SUBMISSION TO THE ACCC

RESPONSE TO THE SUPPLEMENTARY DRAFT DECISION
ON TRANSGRID'S NETWORK REVENUE CAP
FORWARD CAPEX 2004/05-2008/09

24 March 2005

Powerlink appreciates the opportunity to provide comment on the Commission's Supplementary Draft Decision, entitled *NSW and ACT Transmission TransGrid Network Revenue Cap Forward Capital Expenditure 2004/05-2008/09,* released 2 March 2005. The general comments below focus on the way in which the Commission has applied its discretion in reaching a decision on TransGrid's forward capex program rather than on the specifics of the individual projects proposed.

Powerlink notes that overall, the Commission has reduced TransGrid's proposed ex-ante capex program for the forthcoming regulatory period by approximately $595 million (or 39 per cent) based largely upon the advice of its consultants.

The key message coming out of this decision is that pricing outcomes take precedence over reliability of supply. This comes at a time when there is heightened awareness among the general public of electricity supply problems and a clear demand for a better standard of service.

New Regulatory Framework

As stated in the Statement of Regulatory Principles (December 2004), the primary objective of the ex-ante allowance was to provide TNSPs with a higher degree of investment certainty compared to the ex-post assessment framework and to ensure that incentives were provided for efficient investment.

In its supplementary decision the Commission, opted to remove a number of projects from the ex-ante investment cap into the excluded projects category, or even disallow them altogether on the basis of the so-called re-opener provisions. The Commission's eagerness to transfer projects out of the ex-ante cap does not provide a TNSP with a greater level of certainty than that achieved under the ex-post framework. It is Powerlink's understanding that the investment cap was designed to cover most or all expected investments during the regulatory period (including discretionary investment not related to statutory reliability obligations). Therefore, Powerlink's expectation was, and continues to be, that only in rare circumstances would projects be excluded from the ex-ante allowance.

In relation to projects deemed to fit within the 'excluded projects' category, Powerlink has serious concerns with the timing and extent of the Commission's involvement with the assessment of these projects. Not only is a TNSP required to provide analysis of these specific projects at the time of its revenue reset, but once a trigger is activated within-period, a far more detailed investment appraisal, consultation and review process will be conducted by the TNSP in association with the Commission. Satisfying the requirements of the Commission is expected to add at least four to six months to the already lengthy approval process.

The intimate involvement of the Commission at the time of a TNSP's assessment of an augmentation project is overly intrusive. Under the Code, the regulatory test procedure is established, conducted and finalised exclusively by a TNSP – not the Commission. Throughout the regulatory period it is also possible that more than one trigger could be activated, thus invoking another assessment by the Commission. The Commission is also proposing what will effectively be 'mini reset caps' for these excluded projects when they are triggered. The implementation framework described for excluded projects will result in additional administrative and regulatory costs during a regulatory period. Powerlink considers that any implementation arrangements included in the TransGrid decision should not set a precedent for other TNSPs and that the Commission should work through any such implementation issues with all TNSPs so that all issues can be identified and appropriately taken into account.

Reliability

One of the main benefits of an ex-post regime is that a TNSP has the freedom to assess and undertake network investment in a timely manner that ensures reliability is maintained, albeit at some risk of an increase in price. Powerlink is very concerned that the Commission's tendency to squeeze projects which are within the ex-ante cap and the delays that will inevitably result from its excluded projects and reopener implementation framework could potentially threaten Powerlink's ability to meet its Code and other legislative obligations. Powerlink has very clearly defined reliability of supply criteria in its Transmission Authority which must be satisfied in order for Powerlink to maintain it licence.

As the Commission will no doubt be aware, an independent review of the Queensland electricity distribution networks found that there needs to be sufficient expenditure to meet increased growth in demand as well as to adequately maintain the networks. Further, the review found that in times of volatile load growth, the revenue cap approach has serious shortcomings and could mean that capital expenditure which should be incurred to maintain and necessarily expand the network may not be spent.

To avoid similar outcomes in the transmission networks, the Commission must provide certainty by allowing adequate investment in the ex-ante cap in particular to ensure that augmentations can be undertaken in a timely manner to cater for growth in peak demand as well as to replace assets at the end of their useful lives. Despite statements by the Commission that the draft decision in relation to TransGrid provides this certainty, Powerlink does not consider that this has been achieved.

Escalation of Costs

The Commission considered that there were a number of problems associated with TransGrid's escalation of input costs via a weighted average index of its actual input costs. On this basis, the Commission decided to continue its use of CPI to escalate capital expenditure allowances.

The Commission must recognise the significant increase in material costs that have occurred in recent years. For example, steel and aluminium comprise, respectively, approximately 33 per cent and 25 per cent of transmission line construction costs. Between 2001-2004, the cost of steel increased by 87 per cent. Similarly, the cost of aluminium has risen by 25 per cent in the last year. This upward trend is also expected to continue at least in the near future.

Any transmission network operator that is acting efficiently and in accordance with good industry practice will be aware of, and make adjustments for, new information that is pertinent to the technical and commercial operations of its business. This includes the expected rate at which construction costs will change.

Powerlink does not consider that CPI escalation provides certainty that sufficient funds will be available to implement the necessary projects.

Inconsistent Application of Regulatory Principles

Powerlink and other industry participants have consistently argued that regulatory certainty and consistency is vital in providing a stable environment for investment. To this end, the Commission sought to promote certainty through its revision of the regulatory principles, which outlines how it intends to implement its obligations under the Code.

Notwithstanding this, Powerlink considers that some aspects of the Commission's decision on TransGrid are inconsistent with the principles established in the SRP. These include:

- the view that excluded projects can be substituted for projects proposed for inclusion in the ex-ante cap. The ex-ante cap was designed to include most or all expected investment relating to main investment drivers such as growth in peak demand. On the other hand, excluded projects were to relate to specific or unique investment drivers and would capture large and uncertain projects; and

- the Commission's willingness to use the re-opener provision to deal with investment uncertainty. This is clearly not a favourable option for a TNSP given it faces the prospect of further regulatory intervention and possible off-setting adjustments to its revenue cap within-period. It is Powerlink's understanding that this was to be used for unusual and significant events, not used generally for capital investment projects that could be catered for in the ex-ante cap or excluded projects framework; and

- the Commission has reached draft and supplementary decisions about excluded projects (including the establishment of an implementation framework) and has explicitly stated that TransGrid can seek to re-open the revenue control to obtain compensation for certain projects that may eventuate, but are not otherwise included in the revenue cap. Powerlink notes that these are the first round of decisions made under the SRP released by the Commission in December 2004. However, as the Code currently stands, the Commission does not have the necessary power to establish or administer such arrangements.

Support the Business Expenditure

There are two separate issues that arise in relation to the Commission's decision on support the business capex.

First, the Commission appears to have a misplaced notion that a major motivating factor for higher levels of support the business investment is to reduce operating costs. In Powerlink's view, the Commission needs to understand that additional expenditure is required in its own right to enable the provision of a higher standard of service.

Second, to account for capex associated with the contestable segment of TransGrid's business, the Commission simply allocated a proportion of total operating expenditure (averaged over two years). Powerlink strongly recommends that, where comprehensive methodologies for attributing costs to the non-regulated part of the business can be demonstrated, the Commission should accept this alternative approach.

Pricing Outcomes

It appears that the Commission has attempted to gain broad acceptance of its decision among users by highlighting its implications on transmission prices. In addition, Powerlink believes that a comparison of price paths in the manner applied by the Commission misrepresents the true outcomes of the decision, in particular, as it does not incorporate the costs of excluded projects. Given the Commission's decision to shift some projects out of the ex-ante allowance into the excluded projects category, some of these projects are likely to eventuate during the regulatory period. This means that prices will vary from the path established and publicised by the Commission.