SP AusNet™
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Mr Philip Weickhardt
Presiding Commissioner – Electricity Network Regulation Inquiry
Productivity Commission
Level 2, 15 Moore Street
Canberra 2600

Email to: electricity@pc.gov.au

Dear Mr Weickhardt

Re: Issues Paper - Inquiry into Energy Network Regulation

SP AusNet welcomes the opportunity to contribute to the Productivity Commission's inquiry into Electricity Network Regulation, and this submission is made in response to the Commission's Issues Paper.

SP AusNet is a diversified energy business and owner of the Victorian electricity transmission network, and electricity and gas distribution networks in Victoria. The effectiveness of the regulatory arrangements to provide adequate compensation for provision of network services, and to provide appropriate investment signals, is of considerable interest to SP AusNet.

The Productivity Commission's terms of reference are directed to the specific areas of benchmarking arrangements, and how network businesses apply the regulatory regime for development of inter-regional network capacity in the NEM. SP AusNet notes that these are both issues which have received considerable attention in industry reviews and continue to do so, for example through AEMC reviews that are currently in progress. The referral of the Productivity Commission to these aspects of the regulatory regime reflects the importance to stakeholders for clarification of the effectiveness with which aspects of the regulatory arrangements are implemented. Having regard to this context, SP AusNet commends the Commission for producing a thoughtful Issues Paper as a basis for gathering stakeholder input.

As a network service provider SP AusNet is a member of the Energy Networks Association and Grid Australia, and has participated in the preparation of the submissions made by these associations. We endorse these submissions.

The remainder of this submission considers the distinct areas of inquiry in turn.

Benchmarking

The use of benchmarking is an inherent component of the process established in the National Electricity Rules for determination of operating and capital expenditure. Experience is that the AER makes significant use of benchmarking approaches in its reviews of network business revenue requirements. Benchmarking approaches can be effective when carried out robustly and consistent with the incentive-based framework of the Rules. The relevant data, cost drivers, and understanding of the subject business' circumstances are aspects typically disputed in benchmark studies. The work of the Productivity Commission's inquiry can contribute to enhancing the use of benchmarking by providing guidance which can improve the accuracy and confidence in benchmarking assessments.

Reviews to date have concluded that there are difficulties in applying a purely statistical benchmarking approach for revenue setting based on high levels of data aggregation. SP AusNet has previously shown support for initiatives to introduce a total factor productivity approach to economic regulation, specifically in the initiation stage of the AEMC review for the rule change proposal. Our submission noted that "…in broad terms, TFP provides a means of delivering substantial benefits to customers and regulated companies through the provision of more powerful incentives and the lowering of costs associated with regulation". We perceived the potential for mutual benefits, given the right design of the scheme.

However, neither the design in the rule change proposal, or further development of the concept in the course of the review led to appropriate regulatory certainty for network businesses.

As already discussed, benchmarking should be carried out consistent with the incentive regulation framework established through the National Electricity Law. In this regard we note the discussion in the Issues Paper surrounding the process for approving future investment and operating expenditure. In that discussion the Commission reflects on the benchmark setting most appropriate for determining an expenditure estimate, and appears to suggest that this could be based on best performer, or a benchmark close to this.

However, SP AusNet considers there is risk that neither of these benchmark settings would be consistent with the principles of incentive regulation or the objective of benchmarking, which are both to encourage firms toward the efficiency frontier. An example of positive application of incentives and benchmarking is the Victorian electricity distribution service reliability regime. This provides strong efficiency incentives, with revenue linked to performance against benchmark. This is achieved through the use of probabilistic planning for service reliability, the incentive on businesses to make the most efficient use of capital awarded, combined with a high powered Service Target Performance Incentive Scheme. A distribution business' benchmark for network reliability, and its reward for level of service, are both established based on its performance across the regulatory control period.

Inter-regional Investment

The Issues Paper identifies the main considerations in assessing the appropriate role of interconnectors in the NEM and mechanisms for achieving the right levels of investment. The arrangements have continued to evolve through a number of reviews, and as discussed in the Issues Paper, through the on-going Transmission Framework Review being conducted by the AEMC.

The National Transmission Network Development Plan (NTNDP) prepared by AEMO identifies a 20 year outlook for transmission development requirements along flow paths of importance to the national electricity market. The annual plan development process provides an opportunity for re-assessment of emerging network constraints which are, or may within the planning horizon, impact on the efficiency of the market.

Network augmentation needs identified in the NTNDP are progressed by the Transmission Network Service Providers (TNSP), subject to a regulatory investment test in accordance with the National Electricity Rules. The 2011 NTNDP indicates a good alignment between the plan and TNSP activity in progressing augmentation projects. Having regard to this industry information SP AusNet sees no evidence that interconnector investment is sub-optimal.

For the purpose of clarification we note that the Victorian transmission arrangements are different to those that apply in other states in the National Electricity Market. Specifically, Victoria has a network structure in which asset ownership is separated from planning and investment decision making. SP AusNet owns Victoria's primary network of transmission assets, but AEMO plans and directs most network augmentation. AEMO also buys bulk transmission network services from SP AusNet for sale to customers. In several aspects the separation of services may not be optimal, including via a reduced service breadth subject to incentives, and complex network service procurement arrangements, including costly contractual negotiations for new connections.

We look forward to participating in the subsequent phases of the Commission's inquiry. We invite you to contact Kelvin Gebert, SP AusNet's Manager Regulatory Frameworks, for any inquiries regarding this submission.

Yours sincerely,

Alistair Parker

Director, Regulation and Network Strategy