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Mr Michael Rawstron
General Manager
Regulatory Affairs - Electricity
Australian Competition and Consumer Commission
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Dear Mr Rawstron

ACCC Regulation of Victorian Transmission Network

I refer to the ACCC's forthcoming determination of maximum allowable revenues for non-contestable transmission network services for the Victorian Electricity Transmission Network for the proposed regulatory period 1 January 2003 to 31 March 2008.

This letter addresses two issues relevant to the ACCC's determination.

1. The use of incentive regulation for the Victorian Networks Energy Corporation (VENCorp) in view of its not-for-profit status; and

2. The treatment of connection assets in the regulatory arrangements.

VENCorp's Role

The Victorian Government's policy framework for the electricity industry in Victoria provides for the separation of electricity transmission network ownership from planning services. VENCorp is responsible for intra-regional planning of the transmission network.

The rationale underlying the separation is to prevent the transmission system owner from inefficiently increasing its asset base to increase its revenues, and to facilitate the competitive provision of new infrastructure.

By vesting the network planning function in VENCorp, the Victorian Government has ensured that planning is not inappropriately influenced by the commercial interests of an incumbent monopoly network service provider but is instead based on the objective of providing a secure, reliable and efficient electricity system with an effective open access regime.

Victoria
The Place To Be

Centralised and independent last resort planning also provides for the ongoing reliability of the network while ensuring that market driver investment is encouraged. Full reliance on market outcomes would not provide an adequate guarantee that the necessary network investment would be forthcoming to provide the required level of security particularly in the absence of more regionalised wholesale pricing.

The separation of planning and ownership of the electricity transmission sector in Victoria has implications for the application of the provisions of the National Electricity Code, in particular for the use of efficiency incentives. Clause 6.2.4 of the Code requires transmission pricing regulation "of the Transmission Network Service Provider and/or Transmission Network Owner (as appropriate)" to be of the CPI-X form, or some other incentive-based variant of the CPI-X form.

VENCorp is owned by the Victorian Government and is operated on a not for profit basis. The use of profit-related incentive mechanisms are therefore not appropriate for the regulation of VENCorp. VENCorp has no commercial interest in owning or developing transmission network assets, and has no capital base to absorb the market risk associated with its transmission investment decisions. That risk can only be passed on to Government which would then face an incentive to play an active role in managing that risk.

Further, VENCorp faces significant non-financial efficiency incentives because it is subject to requirements in its licence and the National Electricity Code to conduct its planning activities in a transparent manner, accountable to market participants.

Governance arrangements for VENCorp provide further incentives on VENCorp to make efficient decisions on operating costs and network investment.

The VENCorp Board approves the Corporation's goals and direction, considers strategic plans, approves performance targets and provides overall policy guidance. The Board ensures that appropriate policies, procedures and associated internal controls are in place to manage costs and risks. The Board has a number of Directors drawn from participants in the gas and electricity industries, at least three Directors are required to be independent of the industry, and all are required to act in the best interests of VENCorp.

One of the basic functions of the VENCorp Board is to ensure that VENCorp executes its role as Victorian transmission network planner and transmission network service provider in an objective, independent, consultative and transparent manner, so as to maximise net benefits to industry participants (including end consumers) as a whole.

VENCorp's Board has in place a number of processes, including internal and external scrutiny of forecast and actual cost performance, to ensure that budgeted and actual cost performance are consistent with best practice. For example:

- VENCorp provides monthly financial reports to all stakeholders. These reports show in detail the month, year to date and full year forecasts, and are designed to keep all stakeholders informed of VENCorp's financial performance. Each month, VENCorp also publishes month and year-to-date key performance statistics compared to budget targets.

- In accordance with the VENCorp's not-for-profit and full cost-recovery status, the organisation's management and internal control arrangements provide limited expenditure delegation, and regardless of whether or not an approved budget provision exists for an item of expenditure, all expenditure must be justified prior to proceeding.

These arrangements are aimed at providing industry stakeholders (and in particular, those stakeholders who bear the costs of VENCorp's statutory electricity functions) with an active role in scrutinising and reviewing VENCorp's budgeted and actual cost performance. In view of the arrangements and internal controls in place, all stakeholders can be assured that the costs recovered by VENCorp through its Transmission Use of System charges reflect efficient costs.

DNRE is therefore firmly of the view that it is neither appropriate nor necessary to impose financial incentives on VENCorp to find efficiencies.

Reliability Incentive for Connection Assets

There is currently a performance incentive regime in place between VENCorp and SPI PowerNet which is designed to ensure that the latter makes shared network assets available when required. An enhanced regime is proposed for 2003 onwards as part of the transmission price review. DNRE strongly supports financial incentives to maximise network reliability.

Accordingly, DNRE is concerned that the proposed incentive regime for SPI PowerNet does not cover connection assets (transmission assets that take supply from the shared network and transform it for supply to distributors' networks).

Distributors are responsible for planning connection assets, and the adequacy of their planning is subject to the reliability incentive scheme in the distribution price controls.

DNRE recommends that the existing incentives be complemented by including in the price control arrangements for SPI PowerNet for an incentive regime that promotes reliability and security of connection assets.

Yours sincerely

Richard Bolt

Richard Bolt
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cc *Matt Zema, VENCorp*
Nino Ficca, SPI PowerNet