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electricity transmission network

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Michael Rawstron
General Manager
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Australian Competition and Consumer Commission

By email: electricity.group@accc.gov.au

Dear Michael,

ACCC Review of the Regulatory Test

The ACCC released an Issues Paper on 10 May 2002 commencing a review of the regulatory test for proposed interconnectors and network augmentations. ElectraNet SA welcomes this opportunity to provide input to the ACCC's review.

ElectraNet SA recognises the important role of regulated network investments in facilitating competition in the NEM and thereby maximising the benefits of the market arrangements to consumers. Application of the regulatory test should allow efficient network investments to proceed in a timely manner in order to effectively capture these competition benefits. We support refinement of the regulatory test with this objective in mind.

The following comments are made under the headings of the key issues raised in the ACCC's Issues Paper.

Maximising net benefits

An augmentation option satisfies the current regulatory test if it meets an objectively measurable service standard or maximises the net present value of the market benefit "having regard to a number of alternative projects, timings and market development scenarios".

A key issue in the application of the regulatory test is the meaning of "alternative projects". ElectraNet SA believes that the regulatory test should be amended to clearly define "alternative projects" to mean projects other than regulated augmentations to the NSPs network. In other words, consistent with the requirements of the Code, the NSP should be required to consider projects competing with its commercial interests, including *generation* options, demand side options, *market network service* options and options involving other *transmission* and *distribution networks.*

The regulatory test should be amended to define "alternative projects" to mean projects other than regulated augmentations to the proposing NSPs network.

The Issues Paper raises the question of whether the current test dealing with reliability driven augmentations is appropriate. There appears to be an implication that because the majority of augmentations to date have been reliability driven that TNSPs may be using the reliability part of the regulatory test as an easy option for seeking approval of augmentations.

However, the high proportion of reliability augmentations simply results from the requirement to maintain reliability standards as growth in customer demand increases. To illustrate approximately 80% of the capital expenditure allowance included in ElectraNet SA's recent revenue cap application is related to reliability augmentations, representing 90% of the underlying capital projects.

In addition to the requirements of the National Electricity Code, these augmentations are required to meet the prescriptive service standard requirements of the South Australian Transmission Code. ElectraNet SA is required to comply with specific reliability standards at each transmission network exit point as a condition of its Transmission Licence in South Australia.

The Code process for making new regulated network investments must not be allowed to impede or interfere with a TNSP's legal obligations to meet required reliability standards. Clause 5.6.5A requires that the ACCC

> "have regard to the obligations imposed on *Network Service Providers* to meet the *network* performance requirements set out in Schedule 5.1 and relevant legislation and regulations of a *participating jurisdiction*, in developing and maintaining the *regulatory test*."

It is important, therefore, that the current provisions of the regulatory test for reliability augmentations actually be strengthened. Part (a) of the test should be amended to reflect the intent of the Code as follows (the underlined text has been added):

> "In the event the augmentation is proposed in order to meet an objectively measurable service standard linked to the technical requirements of schedule 5.1 of the Code or an objectively measurable service standard set out in relevant legislation, regulations or codes of a participating jurisdiction – the augmentation minimises the net present value of the cost of meeting those standards"

The regulatory test should be amended to explicitly recognise that, in addition to its existing provisions, an augmentation option satisfies part (a) of the regulatory test if it meets an objectively measurable service standard set out in relevant legislation, regulations or codes of a participating jurisdiction.

We also note that "having regard to a number of alternative projects, timings and market development scenarios" does not make much sense with respect to timings when applied to reliability augmentations.

The regulatory test should be amended to confirm that sensitivity analysis with respect to this aspect is only required for net market benefits projects.

The regulatory test should be amended to clarify that sensitivity analysis with respect to timing is only required for net market benefits projects.

Competitive impacts of network investment

ElectraNet SA supports the idea of competition benefits being taken into account in assessing proposed regulated interconnectors recognising that increased competition can reduce prices and lead to increases in overall economic welfare. Amending the regulatory test to take competition benefits into account would acknowledge that the current market is not as competitive as it could be; that at times monopoly power is exercised and participants supply at higher than marginal cost.

However, ElectraNet SA also recognises that if competition benefits are to be quantified through a process of pool modelling the assumptions involved will always be questioned by market participants leading to greater scope for disputes and delays in approval processes.

ElectraNet SA does not have a solution to this dilemma, but suggests that consideration should be given to taking into account competition benefits only in special circumstances where a competition benefit can be clearly demonstrated and where it may make the difference between a regulated interconnector satisfying or not satisfying the regulatory test.

Network and distributed resources code change package and timing delays

A key objective of the network and distributed resources package of Code changes was to streamline the approval processes for network investments. A key initiative was the definition of new large network investments and new small network investments with the idea that a simpler streamlined approval process should apply to smaller more routine investments.

The Code defines a new large network asset as:

> "An asset of a *Transmission Network Service Provider* which is an *augmentation* and in relation to which the *Network Service Provider* has estimated it will be required to invest a total capitalised expenditure in excess of $10 million, unless the *ACCC publishes* a requirement that a *new large network asset* will be distinguished from a *new small network asset* if it involves investment of a total capitalised expenditure in excess of another amount, or satisfaction of another criterion. Where such a specification has been made, an asset must require total capitalised expenditure in excess of that amount or satisfaction of those other criteria to be a *new large network asset*."

A new small network asset is defined as one that requires a capitalised investment greater than $1 million. Oversight of minor investments below this threshold is provided via the process of the ACCC setting the TNSPs revenue cap.

The Issues Paper asks whether the problems of time delays have been sufficiently addressed in the network and distributed resources package. While recognising that this question was in relation to interconnectors, ElectraNet SA believes that, more generally, further streamlining of network investment approval processes can be appropriately achieved by raising the $1 million and $10 million thresholds defining new small and large network assets. We propose that $5 million and $15 million would be more appropriate thresholds to apply in the case of ElectraNet SA. At present a routine transformer replacement, which might cost $2-3 million, would need to be subjected to the public consultation processes set out in the Code with little if any value to be gained from the cost of doing so.

Appropriate increases in the capital investment thresholds defining large and small network assets (as allowed by the Code) would further streamline network investment approval processes.

The Issues Paper raises questions in relation to whether appropriate checks and balances are in place to prevent a TNSP from misusing its monopoly position and preventing appropriate consideration of non-network options. In our view the current Code requirements for public consultation provide more than adequate checks and balances to ensure that alternative augmentation options, including non-network options, are considered.

In relation to whether the regulatory test should be more prescriptive, ElectraNet SA supports a more prescriptive test that defines which costs and benefits should be taken into account. A more prescriptive test will be easier to apply and less open to challenge.

In relation to a proposed market test period, ElectraNet SA is of the view that adequate provision for this has already been made in the regulatory test. Note (7) of the test provides that:

> "In determining the market benefit, the proposed augmentation should not pre-empt nor distort potential unregulated developments including network, generation and demand side developments"

and to this end

> "unless there are exceptional circumstances, new interconnectors must not be determined to satisfy this test if start of construction is within 18 months of the project's need being first identified in a network's annual planning review or NEMMCO's statement of opportunities".

ElectraNet SA believes that this provides adequate opportunity for alternative unregulated developments to be proposed.

Other issues for consideration

In relation to the question should the Commission clarify its optimisation of network investment that has been assessed in accordance with the regulatory test, we strongly encourage the Commission to address this issue.

Our view is that investments that satisfy the regulatory test should not be subject to optimisation. If this position is not accepted and the proponent of a regulated investment continues to be exposed to optimisation risk, then in principle the proponent should be given greater freedom to apply the regulatory test with minimal intervention from the regulator or other parties.

We have particular difficulty in understanding why a new large network investment, which the ACCC has determined to satisfy the regulatory test in accordance with clause 5.6.6(o) of the Code, should be subject to optimisation. We note that 5.6.6(p) requires that:

> "the determination of the *ACCC* pursuant to 5.6.6(o) shall only apply until the end of the *regulatory control period* in which the determination is made".

In relation to what discount rate should be applied in the analysis of a regulated investment, in principle this should clearly be the regulated rate of return that the investment will earn once it is included in the regulated asset base. However, ElectraNet SA and other investors have been arguing that current regulated rates of return are too low to encourage private enterprise investment. If the ACCC is recognising that private enterprise investment may indeed require a higher hurdle rate, then this should be reflected in the regulated rates of return that the ACCC is applying in its revenue cap decisions. ElectraNet SA has presented strong and detailed arguments for the ACCC to adopt a more appropriate treatment of the cost of capital as part of its current revenue cap review process.

Another issue that has been raised by others, particularly in South Australia, is whether the regulatory test should give some recognition to the environmental benefits derived from connecting renewable energy sources to the grid. For example, the significant number of wind farm developments that are expected to eventuate in response to the Commonwealth Government's greenhouse policy.

Conclusion

This submission provides comments on questions raised in the ACCC's Issues Paper on the regulatory test for proposed interconnectors and network augmentations. Our comments have been focussed on a relatively small number of key issues and we look forward to participating further in the review process.

Please do not hesitate to contact me on 8404 7983 if you would like to discuss any aspect of this submission.

Yours sincerely,

[Sgd] Rainer Korte

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MANAGER REGULATION