VENCorp

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Mr Sebastian Roberts
Acting General Manager
Regulatory Affairs - Electricity
ACCC
PO Box 1199
Dickson ACT 2602

Dear Sebastian,

VENCORP RESPONSE TO ACCC DRAFT DECISION ON VICTORIAN ELECTRICITY TRANSMISSION REVENUE CAPS

VENCorp welcomes the ACCC's publication, on 11 October 2002, of the Victorian electricity transmission revenue cap Draft Decision. This letter sets out VENCorp's comments in relation to some issues, for your consideration in reaching a final decision.

1. Information regarding SPI PowerNet's capital expenditure forecasts

VENCorp is responsible for planning and directing the augmentation of the Victorian shared transmission network. VENCorp works closely with SPI PowerNet, to ensure the coordination of asset renewals and network augmentation expenditure, thereby minimising total capital costs. Whilst VENCorp and SPI PowerNet have established a sound working relationship to ensure effective coordination, VENCorp considers that the present arrangements would be further enhanced if more detailed information on SPI PowerNet's asset renewals and replacement program were made publicly available. Availability of detailed information to VENCorp and the Victorian distributors (in their respective roles as planners of the shared network and transmission connection assets) would:

- enhance the already high level of transparency of transmission planning and investment decisions in Victoria; and
- provide VENCorp and the distributors with a means of ensuring that excluded service charges levied by SPI PowerNet for network augmentations do not also recover costs associated with asset replacement, where recovery of those costs has already been provided for in SPI PowerNet's revenue cap.

2. Efficiency carry-over ("glide path") arrangements

In its application, SPI PowerNet proposed the incorporation into its new revenue cap of a "glide path" or efficiency carry-over totalling around $30 million, as a reward for cost savings achieved in the first regulatory period.

The Draft Decision does not set out any assessment of, or comments on SPI PowerNet's proposed efficiency carry over arrangements. Analysis of the limited detailed data contained in the Draft Decision regarding the composition of the proposed revenue cap suggests that the $30 million reward sought by SPI PowerNet has not been included.

Page 68 of the Draft Decision states:

> "VENCorp agrees that SPI PowerNet should benefit from genuine efficiency gains and notes that the ESC has undertaken considerable analysis of this area, including the design of effective carry-over mechanisms. VENCorp submits that the Commission should undertake a detailed analysis of incentive arrangements as part of its revenue cap determination, as well as setting out the arrangements to be applied for the 2008 reset."

The Draft Decision does not respond in detail to VENCorp's suggestions. It would be helpful if the Final Decision clarified the ACCC's position on these matters.

3. Regulatory arrangements governing capital expenditure

VENCorp considers that the ACCC's Final Decision should clearly set out the efficiency incentive arrangements relating to capital expenditure that are to be applied to SPI PowerNet at the 2008 revenue cap review. This would minimise the perceived level of risk associated with regulatory treatment of efficiency gains, thereby maximising the incentives for SPI PowerNet to achieve efficiency gains from the commencement of the second regulatory period. This view was echoed by a number of the speakers at the public forum held on 14 November on the ACCC's draft decision.

In its recent Final Decision on Victorian gas distribution price controls, the Victorian Essential Services Commission (ESC) assessed capital expenditure forecasts from some distributors that represented significant increases on their recent actual levels of expenditure. In its Final Decision, the ESC accepted these forecasts for the purpose of setting the price controls, noting however that:

- the forecasts represent significant increases on historic levels of expenditure; and
- appropriate regulatory arrangements will be implemented to ensure that the distributors implement the plans upon which the capital expenditure forecasts are based.

The regulatory arrangements foreshadowed by the ESC include:

- monitoring and reporting arrangements in relation to the distributors' capital replacement programs;
- regular reviews of each distributor's replacement program; and

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- further development of each distributor's asset management plans and their predictive modelling tools, to ensure that priority is given to areas that have the most significant impact on network safety and reliability.

In addition, the ESC stated that if actual capital expenditure were less than forecast, the ESC would need to be satisfied that this is not a result of "imprudent and uneconomic deferral of necessary works". Any savings achieved as a result of imprudent deferral will not be included in the calculation of efficiency gains.

In view of the above, VENCorp considers that:

- the ESC's analyses of regulatory issues relating to the forecasting of capital expenditure and the construction of incentive-based regulatory controls are worthy of the ACCC's examination; and

- further, more detailed consideration of these issues in the ACCC's Final Decision is warranted.

4. Service standards

On 1 November, the ACCC published its Draft Decision on Victorian transmission network revenue cap service standards The Draft Decision proposes:

- the application of a performance monitoring regime to SPI PowerNet; and

- the application of a financial incentive scheme to SPI PowerNet, in addition to the availability incentive scheme proposed jointly by SPI PowerNet and VENCorp.

Our initial analysis of Draft Decision suggests that the ACCC's proposed financial incentive scheme seeks to unnecessarily duplicate the arrangements that have already been proposed jointly by SPI PowerNet and VENCorp (It is noted that the arrangements proposed by SPI PowerNet and VENCorp were developed from a scheme that has been in place since 1994). There also appears to be some likelihood that the ACCC's proposed financial incentive scheme may distort the signals that would be provided by the SPI PowerNet / VENCorp availability incentive scheme. This may, in turn, reduce the financial incentives that would otherwise be present to encourage SPI PowerNet to optimise the availability of its assets.

It is our view that the availability incentive scheme proposed by SPI PowerNet and VENCorp provides performance incentives that are consistent with and more powerful than those provided by SKM's proposal, and put a greater percentage of revenue at risk, i.e. 2% rather than 0.5%. The Victorian scheme provides well directed signals for transmission network outages to be programmed at non-critical times (away from peak load periods), and also weights the penalty payable according to the importance of the particular transmission elements. Of note, the scheme provides combined incentives to reduce the number, duration and criticality (peak, off peak and season) of outages. We therefore believe this scheme is a more advanced scheme, provides more significant financial incentives and therefore satisfies the ACCC's objectives for an incentive scheme.

In light of these views, VENCorp considers that it is undesirable for the two proposals to be operated in parallel. VENCorp suggests that the ACCC should adopt the availability incentive scheme proposed by SPI PowerNet and VENCorp for the purpose of its Final Decision.

5. SPI PowerNet policy for pricing of new non-contestable projects

VENCorp's submission to the ACCC on SPI PowerNet's revenue cap application provided a number of comments on SPI PowerNet's proposed policy for pricing of new non-contestable projects. The Draft Decision does not set out a consideration of SPI PowerNet's proposed policy. VENCorp considers that the ACCC's Final Decision should set out a determination of these matters.

We would be pleased to provide further information in relation to any of the issues addressed in this letter. For further information, please contact Joe Spurio on (03) 8664 6613.

Yours sincerely

M. Zema

Matt Zema
Chief Executive Officer