Our Ref: D07/36099

13 June 2007

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
By email

Dear Chris

Re: VENCorp and SP AusNet Revenue Proposals

Transend Networks Pty Ltd (Transend) welcomes the opportunity to comment on the revenue proposals from VENCorp and SP AusNet. As the transmission network service provider in Tasmania, Transend is not directly affected by the VENCorp and SP AusNet revenue proposals. Therefore, Transend has confined its comments to broader issues of regulatory precedent or principle that may have a bearing on the AER's future approach to transmission revenue regulation.

Comments on VENCorp's revenue proposal

In its revenue proposal, VENCorp argues (on page 3) that the electricity transmission arrangements in Victoria and VENCorp's governance arrangements provide the AER and other stakeholders with a considerable degree of comfort that:

- the operating costs incurred by VENCorp in undertaking its network service provision, network planning and related functions are efficient;
- the transmission investment decisions made by VENCorp are efficient and effective, particularly as:
    - VENCorp is the only TNSP in the NEM who applies the market benefits limb of the AER's regulatory test; and
    - it does not have a regulated asset base it does not have an incentive to construct network investments over alternative options such as demand side or grid support; and
- given the opportunities for increased competition for construction and ownership of new transmission assets through the competitive tendering provisions, the costs of assets that are created pursuant to a VENCorp investment decision reflect efficient practices.

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Transend notes that VENCorp is factually inaccurate in claiming that it is the only TNSP in the NEM which applies the market benefits limb of the AER's regulatory test. Transend applies the market benefits limb of the regulatory test as required by the National Electricity Rules, and has previously applied an equivalent test in accordance with the Tasmanian Electricity Code. It is disappointing that VENCorp, as an independent planning body, has implied quite incorrectly that other TNSPs fail to discharge their planning obligations under the National Electricity Rules.

Transend also questions VENCorp's claim that its governance arrangements provide adequate comfort to stakeholders in relation to its efficiency. In particular, VENCorp notes that its corporate objectives explicitly require VENCorp to deliver its services, and to perform its functions, in a commercially-neutral and cost-effective manner.

Transend notes that economic theory and business practice strongly suggest that the profit motive within a CPI-X regulatory framework provides a very powerful incentive to drive efficiency improvements. It is highly questionable whether the improvements in efficiency that have been observed across a number of regulated sectors both nationally and internationally could have been achieved by adopting a not-for-profit governance framework.

Comments on SP AusNet's revenue proposal

As a general observation, SP AusNet's submission appears to be a clear and comprehensive explanation of the company's performance during the current regulatory period and its plans for the future. Transend notes that SP AusNet has set a high standard for future revenue proposals.

In its revenue proposal SP AusNet has identified significant increases in input costs, such as material and labour, as being a key driver of historic and forecast expenditure (refer to section 5.4 of SP AusNet's submission, page 56). Importantly, SP AusNet commissioned a detailed report from Sinclair Knight Merz (SKM) to examine the factors affecting input costs in the electricity transmission sector to provide an independent check on the internal costs estimates. This report has been included in SP AusNet's revenue proposal.

In Transend's view, it is important for the AER to recognise that very similar evidence regarding input costs is emerging across electricity network businesses in Australia that adds weight to SP AusNet's submission. Electricity distributors and transmission businesses in a number of jurisdictions are providing evidence of increased input costs, which is creating substantial pressure on prices for network services. More generally, cost pressures are being experienced in other utility sectors, as rising contractor rates reflect a tightening labour market and a buoyant demand for services.

Whilst the AER must judge SP AusNet's proposed expenditure plans on their merits, Transend believes that it is appropriate for the AER to consider the weight of evidence provided in other sectors regarding increasing input costs.

Notwithstanding the high overall quality of SP AusNet's revenue proposal, Transend is concerned at the use of benchmarking analysis. In particular, SP AusNet presents TNSP benchmarking information using partial measures such as:

- opex/RAB;
- opex/GWh,
- opex/line length; and
- opex/nominal MVA capacity of transformers installed.

This analysis is similar to the partial benchmarking adopted by the AER in its comparative performance reports. SP AusNet's revenue proposal (page 38) notes, quite rightly, that the AER has made the following comments in relation to these benchmarking measures:

> "Comparisons based on partial measures are not very meaningful. Nevertheless, different measures used in combination can help to assess whether a TNSP's opex is reasonable."

Transend is concerned that the benchmarking approach adopted by the AER, and the analysis presented by SP AusNet, provides very limited guidance on the relative performance of the TNSPs. The value of the benchmarking analysis is severely compromised because the partial measures fail to normalise the data for TNSP-specific issues such as:

- network design;
- the location and type of generation; and
- load characteristics, including its size and location and customer density.

It should be noted, for example, that network design has a very significant impact on the future performance of the network in terms of system minutes off supply. Whilst system minutes off supply data is a factual record of actual performance – comparisons between TNSPs provide little insight into relative TNSP performance. The comparative analysis is more properly indicating differences in historical network design, which is a matter largely beyond the TNSP's control.

If the performance measures individually are not considered meaningful – as acknowledged by the AER – it is unclear how the use of these measures in combination can provide any better guidance regarding TNSP performance. It is notable also that SP AusNet's measures cannot provide a like-for-like comparison with other TNSPs that have much broader planning and network augmentation responsibilities.

Transend would prefer the AER to develop a more robust approach to benchmarking, rather than persisting with partial measures that provide weak or inappropriate inferences regarding relative performance.

Yours sincerely

[by email]

Ben Wagner
Acting Manager Business Planning, Regulation and Compliance