of capital expenditure.

In terms of the magnitude of the proposed capital budget, a significant increase in capital spending has clearly been proposed, to a total of $778m over 5 years. By way of comparison, in 2003 annual capex averaged approximately $40m. If approved, the proposed capital spend for the forthcoming regulatory period will exceed $200m pa in some years.

It is noted that ESIPC has undertaken an independent assessment, and has indicated the broad network development program appears reasonable in the context of emerging network limitations. It has not attempted a detailed assessment of the costing of individual projects, asset condition and refurbishment, or optimisation of contingent projects.

However, it would be expected that independent consultants engaged by the AER will subject the proposed capex program to detailed scrutiny, and ensure that:

- the expenditure is reasonable and justified
- all projects are efficiently scoped and costed
- the proposed capex is achievable and manageable
- all contingency projects have been excluded
- all asset replacements and refurbishments are based on assessed asset condition and remaining effective life (not purely on age)
- any flexibility in mandated reliability standards is appropriately taken into account

Contingency projects have been assessed separately, as now required under the Rules. This potential expenditure amounts to a further $950m. Again, it would be expected that these proposals would be carefully reviewed to ensure they satisfy the respective criteria.

Flinders Power also notes that it has separately commented on two small network augmentation projects on which consultation has commenced involving the uprating of the Davenport-Brinkworth-Para transmission lines from thermal capacity of 49ºC to 65ºC. Specifically, Flinders submitted that further consideration should be given to undertaking a full 80ºC line uprating on these lines as a sensible and prudent measure to address emerging congestion on this important transmission corridor. Flinders would therefore support the inclusion of these works in full in the capital works program of ElectraNet, noting that the second element of this project is presently proposed as a contingent project (Item 15).

Operating Expenditure

A significant increase in annual operational spend is proposed. By way of historic comparison, in 2003 annual opex stood at around $35m. Operational expenditure of up to $82m pa is proposed moving forward.

This increase is supported to the extent that this expenditure caters for increased asset condition monitoring, operational practices to improve performance and asset utilisation (eg greater use of dynamic ratings), and preventative maintenance to extend asset life. These practices appear to support more efficient asset usage, and optimisation of asset life.

As demonstrated in the generation sector, the commercial drivers in the regulatory and competitive environment of the NEM have lead to the realisation that electricity asset utilisation and performance can be improved significantly over historic performance levels, and asset lives can be extended far beyond original engineering expectations.

Greater reliance on remaining asset life based on condition assessment and measured network performance is therefore supported in driving both asset replacement and maintenance expenditure. This is preferred over the simplistic use of asset age in prioritising asset maintenance and replacement, given the long lived nature of electricity assets and the local physical environment in which these assets operate. Indeed, local conditions might well be more favourable than the physical conditions in which transmission assets typically operate elsewhere.

The overall level of operating expenditure should therefore be justified, efficient, sustainable and manageable. Again, it would be expected that the AER will satisfy itself on these points, with the benefit of independent expert review. It would also be expected that any under or over expenditure in the current regulatory period would be taken into account.

Revenue

It is noted that, if approved, the maximum allowable revenue proposed would translate into a nominal average annual increase in transmission prices of 6.8% across the regulatory period. This contrasts with the annual 1% real reduction in transmission prices anticipated at the start of the current regulatory period.

The prospect of a 6.8% annual increase in transmission charges should not be dismissed lightly. While equating to a modest increase in the weekly expenditure of a residential consumer, an increase of this magnitude for a large transmission connection such as that of a generator could equate to a rise of several hundred thousand dollars per annum if translated into a direct increase in current charges. Given the nature of these existing connection services is largely unchanging, the expected benefit to be received in return for this substantial cost increase appears unclear.

In conjunction with its consultants and other interested parties, the AER should therefore satisfy itself that the revenue increase proposed is justified against the likely benefits to be delivered to affected network users.

A key variable in the transmission supply picture is the prospect of a significant expansion in northern mining loads in the State, particularly a step increase in the load at Olympic Dam. The potential capital expenditure required has been estimated at up to $250m. However, it is uncertain at this point whether the capital works will be required to provide prescribed or negotiated transmission services.

It has been indicated that the project could potentially result in a downward pressure on average transmission prices across the State toward the end of the regulatory period. However, any revenue capped expenditure that may be involved has been excluded from this calculation. This may offset this reduction.

The revenue proposal includes the development of a generator testing and model validation program at an estimated annual cost of $1.2m, reflecting obligations imposed on TNSPs following recent changes to the Rules. Flinders supports the compliance of ElectraNet with its obligations under the Rules. Having said this, Flinders would expect that the timing and detailed arrangements for such testing would be a matter for negotiation with the relevant generator. Whether or not a specific cost allowance is approved for this activity, it is noted that the obligation to undertake and fund this work will remain with the TNSP (along with the range of other TNSP functions and responsibilities under the Rules).

Service Standards

A series of proposed performance targets have been put forward based on the existing service target performance incentive scheme. While the use of performance incentives is supported as an essential component of the regulatory bargain, it is noted that these existing measures largely target reliability based on historic asset availability measures.

The AER has recently proposed a revised set of performance measures and incentives based on the market impact of transmission congestion which would supplement these arrangements. These arrangements have been under development since 2003, and are expected to be operational by April 2008.

Noting that the next regulatory period for ElectraNet commences after this date, it would seem unfortunate if such measures could not be applied in South Australia until the commencement of the following regulatory period (ie mid 2013). It is therefore suggested that opportunities be explored to incorporate such measures into the current reset process. However, even if financial incentives can not be applied in the forthcoming regulatory period, at least implementing these performance measures at this time would provide valuable information and experience for the TNSP and broader market.

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2. Negotiating Framework

The Negotiating Framework fulfils an important role in the overall regulatory framework, recognising that negotiated transmission services fall outside the full regulatory protections of prescribed transmission services.

Flinders Power recently made a joint submission on the Negotiated Transmission Service Criteria for ElectraNet proposed by the AER. Consistent with this submission, Flinders Power submits that the transmission revenue determination should include specific requirements for the negotiating framework reflecting these finalised criteria, particularly in relation to terms and conditions of access.

These requirements should include the following:

- Reference to costs should only include costs efficiently incurred, including the expenses incurred in processing an application to provide a service and all costs incurred in providing the service. Cost reflectivity otherwise provides little discipline on TNSP expenditure in the absence of efficiency criteria;

- In describing the services the TNSP intends to provide, there should be a clear statement of relevant performance characteristics. In the case of new generator connections, this should include such information as the capacity of the shared network to receive generator output and support power transfer;

- Terms and conditions of access must not limit TNSP liability to any greater extent than that enjoyed by the TNSP under its statutory immunities (noting that under the National Electricity Law, TNSPs do not incur any civil monetary liability in the performance of system operations functions nor for any failure to supply electricity unless due to bad faith or negligence);

- Terms and conditions of access should be even handed, and not allow for one-sided provisions such as indemnities for breach or negligence in favour of the TNSP, or allow the TNSP to unilaterally terminate the agreement, vary access terms and conditions, impose new charges, vary agreed charges, vary the performance characteristics of the service supplied or assign the agreement to the network user's detriment without consent;

- Terms and conditions of access should not seek to impose any technical or compliance requirements on the network user beyond those imposed under the Rules or applicable electricity legislation, or impose any additional rights of entry or inspection;

- Consistent with the intent of negotiated services, the Negotiating Framework should only permit the negotiation of services requested or agreed to by the network user, and only permit the application of charges for such services by express agreement;

- Consistent with the cost allocation principles under the Rules, if costs allocated to prescribed transmission services are reallocated to negotiated transmission services, then under the terms and conditions of access, there should be no increase in prices based on those reallocated costs unless that price is agreed to by the network user. Conversely, to avoid double recovery, if costs initially allocated to a negotiated transmission service are reallocated to a prescribed transmission service, then under the terms and conditions of access there should be a corresponding decrease in negotiated access prices.

At a detailed level, Flinders also offers the following comments on the proposed Framework:

- The requirement to negotiate in good faith should include the terms, conditions and charges for the Negotiated Transmission Service;

- It would be of assistance to the negotiation process if ElectraNet was again required to provide a preliminary offer as the basis on which negotiations could then proceed;

- In the interests of transparency and commercial costing, ElectraNet should be required to publish a specific fee structure and schedule of rates in a form as standardised as possible to guide prospective applicants on the indicative costs involved in applying for access to negotiated services such as network connection;

- It would be helpful if ElectraNet was to publish its standards terms and conditions of connection in the interests of transparency to facilitate connection negotiations;

- The Framework provides little guidance on the process for the negotiation of generator access arrangements (including provision for constrained off or constrained on payments). Further guidance on the negotiation of such arrangements could usefully be provided;

- Any binding agreement a Service Applicant may be required to enter into addressing conditions, guarantees and other matters in relation to the payment of on going costs should be on reasonable terms;

- Options for the formal receipt of documents should include other accepted means of communication (eg email) in addition to personal delivery, mail and facsimile;

- A copy of the Negotiating Framework should be supplied to all Service Applicants on receipt of an application for provision of a negotiated transmission service by ElectraNet, to assist negotiations and ensure all parties are aware of their respective obligations.

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3. Proposed Pricing Methodology

The proposed pricing methodology outlines the approach to be used in the calculation of prices for prescribed services subject to economic regulation under Chapter 6A of the Rules. This does not include the pricing of other services such as negotiated transmission services.

Having said this, there are potential interactions between the provision of prescribed transmission services and negotiated transmission services. The Rules establish certain principles in this regard. For example, costs which have been allocated to prescribed transmission services must not be reallocated to negotiated transmission services. Conversely, costs which have been allocated to negotiated transmission services may be reallocated to prescribed transmission services in circumstances where costs become attributable to provision of such services.

Whilst these are essentially cost allocation principles, the implications of these requirements for the calculation of prescribed transmission charges could usefully be reflected in the proposed pricing methodology. For example, it would be useful to specify the precise manner in which costs which would otherwise be recovered from negotiated services would be recovered through prescribed transmission charges given the non-reallocation rule.

It is noted that ElectraNet again proposes to adopt the modified CRNP pricing methodology under the Rules. Whilst the potential efficiencies of congestion pricing under this approach are acknowledged, it should be recognised that the use of utilisation adjustment under the modified CRNP approach - and the removal of the 50/50 split that otherwise applies between the locational and postage stamp components of the charge - can result in distortions.

For example, utilisation adjustment can result in higher charges for network users that are relatively heavily utilising network assets in situations where further network connection and augmentation is an unlikely prospect. This effectively penalises network usage which might otherwise be regarded as efficient.

The use of equipment rating adjustments in the calculation methodology to reflect the impact of potential network contingencies appears to distort this situation further. If the modified CRNP charging approach is to be retained, consideration may be given to calculating utilisation factors with respect to equipment ratings under system normal conditions, reflecting the requirement of the old Rules that asset utilisation is to be based on the maximum flow allowed on elements within the normal operating constraints of the network. This approach would appear to more accurately reflect the actual utilisation of each asset.

More broadly, it is noted that a number of anomalies currently exist under the Rules in the attribution of transmission costs to generator connections, particularly following network reconfiguration projects. Flinders Power and other generators are currently working to develop a Rule change to address these uncertainties and ambiguities under the Rules, in conjunction with the AER and TNSPs.

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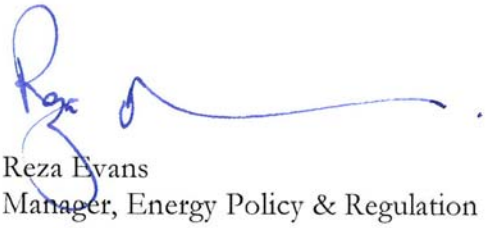
Flinders Power appreciates the opportunity to offer its input to this review. For further information on this submission, please feel free to contact Simon Appleby on 08 8372 8706 or myself on 08 08372 8726.

Yours sincerely



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