



SPI POWERNET

A subsidiary of Singapore Power International

2 December 2004

Mr Sebastian Roberts
General Manager Electricity Group
Regulatory Affairs Division
Australian Competition and Consumer Commission
GPO Box 1199
Dickson ACT 2602

Dear Sebastian,

**RE: APPLICATION FOR WAIVER OF RING-FENCING OBLIGATIONS
RESPONSE TO ISSUES RAISED IN PUBLIC SUBMISSIONS**

The Commission's consultation on SPI PowerNet's waiver of transmission ring-fencing guidelines has attracted three submissions. Parties making submissions are the South Australian Department of Treasury and Finance, VENCORP and the ESC.

SPI PowerNet has reviewed the submissions and we now wish to address the major issues that have been raised.

SPI PowerNet considers that each of the issues can be readily addressed. In particular SPI PowerNet believes that there are no implications that would alter the conclusion that the public benefit would be served by a relaxation of the ring-fencing guideline to permit SPI PowerNet to share resources with the SPIA Group's distribution business.

The remainder of the letter provides SPI PowerNet's response on the issues raised in the submissions.

1 Issues Raised By South Australian Department of Treasury and Finance

Reference - Letter from Department of Treasury and Finance dated 10 November.

1.1 Adverse effect on competitive market

The department's submission identifies that its main focus is to ensure that the competitive retail and generation sectors are not adversely affected. The department also notes that there is nothing in the information provided to suggest this risk would be heightened.

Response

SPI PowerNet is seeking a waiver of ring-fencing guidelines that affect only the relationship between the distribution business and the transmission business, which are both regulated businesses. The application of the ring-fencing guidelines to the



relationship between the transmission business and competitive market businesses will be unaffected by the waiver which is sought.

Additionally, concerns relating to potential anti-competitive behaviour have been covered in the Undertaking agreed with the Commission when it authorised Singapore Power's acquisition of TXU's Australian interests in July. The Undertaking places obligations on SPI PowerNet which are additional to those imposed by the ring-fencing guidelines, and which would be unaffected by the waiver sought.

We note that the ESC submission raises a related issue, being the future status (regulatory/market) of transmission services. This specific issue is addressed within the section assigned to ESC issues.

1.2 Transfer of Savings to Consumers

The department's submission notes that the potential savings appear reasonable, also observing that they are estimates only. The submission then raises as a broader issue the extent to which the claimed efficiency benefits will be reflected as benefits for customers. The transfer of benefits to consumers is also raised in the VENCORP and ESC submissions.

Response

In our application for waiver, SPI PowerNet has identified a number of areas where synergies exist, including the provision of administrative support, finance, human resource management, legal services, IT and accommodation. SPI PowerNet has estimated savings that may be achievable from specific merger actions within these areas. The cost savings identified in these areas are not an exhaustive assessment of synergies, nor do they represent specific plans, however they demonstrate that the savings would be significant, and in SPI PowerNet's view they clearly exceed any public benefit achieved by requiring total separation of activities in operating the businesses.

We note that the ESC submission raises a related issue, being the economic test to be applied. This specific issue is addressed within the section assigned to ESC issues.

In respect of the transfer of benefits to customers, it is SPI PowerNet's view that incentive regulation creates the appropriate drivers on the businesses to actually deliver efficiencies. There is no other reason for SPI PowerNet to seek a waiver, and no benefit to Singapore Power if savings are not realised. Once achieved, SPI PowerNet would expect that these efficiencies would be treated in the same manner as any other efficiency savings achieved in the normal course of business, i.e. the savings would be transferred to customers in accordance with regular carry-over (glide-path) arrangements.

2 Issues Raised by VENCORP

Reference – Letter from VENCORP dated 16 November

2.1 Transmission Governance Arrangements in Victoria

VENCORP generally concurs that the Victorian governance arrangements in respect of provision of transmission services provide increased transparency and mitigate the potential for discriminatory behaviour.

VENCorp also points out that its own relationship with SPI PowerNet is a commercial one, and not one of supervisory oversight.

Response

In our application for the waiver, SPI PowerNet has commented that the role of VENCORP is instrumental in the establishment of network augmentations. VENCORP is solely responsible the planning and directing of shared network augmentations, and is also involved in connection asset augmentations (including those of the distribution businesses), as it is responsible for the negotiation of transmission performance arrangements in respect of all augmentations. No network augmentation proposal should escape VENCORP's knowledge and involvement.

SPI PowerNet agrees with VENCORP that its role is not a supervisory or regulatory role. Nevertheless, the role that VENCORP does fulfil, as an independent transmission network services provider, creates the high level of transparency in Victoria that exists.

In SPI PowerNet's view enhanced transparency extends to regulatory oversight by the Commission and the ESC. This is because the access arrangements for connection assets are contained in industry agreements. These comprise Use of System Agreements between the distribution business and VENCORP and a Connection Agreement between the distribution business and SPI PowerNet for each connection augmentation service. Therefore any differentiation underlying the services provided to the distribution businesses would be quite transparent.

Additionally, all of SPI PowerNet's regulated services are subject to Connection Agreement or Network Agreement, and this is a condition of SPI PowerNet's transmission licence. Connection Agreements will continue to be established for services provided to the SPIA Group's distribution business. The legal separation of the businesses will also ensure that such formal arrangements are necessary. Accordingly, there will be no differentiation in approach for connection services provided to SPI PowerNet's related distribution business.

2.2 Continued Independence of VENCORP's Functions

VENCORP's submission requests that a waiver granted by the Commission contain a provision for review in the event of a material change in VENCORP's role. In particular VENCORP states that it is important that its shared network planning function and its responsibilities for determining load shedding priorities should remain independent of transmission customers.

Response

As observed by VENCORP, clause 6(b) of the Undertaking provides for a review of the Undertaking in the event that some variation may be considered necessary on account of changed circumstances, including a material change in the role of VENCORP.

SPI PowerNet notes that it is highly likely that, in the event of a material change in the role of VENCORP, its electricity transmission functions would transfer to another independent entity. In this circumstance there is no change in the governance structure and a variation would be unlikely to be considered necessary. Further, there are other potential material changes in VENCORP's role that may have no effect

on its electricity transmission functions at all, such as changes to its gas market functions.

In SPI PowerNet's view the provision in the Undertaking adequately addresses the issue raised by VENCORP. There is no need for an additional provision to be attached to a waiver, as this would be superfluous.

However, in the event that the Commission determines that a condition should be applied specifically in conjunction with a ring-fencing waiver, SPI PowerNet believes that the need for a review of the terms of the waiver should be determined by the Commission having regard to the specific circumstances as situations arise. In particular a review should only be necessary if it is clear that there are legitimate concerns of increased potential for SPI PowerNet to favour the SPIA Group distribution business. In this event the review should determine any variation to the terms of the waiver to mitigate the concerns.

2.3 Transparency of Connection Asset Cost Allocation Methodology

VENCORP's submission suggests that, regardless of the Commission's decision on the waiver application, SPI PowerNet should be required to publish details of its transmission connection charging methodology.

Response

SPI PowerNet already provides its connection charging methodology to customers.

SPI PowerNet's connection charges are calculated in accordance with the provisions of National Electricity Code clauses 6.3.1, 6.4.1 and Schedule 6.2. The methodology is contained within SPI PowerNet's *Policy for the Calculation and Allocation of Regulated Revenue*. The policy is attached to statements of charges provided to customers each year, and was the subject of a workshop with customers upon establishment.

Additionally, SPI PowerNet provides VENCORP with a spreadsheet containing the full construction of the charges, to facilitate its calculation of Transmission Use of System charges.

Accordingly SPI PowerNet considers that the transmission charging approach applied by SPI PowerNet is already entirely transparent.

2.4 Transparency of Asset Replacement Program

VENCORP's submission suggests that SPI PowerNet should increase the amount of information publicly disclosed in relation to its asset replacement program, with the objective of guarding against discriminatory behaviour.

Response

SPI PowerNet already shares its asset management plans with its customers.

However, SPI PowerNet considers that the Victorian transmission arrangements also provide for regulatory scrutiny of the company's asset replacement proposals and performance as part of the 5-yearly regulated revenue review. SPI PowerNet's network investment plans are contained to replacement works, and hence are not swamped by a focus on high cost network augmentation plans. The plans are

developed in accordance with SPI PowerNet's asset management strategy, and therefore the consistency in approach across SPI PowerNet's network can be observed.

The need for co-ordination between future distribution network needs and SPI PowerNet's connection asset management makes it imperative for SPI PowerNet to share its asset management plans with customers. This is achieved in several ways, including:

- SPI PowerNet's revenue application sets out the key drivers for capital expenditure in the next 5 year period;
- Joint planning forums convened to review network wide planning issues, with participation from SPI PowerNet, all distribution businesses and VENCORP. SPI PowerNet presents its asset replacement programs at these forums;
- Other consultations with customers to assess future requirements; and
- Provision of terminal station specific plans to the relevant customers.

The majority of SPI PowerNet's terminal stations provide connection services to more than one distribution business. This is a significant driver for SPI PowerNet to share and consult on its asset management proposals openly with the distribution networks sector. Of thirty-one terminal stations providing connection services to distribution companies, the SPIA group's distribution business receives connection services at eleven of these (35%). The SPIA group's distribution business is the sole connected party at only four of these terminal stations.

2.5 Connection Asset Augmentation Planning

VENCORP's submission identifies a "less clear separation of transmission connection asset ownership and planning responsibility in Victoria" as an issue that may need to be addressed in the planning governance arrangements "to safeguard against any risk of inefficient transmission connection investment in the future". A similar issue is raised in the submission from the ESC.

Response

As noted in the preceding section, the majority of terminal stations are shared between distribution businesses. As a result, augmentations to the capability of terminal stations generally will require the participation of more than a single distribution business. Additionally, each of the four stations at which the SPIA Group's distribution business is the sole distribution customer are located away from the metropolitan area of Melbourne, where demand growth and corresponding augmentation needs are reduced.

Connection asset planning in Victoria is the responsibility of the distribution businesses. An objective of this allocation was the delivery of greater transparency in network investment.

Under the planning arrangements the distribution businesses are required to jointly prepare and submit an annual Transmission Connection Planning Report to the ESC. The discipline that this approach brings to the planning process provides considerable transparency and accountability. It also provides for consistency in

approach to planning amongst the distribution businesses. It would be expected that any divergence in approach adopted by a participant would be identified through the process. This accountability would continue to be applied to the SPIA Group's connection asset planning with a ring-fencing waiver granted to SPI PowerNet.

The planning review is frequent (annual) and this permits the trend in planning outcomes to be closely monitored. The transparency of the approach also provides for any differences between the plans forecast and actual investment activities to be identified and scrutinised. The transparency provided by the arrangements will facilitate independent review of the SPIA Group's connection asset investment program.

The joint planning approach therefore mitigates the potential for inefficient investment. It does this by encouraging a common planning approach and planning standard, and bringing to light the occurrence of divergence. There is no reason why the benefits of joint planning should not continue to be achieved in the future, with a ring-fencing waiver in place, and be equally effective in monitoring the activities of SPI PowerNet's related distribution business.

Accordingly SPI PowerNet believes that there will not be any need for the planning governance arrangements to be supplemented on account of the waiver being sought by SPI PowerNet, or additional scrutiny of the augmentation plans of the SPIA group distribution business would be necessary. However, if additional scrutiny is to be performed, as indicated in the submission by the ESC, SPI PowerNet believes that this is unlikely to absorb significant additional resources, due to the level of documentation and transparency resulting from the planning framework.

2.6 Realisation of Savings

VENCorp's submission suggests that there would be merit in giving consideration to the means by which savings are to be transferred to consumers.

Response

This issue has been raised in the other submissions and is addressed in section 1.2 of this letter.

3 Issues Raised by the ESC

Reference – Letter from ESC dated 19 November

3.1 Potential Future Contestability of Transmission

The ESC submission suggests that whilst both transmission and distribution sectors are presently regulated, there is potential for transmission to become increasingly contestable. The ESC submits that consideration should be given to the effect of a waiver on the longer-term implications for competition and efficiency in the event that such a divergence in the governance and regulatory frameworks for transmission and distribution were to transpire.

Response

In responding on this issue, we will firstly discuss the potential for transmission to enter the competitive market, and then discuss the consequential issue of impact in the efficient operation of that market that may arise.

(a) Future Direction in Transmission Sector Regulation

The ESC submission suggests that a shift of transmission service provision into the contestable market is a likely NEM development. In addressing this issue it is important to clarify the concept of a competitive transmission sector as foreshadowed in these comments. We understand the concept to refer to a market-based transmission sector in which the TNSP derives all revenues from the electricity trading market, and makes investment decisions on the basis of the revenue that it could expect to derive from the market for such additional services.

This is to distinguish it from both the Victorian arrangements where new transmission services may be established through a competitive tendering process, and proposals under which transmission becomes more integrated with the energy market, for example through the establishment of a nodal spot price market, and/or through application of market-based incentives on the TNSPs. In both of these circumstances transmission inherently remains as a regulated sector.

In SPI PowerNet's view, all the evidence suggests that transmission is likely to remain within the regulated sector. The evidence comes in the form of experience gained by participants since establishment of the NEM, the results of industry reviews, and of policy direction for the NEM. The following examples are presented:

- Considerable effort was made for the NEM framework to accommodate (and indeed encourage) market-based transmission developments. Two Market Network Services were subsequently established. However, one of the two (Murraylink) has already been transferred to regulated status, and the other (Directlink) has also applied for a transfer to regulated status;
- The COAG Energy Market Review (December 2002) has provided the most far-reaching review of the NEM since the inception of electricity markets in Australia in 1994, and this review has made no suggestion that transmission services should migrate to the competitive market sector;

Further, the review concluded that NEMMCO, not TNSPs, should offer Financial Transmission Rights to market participants (i.e., market involvement by NEMMCO), and that TNSPs should be correspondingly incentivised through a structure of penalties and rewards (i.e., an extension of regulatory performance drivers)¹;

- Policy direction by the Ministerial Council for Energy, subsequent to the COAG review, has reinforced a "central and on-going role for the regulated provision of transmission" (page 10, MCE to COAG 11 Dec 03). The report also proposed that amendments should be made to the National Electricity Code to remove bias toward market-based transmission developments;
- There is also a broad body of opinion that point to point transmission rights are unable to capture the full economic cost of grid investment, and

¹ FTRs have widely been considered a mechanism through which transmission may participate in the energy market, and SPI PowerNet itself has researched concepts that could be applied in the NEM

that because of this, an underlying regulatory regime will always be necessary.

The momentum is clearly toward reinforcement of the regulated status of transmission, and SPI PowerNet therefore cannot see evidence for the sentiment expressed in the ESC letter.

(b) Risk Considerations if Market-based Transmission Sector Evolves

The ESC submission proposes that consideration should be given to the effect of a waiver on the longer-term implications for competition and efficiency in the event that such a divergence in the governance and regulatory frameworks for transmission and distribution were to transpire. However, the submission does not appear to identify any particular implications.

As noted in section (a) above, SPI PowerNet does not consider that a market-based transmission sector is a “likely” eventuality, and accordingly our application has not addressed the issue raised by the ESC. Nevertheless, we discuss the implications that would arise under this scenario for completeness.

In the present industry framework, transmission services are funded largely by the distribution sector, through TUoS charges levied by the TNSP. Under a nodal pricing arrangement it may be anticipated that market transactions for provision of transmission services would occur between market participants, i.e., between the transmission business, and retailers and generators². Consistent with the framework envisaged in the ESC submission, it is then feasible for network investment, including connection asset augmentation, to be driven by the market rather than by TNSP and DNSP central planning. This investment process outcome is an objective of market-based transmission.

The significant point in relation to SPI PowerNet’s waiver application is that the relationship between the transmission and distribution business becomes less significant under the industry framework envisaged in the ESC submission, as the relationship between market-based participants takes on the substantive service accountability.

Accordingly, SPI PowerNet does not envisage a situation where the market-based transmission entity could engage in anti-competitive behaviour via the relationship with its distribution business.

3.2 Potential for Discriminatory Conduct

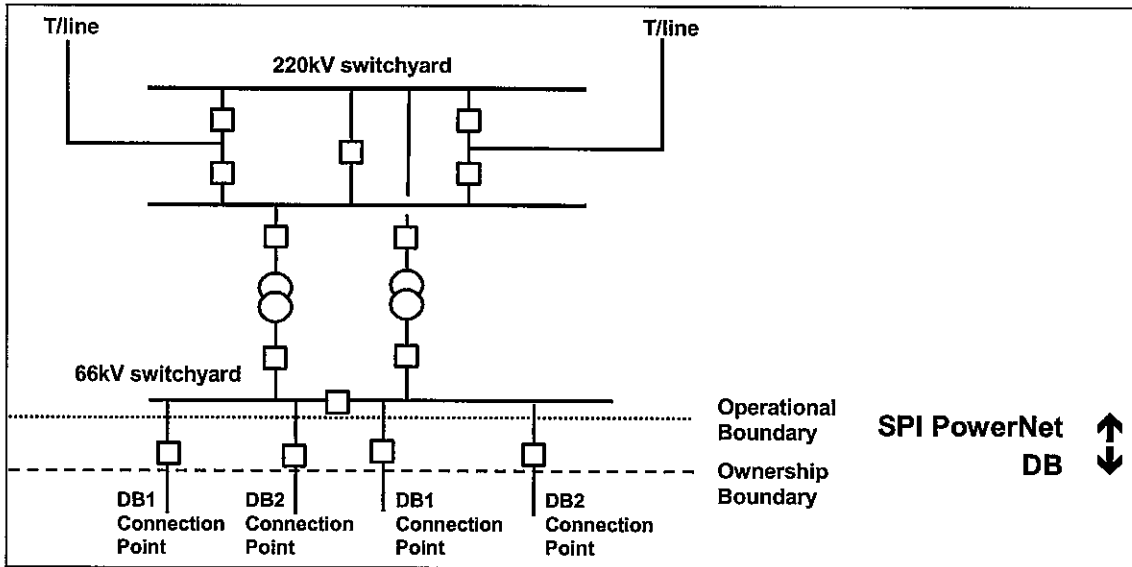
The ESC submission identifies two areas where a ring-fencing waiver would allow potential for SPI PowerNet to engage in discriminatory conduct. These are:

- In relation to service restoration in response to unplanned power outages; and
- In relation to connection asset augmentation (which we have addressed in section 2.5 of this letter)

² It should be noted that nodal pricing by itself does not imply a competitive transmission sector.

Response

The arrangements whereby the network is restored following unplanned outages may not be commonly understood and we therefore provide some clarification, which we believe will address this issue. The potential for SPI PowerNet to engage in discriminatory conduct is mitigated through the operational arrangements that are in place at terminal stations. The following diagram illustrates these arrangements.



The diagram shows that whilst SPI PowerNet's ownership of the transmission network includes the circuit breakers that connect to individual distribution network connection points, its operational control does not. The network elements under SPI PowerNet's operational control are shared by all distribution businesses connected at the terminal station. Operational control of the connections to the distribution network is managed by the distribution businesses themselves.

The ESC submission also notes the possibility that it may seek to include connection assets in the DNSP S-factor scheme as part of its 2006 - 2010 price determination. Whilst this may be the case, the foregoing discussion shows that SPI PowerNet's operational activities will impact all connected distributors equally, and to the extent that SPI PowerNet seeks to mitigate the S-factor penalties of its related distribution business, all connected parties, and electricity consumers, will benefit.

However, SPI PowerNet has some doubt concerning the application of performance incentives for transmission connection assets to the distribution businesses. In SPI PowerNet's view such incentives could equally be placed on the TNSP, and this may be a more effective allocation as the TNSP has the responsibility for the provision of these services. Concepts to achieve this outcome have been canvassed between SPI PowerNet and the Victorian distribution businesses, and the establishment of a connection asset availability incentive scheme is under consideration.

3.3 Legal Separation of the Transmission and Distribution Businesses

The ESC submission identifies several issues that arise as a result of the formation of a single legal entity for the businesses.

Response

We recognise that the application did not make it clear that SPI PowerNet has no plan to form a single legal entity. However, this is the case, and accordingly there is no need to address the particular concerns that are raised in this regard.

3.4 Test for Waiver

The ESC submission describes the interpretation that the ESC places on the test methodology, that the test should be interpreted as a net public benefit test, and then states that SPI PowerNet's interpretation is inappropriate and confusing. The submission also states that SPI PowerNet has not provided sufficient evidence to satisfy the test.

Response

SPI PowerNet can understand that different interpretations of the test under clause 11 of the ring-fencing guidelines may be construed, however we are not entirely clear that our interpretation is different from that of the ESC. The waiver application describes the savings to SPI PowerNet and its associates, which represent ultimate benefits to consumers, and discusses the potential for any dis-benefit to consumers that may result from merged operations.

In SPI PowerNet's view there is no material impact on competitive markets nor is there potential for material discriminatory conduct within the regulated sector. The application reveals these outcomes of SPI PowerNet's analysis throughout. Accordingly, the savings to SPI PowerNet and its associates therefore dominate, and these become the basis of the ultimate public benefits that may be realised through granting of the waiver.

SPI PowerNet also recognises that the potential savings are not fully developed, and has discussed this matter with the ACCC separately. However, in our view the application itself is able to demonstrate that the result of sharing resources is a net public benefit, and hence satisfying the test.

4 Concluding comments

In this letter we have addressed the issues raised in each of the submissions into the Commission's consultation process. As a result of this analysis we believe there are no implications that would alter the conclusion that the public benefit would be served by a relaxation of the ring-fencing guideline to permit SPI PowerNet to share resources between its transmission business and the SPIA Group's distribution business.

If you would like to discuss any matter arising from this letter I would be pleased for you to contact me.

Yours sincerely



**CHARLES POPPLE
GENERAL MANAGER COMMERCIAL**