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General Manager
Regulatory Affairs - Electricity
Australian Competition and Consumer Commission
GPO Box 520J
MELBOURNE VIC 3001

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Dear Sebastian

Re: Discussion Paper 2003 - Review of the Draft Statement of Principles for the Regulation of Transmission Revenues

The National Generator's Forum ("NGF") is pleased to make the following comments in relation to the ACCC's Draft Statement of Principles discussion as published on 29 August 2003.

Summary of NGF Position

The NGF supports the ACCC's initiative to move from a Draft Statement of Principles for the regulation of transmission revenues to a Statement of Regulatory Principles subject to the comments contained within the document.

The NGF is firmly of the view that transmission assets in the National Electricity Market ("NEM") have a major influence on the setting of prices and provides important economic signals for new investments in generation and demand side. Generators have a keen interest in relation to Transmission Network Service Provider ("TNSP") revenues as these monopoly revenues form the basis of services provided by TNSPs to the competitive (wholesale and retail) markets.

In our view transmission investment and operation cannot be separated from the market but rather are part of the deregulated market for electricity. It is therefore essential that TNSP performance measures and incentives are set recognising the market impact of TNSP activities. It is important for the NGF that performance standards and remuneration for TNSPs are linked to activities that matter to the market as a whole. We therefore consider that the Regulatory Principles should be moving towards a regulatory regime that is based on service provided. Key elements should include regulatory principles that are:

- directed at market outcomes that benefit electricity users;
- applied during periods of system stress when performance matters;
- universally applied to all TNSPs both in scope and level;
- focused on best practice in the industry; and
- subject to FM provisions that are consistent with general industry practice.

The NGF is cognisant that growth in customer demand across the NEM is occurring and will continue to grow potentially creating increased intra-regional congestion. The NGF considers that congestion will need to be addressed by efficient investment in the market by generation, transmission, demand side or other initiatives. The ACCC Statement of Regulatory Principles will assist and foster appropriate investment in the NEM by providing a more significant degree of regulatory certainty.

The NGF considers that consistent and predictable remuneration of TNSPs throughout the NEM is desirable. Further, TNSPs should be incentivised through remuneration for positive actions that relate as directly as possible to the market outcomes of TNSP actions.

The NGF has previously submitted its position in relation to the ACCC's recent consultation – Statement of Principles for the Regulation of Transmission Revenues Serve Standards Guidelines. Our comments within this submission reflect those statements previously made. The NGF has not made detailed comments on some aspects of the ACCC current consultation, notably Capex determination, WACC, Ring fencing guidelines or Information Requirements Guidelines.

In summary, the NGF agrees with the ACCC's position that the basis of revenue setting for TNSPs should be via standardised benchmarking parameters and service standards that are consistent with efficient operation and asset utilisation, whilst providing certain flexibility to recognise differences in topography of the various TNSP network assets.

The NGF's comments on areas raised by the ACCC discussion paper are included in the attachment.

Would you please direct any enquiries on this submission to Mr Roger Oakley, Loy Yang Power Management Pty. Ltd. (03) 96122211, email: Roger_Oakley@loyyangpower.com.au



Mike Smith
CHAIRMAN NATIONAL GENERATORS FORUM

1. Revenue Cap Process

The NGF notes that the ACCC considers that the current 6 month review period is inadequate.

In principle the NGF supports a revenue cap process that delivers consistent and regular outcomes. The characteristics of the process are that it should be open, transparent and equitable.

The NGF considers that the ACCC proposed 12 month timeline is acceptable.

2. Revaluation of the asset base V's roll-forward

The ACCC has identified 3 Options that it may consider for treating transmission assets at the next TNSP revenue re-set (and subsequently);

1. Periodic – assets revaluation on a periodic basis using DORC methodology (generates high level of uncertainty each 5 years for TNSPs);
2. Lock-in jurisdiction valuation – i.e. adopt the initial jurisdictional valuation and add in new investments at cost – avoids subjectivity in DORC valuations but locks in any valuation errors in the initial valuation; or
3. Combined Periodic and Lock-in – basically a one-off revaluation using DORC methodology with subsequent reviews rolling in new investments

The NGF considers the objective is to determine over time a uniform philosophy or “good electricity industry practice” in rating and valuing transmission assets. In the short term the objective measure will allow benchmarking or comparison between TNSP's. In the long term this measure will allow the regulator to assess the cost of the assets relative to their rating and move to a regulatory regime that determines the TNSP revenues in a way that is contingent upon good practice in allowing a high utilisation of these assets by the market. The objective is to drive allocative efficiency by attempting to emulate a competitive market for transmission investment.

3. Capital Expenditure (CAPEX)

The ACCC considers that the Code is non prescriptive on how new or proposed CAPEX should be reflected in the regulatory asset base. The ACCC proposes that the regulatory test applies to both augmentation and non-augmentation CAPEX.

The NGF supports consistent treatment and efficient capital investment. The NGF acknowledges that valuation of the asset based is a fundamental issue in setting the level of service provided in return for the right to levy regulated revenue.

4. Operation and Maintenance expenditure (OPEX)

The ACCC considers that it needs to make informed decisions as to whether a TNSP is operating efficiently and has identified three potential methodologies:

1. ACCC uses a combination of performance indicators to assess TNSPs costs including historical and forward looking assessment of cost drivers. The ACCC appoints a consultant to do this and relies heavily on consultant's findings.
2. as above as well as including an efficiency carry-over mechanism. The efficiency carry over mechanism would reward the TNSP with higher profits when it manages to lower its controllable costs.
3. the ACCC make greater use of external benchmarks

The NGF supports the ACCC making greater use of external benchmarks and has previously submitted to the ACCC that TNSPs should be benchmarked, especially to ensure that the market impact of TNSP operations is taken into account. It is important that the operating regime and management practices of the TNSP work to ensure the capability of the network is managed within a defined rating envelope and a market impact assessment/report embedded into the methodology. The market impact report should be published on a quarterly basis and used as input to a benchmarking process.

5. Self Insurance and Pass through events

The ACCC considers expenditure on insurance to be rational and prudent part of risk management by TNSPs – these are able to be subjected to efficiency measures, benchmarks etc.

However some costs are uncontrollable and therefore should not be part of incentive measures. TNSPs should be able to pass through the costs of certain designated events directly to the customer.

The ACCC has identified three approaches:

1. external insurance;
2. self insuring for certain risks; or
3. agreeing pass through rules for designated events to customers

ACCC supports pass through in certain limited circumstances

The NGF agrees that there should be pass through but only in very limited circumstances. The methodology should be structured to ensure that no overlap is possible between the three approaches identified. The circumstances of pass through occurring should however be extremely rare - i.e. "extraordinary". The NGF relates this concept to the commercial concept of Force Majeure ("FM").

The NGF's recent comments to the ACCC on FM in the ACCC's service standards consultation are relevant. In summary, the NGF considers that outages or plant failures fall into two categories:

1. those that are certain in nature but uncertain in timing, and
2. those that are both uncertain in nature and timing.

It is only the latter category which are classified as FM events

Also for events other than plant failures those events which the TNSP could reasonably be expected to have some control should not be considered to be FM events.

6. Incentive mechanism and benefit sharing

The ACCC considers it important for the regulatory regime to yield continuous incentives for productive efficiency.

With 5 year re-set, the cost out turn for the test year of the previous period may influence the upcoming five year set. Specifically this may induce cost reductions in some years and weak (or negative) incentives in the test year.

The ACCC prefers to adopt an incentive mechanism that creates constant incentives for efficiency over time

The NGF agrees with constant incentives for performance however the incentive mechanisms should measure what matters as service providers and should therefore be biased towards system stress such as incentives to focus risk mitigation on minimising market impact

7. Benchmarking

NGF supports the greater use of benchmarking as outlined in our response to point 4 above.

8. Weighted Average Cost of Capital (“WACC”)

The NGF does not have any specific comments in relation to the parameters of the CAPM model or its key inputs such as the value of the Risk Free rate or WACC. The NGF acknowledges the importance of these inputs and supports a consistent, mechanistic process to determine a fair and reasonable WACC for TNSPs.

9. Ring Fencing Guidelines

The NGF does not have specific comments on the separation of information reporting between regulated and unregulated activities however generally supports the concept of transparent and well articulated ring fencing guidelines being published and regularly reviewed.

10. Information Requirements Guidelines

The NGF supports the concept of information requirements guidelines and monitoring of TNSPs for compliance with the ACCC determined revenue cap

11. Review of Service Standards Guidelines

The ACCC is required under part B of Chapter 6 of NEC to set revenue caps for TNSPs.

Draft service standard guidelines were published on 28 May 2003 and included guidelines for:

- Circuit availability;
- Outage duration;
- Frequency of loss of supply information;
- Hours of inter-regional constraints; and
- Hours of intra-regional constraints.

The Draft guideline proposed to the set performance benchmark. 1% at risk

As set out in joint ERAA and NGF submission to ACCC, the ERAA and NGF consider that the ACCC made a good initial step with the draft guidelines. The ACCC should, however, immediately:

- apply the standards universally, using a benchmarking approach rather than individually as currently proposed
- measure the standards during periods when the network performance is important to the market
- revise the FM provisions.

The ACCC should build on this start by developing standards, in conjunction with the TNSPs and market participants, that relate as directly as possible to the market outcomes of TNSP actions.

In the NGF submission to ACCC, the NGF suggested that:

- **Transmission circuit availability** - The unweighted availability measure should be replaced with a measure based on peak demand periods on peak demand days.
- **Average outage duration** - Revision of the FM provisions to provide more certainty in interpretation.
- **Frequency of “off supply” events** - Expansion of the loss of supply events to include a market impact measure.
- **Intra and inter regional constraints** - New market based measures & benchmarking.

The market based performance measures proposed:

- promote transparency on transmission capability,
- measure performance in terms of the dollar impact on the competitive market,
- are based on signals that are consistent with efficient transmission operation and utilisation.