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Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215
submissions@aemc.gov.au

Dear Dr Tamblyn

REVIEW OF THE ELECTRICITY TRANSMISSION REVENUE RULES

Thank you for the opportunity to comment on the AEMC's Transmission Revenue Rule Proposal Report.

The Planning Council undertakes some of the planning roles of a TNSP in accordance with 9.28.3 of the *National Electricity Rules*, but does not own or have any vested interest in the revenue determinations or revenue rules set by the AEMC.

In considering the rules proposal, the Planning Council offers both some general observations on the overall structure and tone of the package of rule changes and some specific comments on individual recommendations for the Commission's consideration:

1. *General Comments*

Overall

The weight of rule changes proposed in this package of amendments appears to be in favour of certainty for the TNSPs over flexibility for the Regulator. While the Planning Council supports certainty and transparency for the regulation of transmission, it should only be made certain and clear where this creates the most efficient outcome. There is a natural tension between certainty and flexibility in any regulatory scheme where flexibility is required to respond to specific requirements and to manage accountability. In an area of often large and lumpy investment in long term assets, the TNSPs have frequently argued that such techniques as benchmarking are of only limited application. The obvious corollary of this assertion is that the regulatory regime needs to retain the flexibility to deal with the uniqueness of each capital program and not constrain the regulator to a pre-defined, black-box calculation.

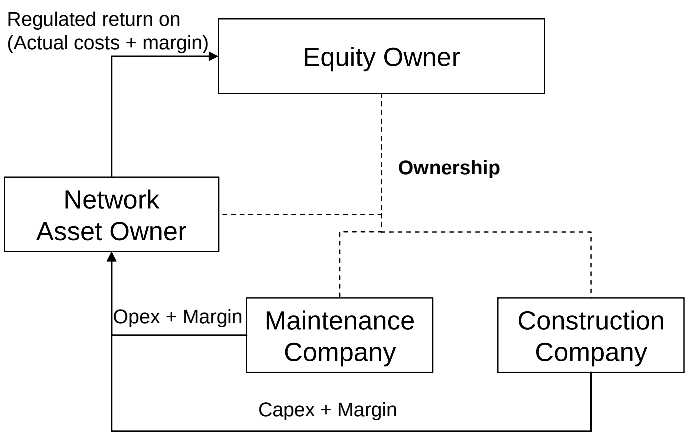
This Rule proposal will determine how the AER regulates several billion dollars of existing and new investment. While having a fixed, certain structure for considering these reviews provides a positive investment environment, it has to be remembered that doubling or tripling the costs of information provision and processing will be a negligible cost compared to ruling a single project in or out the asset base.

As such, the Planning Council would prefer to see more discretion left to the AER in terms of it's information collection, it's ability to independently determine capital (as opposed to a pure propose/respond model) and it's ability to reopen the revenue determination.

There is a danger that the AEMC will consider the weight of submissions as evidence that the Rule proposals are widely endorsed by the industry whereas, as highlighted by the public forums, the overall impact on Generators and Retailers is negligible and most of the positive submissions will therefore represent the views of the network owners.

Growth of Complicated Finance Structures

One aspect of the revenue assessment structure where discretion may need to be reserved to the AER is it's ability to obtain information on the financing arrangements and ownership structures of major suppliers to the network owners. While this is an awkward area in terms of commercial confidence, the emergence of structures similar to the following example, can lead to double counting of profits in the asset base and an over-statement of operating expenditure.



The allowance in the Rules for some measure of benchmarking will, hopefully, help to limit, or at least identify, this issue.

Short-Term Focus

One of the inherent difficulties associated with the periodic revenue regulation of assets that can have a service life in excess of 50 years. The Planning Council is concerned that the proposed Rule changes will increase the incentives on TNSPs to plan only for the next revenue reset period and not assess their capital program on an holistic, long term basis. Some obligation may be required to ensure there is a link between the planning forecasts prepared under 5.6 of the *Rules* and the revenue proposals presented in Chapter 6.

2. Specific Comments

Prescribed and Negotiated Services

The Planning Council supports the proposed distinction between Prescribed and Negotiated Transmission Services and the related requirement to report on the methodology for splitting costs between the two categories.

However, the Planning Council has some concerns regarding the interpretation of the bracketed part of the proposed definition of Prescribed Transmission Services as "a shared transmission service that meets (but does not exceed) specified performance requirements."

The defined reset-period regulation approach to transmission has a tendency to encourage Transmission owners to limit their risk by considering projects that are incremental and that will solve constraints within a single period, thus limiting exposure to asset write down in the future. While this minimalist approach may, at times, represent efficient deferral of capital, without understanding the longer term implications and examining NPV over the life of the project, it is almost impossible to establish when a deferral is efficient and when it is simply convenient for regulatory purposes.

The use of the words "but does not exceed" tends to further encourage this short-tem behavioural focus to the detriment of genuinely efficient, larger, long-term projects. The Planning Council would prefer to see those words removed. It is already stated that any solution to reliability based issues should be "least cost" over the life of the project. This should be sufficient to classify Prescribed services simply as a service designed to "meet" performance requirements.

Propose-Respond Model and Clause 6.2.6

The Planning Council has significant concerns with the proposed 6.2.6(b) which states that the AER MUST accept forecast capital expenditure providing the TNSP achieves certain evidentiary thresholds.

The Planning Council's concerns concentrate to the following issues:

- The provision further encourages TNSP's to concentrate their capital on reliability rather than regulatory test augmentations. While this is already the case under the existing framework, this new provision provides (at 6.2.6(b)(2)) that any reliability augmentation must be automatically accepted by the AER unless the "Total" forecast capital can be considered as "unreasonable". This Rule effectively abrogates all responsibility for reviewing individual projects, despite their high potential value or impact on the market, providing that the TNO can meet what appears to be a fairly low "reasonability" threshold.

- 6.2.6(b)(3) only allows the AER to consider the reasonableness of the "total" capital expenditure. This would seem to be taking a preference for "light handed" regulation to the extreme. Given the potential high cost of individual transmission projects and their potential to impact on both the competitive side of the market and the market for the main transmission substitute, namely gas pipelines, it is hard to understand why the AEMC would want to preclude the AER from investigating the merits of individual capital claims.

> While it may be efficient from a regulatory view point to allow a certain level of projects to be accepted on the basis of historical trends or relevant benchmarks, the lumpy nature of transmission investment would seem to suggest that the only effective way of understanding the reasonableness of the total capital proposal is to allow the AER to require information about, and to test the reasonableness of, individual transmission projects.

<u>Revenue Cap Re-Openers</u>

While the Planning Council appreciates that a one-sided re-opener model provides greater certainty and lowers investment risk for the TNSP, the customers of the transmission system may feel understandably aggrieved if, as a result of the AER not being able to reopen a revenue cap, they are required to pay, if only in the short term, for projects that are no longer required as a result of changes to the reliability standards. As such, the Planning Council would prefer that the AER be allowed to reopen the revenue cap.

The Planning Council considers that limiting the ability to reopen to either the TNSP or the AER provides an equitable balance that recognises that external events can both increase or reduce capital requirements and serves to limit the risk of mischievous and expensive reopen applications by third parties.

The Planning Council agrees with the TNSPs that events that would normally be allowed as a trigger under the re-open provisions should not be precluded simply because the TNSP has made efficiency savings in other areas that mean that capital is still available under the existing cap.

<u>Project Specific Capital Proposals</u>

In order to understand when a re-open is genuinely required because of changes to reliability standards, it appears evident that the AER must have a reasonably clear view of the actual projects that fall under the revenue cap. The move in this rule proposal to require the AER to look more at “total” capital rather than build up total capital with a series of identifiable projects makes many aspects of regulation (in particular reopens and inter-period capital allocations) almost impossible to administer.

This concern continues a general level of discomfort over the trend towards probabilistic based capital proposals. While uncertainty is an inherent factor in the National Electricity Market, the long lead and construction times associated with transmission projects should lead to reasonable project certainty over the short to medium planning horizon and enable the TNSPs to present capital programs that specifically identify most of the actual projects that are planned for the next reset period.

Having such a project plan will not only allow for effective regulation of re-openers, it will also allow TNSPs to demonstrate when a short term deferral project has a positive NPV compared to the existing capital program.

Perhaps consideration needs to be given to requiring the capital proposal of the TNSPs to be linked to the projects they are required to identify under 5.6 of the *National Electricity Rules*.

Without understanding the particular projects that are proposed within a revenue cap, the Planning Council is at a loss to understand exactly how the regulator is able to determine whether a general capital underspend is a result of efficiency measures implemented by the TNSP or a mis-estimate of required capital. The former should, of course, be appropriately rewarded. In the absence of knowing exactly which projects have been deferred and why, any claim of efficiency-based regulation would be hard to defend.

I would welcome the opportunity to discuss any of the matters raised above with you or your staff.

Yours sincerely

Braden Cowain
CORPORATE SECRETARY