ElectraNet SA

ACCC Draft Decision on Review of the Regulatory Test

Submission - April 2004

ElectraNet SA
electricity transmission network

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1. Introduction

ElectraNet is pleased to contribute to the ACCC's review of the regulatory test and comment on its *Draft Decision: Review of the Regulatory Test for Network Augmentations* dated 10 March 2004.

ElectraNet generally accepts the outcomes of the draft decision and welcomes the retention of the reliability limb of the test as a "cost minimisation" assessment. However, there are some issues remaining including the treatment of competition benefits.

ElectraNet notes that the application of the regulatory test may need to be changed substantially in the future depending on the outcomes of the ACCC's current review of the capital expenditure framework. The regulatory test would no longer be required for capital projects included within a firm ex-ante cap on investment.

ElectraNet's comments on the ACCC's Draft Decision follow under the headings of the key issues raised in the paper.

2. Minor Amendments

ElectraNet supports the ACCC's proposed minor amendments to bring the wording of the regulatory test into line with the Network and Distributed Resources (NDR) Code changes.

2.1 Replacement Assets and Refurbishment Capital Expenditure

The Draft Decision defers the issue of the regulatory test acting as a safety net for asset replacement expenditure pending the outcome of the review of the capital expenditure framework.

ElectraNet agrees with this deferral. The issue of whether the regulatory test should be applied to asset replacement would no longer be relevant if this type of capex is included within a firm ex-ante cap on investment.

The Draft Decision states that:

> *"In instances where an asset replacement or refurbishment simultaneously augments the network the Commission believes that the Code is clear and requires that the regulatory test must be applied to that part which augments the network"*

ElectraNet generally accepts this point of view. However, we reiterate from our April 2003 submission[1] that in some cases an asset replacement project designed to maintain or restore existing service capacity may result in an incidental increase in service capacity. For example where:

- standardised replacement plant is used (to ensure compatibility with spare holdings and plant used elsewhere in the network – consistent with good electricity industry practice);

[1] ElectraNet Submission on "*Review of Regulatory Test - ACCC Discussion Paper February 2003*", April 2003

- plant of a higher capacity is more cost effective (for example due to changes in technology); and

- network service capacity is restored by an alternative development that is more cost effective than a simple one on one replacement.

In such cases, the replacement should not be treated as an augmentation if any increase in service capacity is a benefit that is only incidental to implementing the most cost effective approach to maintaining existing service capacity.

ElectraNet believes that a TNSP is NOT required to apply the regulatory test in such cases.

2.2 Thresholds for Small and Large Network Assets

ElectraNet proposed in its April 2003 submission that further streamlining of the network investment approval processes can be appropriately achieved by raising the current $1 million and $10 million thresholds defining new small and new large network assets.

In our view, raising the thresholds will improve the efficiency of the current approval processes.

ElectraNet notes that the Draft Decision defers this issue pending the outcome of the review of the capital expenditure framework.

Nevertheless, we reiterate our position that the existing thresholds are too low and should be raised to at least $5 million for new small network assets and at least $20 million for new large network assets.

ElectraNet notes that irrespective of the outcomes of the review of the capital expenditure framework that some investments will likely continue to be regulated on a project-by-project basis and be subject to the regulatory test.

Therefore, the issue of thresholds for new small and new large network investments will ultimately have to be addressed.

3. Definitional Amendments

The Draft Decision proposes a number of definitional amendments to clarify elements of the regulatory test that may be ambiguous and open to interpretation.

ElectraNet's comments on the proposed changes follow.

3.1 Alternative Projects

ElectraNet argued in its April 2003 submission that it is not practicable to consider an alternative project for a reliability augmentation unless it has a clearly identifiable proponent who is prepared to enter into a network support agreement for the provision of the relevant services.

ElectraNet welcomes the ACCC's acceptance of this position in its Draft Decision and the proposed changes that will avoid putting at risk the mandated timeframes associated with reliability augmentations.

Changes proposed for non-reliability augmentations clarify that the absence of a proponent will not exclude a project from being an alternative project for the purposes of the regulatory test.

ElectraNet believes that it is important that this requirement be clarified further as follows:

- If a project that has no proponent is ranked most highly in the regulatory test assessment then a TNSP would be expected to make reasonable endeavours to find a proponent through for example a registration of interest or request for tender process.

- However, if no proponent is found to implement the most highly ranked project within a reasonable timeframe then the next highest ranked project should automatically be deemed to pass the regulatory test – a period of time may need to be specified in the regulatory test.

Addressing this scenario would avoid the possibility of the market being denied the benefits of a second best alternative simply because no proponent has come forward to deliver an alternative with higher market benefits.

3.2 Benefits and Costs

ElectraNet supports the inclusion of the benefits and costs proposed by the ACCC as examples after the definitions of “market benefits” and “costs” in the regulatory test.

However, the examples should not preclude other valid benefits and costs from being included in the analysis where these are applicable.

Neither should the examples mandate the calculation of the listed categories of benefits and costs for all applications of the regulatory test, rather flexibility should be maintained.

3.3 Commercial Discount Rate

The Draft Decision includes a formula for calculation of a discount rate to be used in the regulatory test assessment.

ElectraNet does not consider that the inclusion of the proposed formula is helpful and proposes that it should be removed. Including the formula would only lead to more debate about the parameter values that should be used in the formula.

The choice of discount rate should not be a critical issue because application of the regulatory test requires sensitivity analysis with respect to the discount rate and the regulatory test has to date only been concerned with the ranking of alternative projects and not the absolute project costs.

As stated in our April 2003 submission, ElectraNet supports the use of a pre-tax real discount rate based on the weighted average cost of capital (WACC) determined by the ACCC in its regulated transmission revenue cap decisions.

3.4 VoLL

In determining market benefit, the Draft Decision proposes changes that would allow the use of "*either the level of VCR and/or VoLL*" to determine the value of energy to electricity consumers.

ElectraNet made the point in its April 2003 submission that VoLL, as defined in the Code, is simply a wholesale market price cap and is not an estimate of the value of lost load to end use customers, which will tend to vary by customer type and location.

We recognise that the proposed changes are a step forward to the extent that they allow use of a VCR in place of VoLL.

However, ElectraNet believes that the changes need to go further and remove the reference to VoLL from the regulatory test altogether. We also note that the term VCR is presently undefined.

ElectraNet suggests these issues can best be addressed by making the following changes:

> *"reasonable forecasts of the value of energy to electricity consumers ~~as reflected in either the level of VCR of VoLL~~"*

ElectraNet supports the adoption of a realistic value of lost load based on customer research, including the adoption of different values at different locations, where this information is available. In the absence of specific locational information, a composite value of at least $20,000/MWh would appear to be more appropriate than the wholesale market price cap specified in the Code.

The jurisdictional planner should be required to undertake a determination of the value of unserved energy or VoLL across various customer groups and locations on a regular basis for use in planning decisions.

If the value of unserved energy is under-estimated then application of the regulatory test could lead to an inefficiently low level of network investment; and the market as a whole will not benefit from transmission investments that deliver market benefits in excess of their costs.

4. Competition Benefits Test

The Draft Decision proposes changes to clarify that competition benefits can be included in a regulatory test assessment and that competition benefits can only be calculated using market simulations that include bidding behaviour that reflects imperfect competition.

ElectraNet supports these changes, which are consistent with our April 2003 submission.

However, we note that while the proposed changes capture the net market benefits of increased competition (resulting from price elasticity - the relationship between consumption and price), they do not capture the transfer of monopoly rent from producers to consumers (resulting from a reduction in market power).

The ACCC has stated that including these latter benefits would be inconsistent with the principles of economic efficiency set out as objectives in the National Electricity Code.

Given that the Ministerial Council on Energy (MCE) has specifically asked the ACCC to address this issue, ElectraNet considers it is a matter for the MCE to provide further guidance as to whether the ACCC's interpretation is consistent with what the MCE intended.

ElectraNet supports the work proposed by the ACCC to apply market simulations to the calculation of competition benefits for some real life examples to illustrate how this might be done and to quantify the magnitude of the potential market benefits.

For further information, contact:

Rainer Korte
NEM Development & Regulation Manager
(08) 8404 7983