

Mr Sebastian Roberts
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Dear Mr Roberts

TransGrid Submission – Draft Decision: Statement of Principles for the Regulation of Electricity Transmission Revenues (August 2004)

TransGrid appreciates the opportunity to respond to this important consultation regarding the Commission's Draft Decision on the Statement of Principles for the Regulation of Electricity Transmission Revenues (the Draft Decision). The Commission has clearly applied considerable thought and effort to reviewing the current Draft Statement of Regulatory Principles (May 1999). The documents making up the Draft Decision also provide a relatively clear view of the Commission's position to date, and this is most helpful.

As you are aware TransGrid has been working with the Commission on certain aspects of the proposed Principles and their possible application to TransGrid as part of TransGrid's revenue cap setting process. Accordingly a number of aspects included in the Draft Decision have been considered to date in some detail. These include operating expenditure efficiency carryover mechanisms, the pass-through arrangements for operating expenditure, and the newly proposed *ex ante* capital expenditure regime. Indeed, a number of letters and expert reports have been provided to the Commission on these matters as they may apply to TransGrid.

These documents are again provided and, together with this letter, represent TransGrid's submission on this matter. TransGrid would welcome publication of this letter, together with the attached documents, to assist interested parties to gain some understanding of the practical and theoretical considerations arising as we attempt to implement aspects of the Commission's Draft Decision.

For the record TransGrid has not yet accepted that the proposed capital expenditure regime, including the incentive structure, is appropriate. Specifically, we consider that some element of ex-post review is necessary even though TransGrid would agree that there are benefits in minimising the need for such reviews where reasonably appropriate.

TransGrid also does not accept that the severity of the penalties that arise when actual capital spending levels exceed ex-ante expenditure targets results in an efficient outcome. Indeed, when combined with the absence of any form of ex-post review, this can lead to transmission businesses being penalised, sometimes severely, for meeting statutory obligations. Notions that this can be compensated for by setting the ex-ante target expenditure levels 'on the high side' may have some theoretical merit, but appear to be impractical from either a transparency and measurement perspective.



The severity of the penalties also introduces unnecessary complexity in the treatment of excluded projects and off ramps. Among other matters there is a strong incentive for regulated businesses to have projects treated on this basis in preference to their inclusion under the ex-ante spending targets. This is particularly true if the 'overspend' penalties are less when projects are treated as excluded or as off ramps. TransGrid believes that a cogent case can be made for an ex-ante incentive regime that has 'overspend' penalties similar to the 'underspend' incentives that are currently proposed for the ex-ante target levels of expenditure.

A detailed alternative proposal to address these concerns is being finalised for possible application to TransGrid and will be forwarded shortly under separate cover for your consideration. We are hopeful that the Commission, ahead of finalising the Statement of Regulatory Principles, will also consider this proposal.

There are other issues with the proposed capex incentive regime that need to be further considered. The administrative arrangements proposed by the Commission in relation to the excluded projects and off ramps do not make adequate provision for the need to 'fast track' some projects. This can arise when an event or trigger occurs that requires a network development to be delivered within reasonable lead times. A number of other important details do not appear to have been settled either. For example, is the ex-ante expenditure target a Net Present Value target over the reset period or an annual target? How will 'return of capital' be treated on 'underspend' from one reset period to the next? In summary the regime needs further development in a range of areas.

I trust that these comments, and the attachments to this letter, are helpful to the Commission in relation to the Draft Decision. Should you wish to discuss any of the matters raised in this letter, I would be pleased to liaise further with you or your staff.

Yours faithfully

[Original Signed]

Philip Gall
Manager/Regulatory Affairs

Encs