REVIEW OF THE REGULATORY TEST FOR NETWORK AUGMENTATIONS

ACCC Draft Decision (10 March 2004)

Ergon Energy Corporation Limited

23 April 2004

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1. INTRODUCTION

On 10 March 2004, the ACCC released its Draft Determination "Review of the Regulatory Test for Network Augmentations" seeking comments by 23 April 2004.

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2. EECL'S POSITION SUMMARISED

EECL strongly supports a review of the Regulatory Test and an effort to eliminate disparities between the Regulatory Test and the National Electricity Code. We also welcome the opportunity to provide comment and trust that we can be constructive in doing so.

EECL's overarching view is that it is a much repeated flaw in the ACCC's considerations throughout this Draft Decision that most of its logic and considerations have been based on TNSPs and *transmission networks* – and that DNSPs and *distribution networks* receive only peripheral comment.

This has resulted in the proposed amended Regulatory Test containing numerous unworkable anomalies - despite the ACCC stating that one of its objectives in this exercise is to remove inconsistencies between the Regulatory Test and the Code.

A strict reading of the existing Code and the proposed Regulatory Test would mean that – for DNSPs:

1. There is no threshold exemption from carrying out consultation and the Regulatory Test – meaning that it is required for all augmentation works, no matter how small (see our Section 4.1);
2. There is no ability to carry out the Regulatory Test for *reliability augmentations* – despite these being the only type of augmentation that we as a DNSP can envisage ever building - since *reliability augmentations* relate only to *transmission network augmentations* (see our Section 4.2);
3. There would never be a need for us as a DNSP to carry out other non-reliability augmentations (since we only build customer requested or reliability triggered assets) – and in any event, we could not undertake the *market benefit* analysis discussed in the Regulation Test (see our Section 4.2).

EECL cannot encourage the ACCC strongly enough to address the drafting anomalies as part of its current review process – including ensuring that Code changes occur.

EECL thinks that the Regulatory Test should not be applicable to any replacement or refurbishment works, or parts thereof, provided that any increase in *network* capability is incidental to the replacement or refurbishment. We think it unworkable to dissect the costs of a refurbishment or replacement augmentation project to arrive at those costs that result in increased network capability as the ACCC intends (see our section 4.3). Another important matter is that applying the Regulatory Test in the way suggested with be an explicit barrier to utilisation of new technologies and equipment.

EECL also considers that the existing threshold for the Regulatory Test should be considered, for DNSPs at least, as part of the Final Decision on the "Review of the Regulatory Test for Network Augmentations" – and not deferred to be incorporated in the ACCC's related, but separate, "Review of the Draft Statement of Principles for the Regulation of Transmission

Revenues – Capital Expenditure Framework" – since the latter review has no bearing on DNSPs (see our Section 4.4).

EECL's view is that the existing threshold (>$10M) is significantly too low – and should have an escalation methodology attached to it once it has been uplifted (see our Section 4.4).

EECL's first position is that the Regulatory Test should not be applicable to any *distribution network augmentations.*

But in the event that it is intended to be applicable, then the Code and the Regulatory Test must, as part of this review be drafted to ensure that:

(i) they are not be incompatible with the intent – thus changes are needed to the Code and its definitions.

and

(ii) DNSPs should not be required to consult or carry out the Regulatory Test unless the augmentation is a *new large distribution network asset*

AND

the threshold be uplifted significantly – we suggest $20 M then with annual escalation

AND

be for the purpose of a *reliability augmentation (*with that definition amended to include *distribution networks* purposes)

AND

that refurbishment or replacement augmentation not be subjected to the Regulatory Test requirement, even if there is incidental increased *network* capability.

3. EECL'S STATUTORY ENVIRONMENT

Queensland has a permanent Code Chapter 9 derogation that effectively says that assets owned by the TNSP are *transmission networks* – and these do not include *networks* owned by DNSPs.

This has a bearing on the application of the Regulatory Test in Queensland.

9.32.1(b) For the purposes of the *Code*, to the extent that any *network* is located in Queensland, a *network* or part of a *network* is a *transmission network* if and only if it satisfies the following definition of *"transmission network"* and the definition of "*transmission network"* given in the glossary in Chapter 10 of the *Code* does not apply in those circumstances:

transmission network	Despite clause 6.2.1(d) and the glossary of the *Code*, in Queensland the *transmission network* assets shall be taken to include only those assets owned by Powerlink Queensland or any other *Transmission Network Service Provider* that holds a *transmission authority* irrespective of the *voltage* level and does not include any assets owned by the *Distribution Network Service Providers* whether or not such *distribution* assets are operated in parallel with the *transmission system*.

4. EECL'S COMMENTS ON THE DRAFT DECISION

4.1. ACCC Section 2.4 – Network and Distributed Resources Code Changes + ACCC Section 3.2.1 - Aligning the Regulatory Test with the National Electricity Code

It is noted in the Draft Decision that as a result of the Network and Distributed Resources Code changes, the Code was amended to ensure that the Regulatory Test would continue to be applicable to DNSPs:

> While the proposals were developed with transmission network planning in mind, NECA modified the code to ensure that the existing provisions and obligations on Distribution Network Service Providers (DNSPs) were maintained but not extended. That is, DNSPs must continue to carry out economic cost effectiveness analyses of options that satisfy the regulatory test where it has identified necessary augmentations in its annual planning review.

The Code changes that were made at the time were clearly erroneous. EECL has taken legal advice specifically about the current Code clauses which, when read literally, place the following obligations on DNSPs:

1. 5.6.2(f) - After joint planning (ie. with TNSP) or annual planning (DNSP's internal planning) has been carried out – then the DNSP must consult about *distribution system augmentations*; except that
2. 5.6.2(f) – DNSPs do not need to consult about *new small network assets*; where
3. Ch 10 – *new small* (and *large) network assets* can only be assets of a TNSP; and further
4. 5.6.2(g) – DNSPs must carry out the Regulatory Test if it is required to consult as per clause 5.6.2(f).

Therefore DNSPs do not have the benefit of the exemption from consultation and carrying out the Regulatory Test for augmentation works of any size.

The matter of the use of "*new small* (and *large) network assets"* has been raised previously by DNSPs and the National Electricity Distributors' Forum[1] – and acknowledged by the ACCC in this Draft Decision (page 15):

> The National Electricity Distributors Forum (NEDF) suggests that the Commission's amendments which reference NSPs should explicitly recognise that the new small and new large network asset code provisions only relate to TNSPs.

[1] NEDF Submission to ACCC re Review of the Regulatory Test dated 18/4/03 page 2.

Another anomaly that exists whereby the definition of *new small distribution network asset* is that these are assets owned by a TNSP that form part of a *distribution system.*

new small distribution network asset

A *new small network asset* which forms, or will form, part of a *distribution system*.

with *new small network asset* being:

new small network asset

An asset of a *Transmission Network Service Provider* which is an *augmentation* and:

(a) in relation to which the *Transmission Network Service Provider* has estimated it will be required to invest a total capitalised expenditure in excess of $1 million, unless the *ACCC publishes* a requirement that an asset will be 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 small network asset*; and

(b) is not a *new large network asset*.

EECL is cognisant that it is for NECA to initiate Code changes. However the ACCC authorises Code changes, and in view of the fact that the errors we have noted here relate specifically to the Regulatory Test, and cloud interpretation and application of the Regulatory Test – we think it reasonable that the ACCC takes carriage of ensuring that there be no Code inconsistencies upon implementation of the revised Regulatory Test.

1. EECL submits that, if the ACCC intends to retain the obligations that DNSPs must apply the Regulatory Test for *distribution networks* - then it is imperative that, in implementing the amendments to the Regulatory Test, the Code also be amended to rectify the 2 anomalies that exist whereby:

(i) DNSPs have no exemptions from consultation and the Regulatory Test for any augmentation works; and

(ii) *new small distribution network assets* are assets owned by a TNSP that form part of a *distribution system*.

4.2. ACCC Section 3.3.1 - Definition & Application of Reliability Augmentation

The ACCC's discussion in this section relates only to *transmission networks* and TNSPs. There is no discussion about the applicability to *distribution networks*.

Given that the Code defines *reliability augmentation* to be:

> **reliability augmentation**
>
> A *transmission network augmentation* that is necessitated solely by inability to meet the minimum *network* performance requirements set out in schedule 5.1 or in relevant legislation, regulations or any statutory instrument of a *participating jurisdiction*.

the resultant situation is that DNSPs will never be conducting the Regulatory Test limb (a) *reliability augmentation* (unless they are a DNSP that owns a *transmission network)* – but will instead be limited to limb (b) "other augmentations" that require *market benefit* comparisons of *alternative projects* in a majority of *reasonable scenarios.*

EECL considers the practical application should be that limb (a) is applicable, but not limb (b):

1. Limb (a) - Reliability Augmentation

   EECL would only ever augment our *distribution network* for reliability purposes – but the definition of *reliability augmentation* and its references in the proposed Regulatory Test itself, will mean that DNSPs are not required under limb (a) to carry out the Regulatory Test since they relate only to *transmission networks*;

and

2. Limb (b) – Other Augmentation

   EECL cannot at this point in time, envisage any situations whereby our network would be augmented for a non-reliability purpose (eg. to provide a interconnector between regions) – thereby eliminating the need to ever undertake limb (b).

   Further, DNSPs will struggle, and we suggest will find it impossible, to carry out the *market benefits* analysis – simply because we are not involved with market matters, nor do we have access to the information necessary (taking the points listed in the ACCC's proposed amended Regulatory Test clause 5). It is also noted that the Regulatory Test clause 5 talks about "transmission" investments, losses, ancillary services etc – matters which DNSPs have no involvement with.

2. EECL submits that the ACCC needs to clarify whether it is intentional that DNSPs will never be required to carry out the Regulatory Test for under limb (a) *reliability augmentation* due to the Code definition that limits *reliability augmentation* to *transmission networks* – and if that is intended that DNSPs carry out limb (a) Regulatory Tests, then the definition of *reliability augmentation* in the Code must be expanded to include *distribution network augmentation.*

3. EECL submits that the ACCC needs to

(i) clarify what is intended under limb (b) regarding its applicability to *distribution network* augmentations (we cannot envisage this situation ever arising); and

(ii) in the event that there is some *distribution network augmentation* that is non-reliability augmentation, then it needs to be recognised that DNSPs will not be able to carry out the limb (b) *market benefits* analysis for a *distribution network augmentation*.

4.3. ACCC Section 3.3.2 – Replacement & Refurbishment Capital Expenditure

The Draft Decision is that:

(a) The Regulatory Test does not relate to replacement and refurbishment capital expenditure; but

(b) Where the replacement or refurbishment results in an increase to *network* capacity – then the Regulatory Test must be applied to that part of the capital expenditure.

EECL considers that the process to dissect that part of a refurbishment or replacement that relates to increased *network* capability will be problematic to perform - and more importantly, would be an explicit barrier to utilisation of new technologies and equipment.

We refer again to the earlier National Electricity Distributors' Forum submission[2] on this point, wherein this view was expressed:

> The NEDF supports the ACCC's clarification that the direct replacement of assets should not be considered an augmentation for the purpose of the Test. However, it must be recognised that a straightforward replacement of aged assets with their modern equivalent may increase the capability of the network. For example, modern switchgear would generally have both higher fault level rupturing capacity and higher current rating than the equipment near the end of its life that it might replace. In this circumstance, it would be inappropriate for the Test to apply only to the increased capability such an augmentation could deliver. Therefore, the NEDF recommends that the primary intent of an augmentation should be the determinant of whether the Test would be applied.

[2] NEDF Submission to ACCC re Review of the Regulatory Test dated 18/4/03 page 2.

4. EECL submits that the Regulatory Test should not be applicable to any replacement or refurbishment works, or parts thereof, provided that any increase in *network* capability is incidental to the replacement or refurbishment.

4.4. ACCC Section 3.3.3 – New Small and New Large Network Assets Thresholds

EECL notes that the ACCC intends to defer consideration of the thresholds pending the outcome of its review of TNSP's Capital Expenditure Framework.

Since TNSP's Capital Expenditure Framework has no relevance to DNSPs, we think that this is an inappropriate approach, at least from DNSPs' perspectives.

Further, we consider that it is a much repeated flaw in the ACCC's considerations throughout this Draft Decision that most of its logic and considerations have been based on TNSPs and *transmission networks* – and that DNSPs and *distribution networks* receive only peripheral comment.

If it is intended that the Regulatory Test be applicable to DNSPs, then it is absolutely imperative that their situation be given appropriate consideration and discussion throughout.

EECL submits that in considering the thresholds for performance of the Regulatory Test:

5. The ACCC needs also address *New Small* and *Large Distribution Network Assets* – being assets of DNSPs. Thresholds for DNSPs should be explicitly dealt with, including correcting the Code definitions.

6. In view of the apparent intention that the Regulatory Test be applicable to *distribution networks* – then the ACCC's Capital Expenditure Framework for TNSPs is of no relevance to DNSPs – and therefore it is entirely appropriate to consider the thresholds for DNSPs *New Small* and *Large Distribution Network Assets* in the ACCC's Final Decision about the Regulatory Test.

Regarding the thresholds, EECL notes that since inception of *new small* and *large network assets*, the >$1M and >$10 M thresholds have remained static – that is, there has been no express movement, nor routine escalation.

We think that this is inappropriate – and that there should, as a minimum, be escalation consistent with the escalation principles applied to TNSPs and DNSPs annual revenue/price caps. Whatever the escalation mechanism is decided to be, it should be enshrined in the Regulatory Test.

DNSPs can, and in EECL's case, do, encounter sudden unpredictable bursts of load growth in particular areas and must respond quickly to ensure that the lights do not go out (a situation that attracts significant political, customer and media attention). Implementation of solutions should not be hampered or delayed because the thresholds for the Regulatory Test are set too low and are not escalating over time consistently with NSP's costs.

We also refer to the NEDF submission on this point[3], wherein it was stated:

> In relation to the classification of small and large assets, the NEDF is of the view that both limits are so low as to present an unwarranted burden upon NSPs and unduly delay the provision of necessary augmentations. This is a particular issue for DNSPs, where short lead times are the norm in meeting rapidly changing customer requirements. The construction or modification of a new zone substation in a metropolitan area would routinely exceed the $10 million limit, meaning that an urban DNSP may have a few large projects per annum under the existing definition. The NEDF therefore suggests that both limits for asset classification could be doubled.

7. EECL submits that:

(i) The thresholds should be reviewed as part of the Final Decision, and increased significantly – we would suggest at doubled; and

(ii) After an appropriate adjustment has occurred, there should be an automatic annual escalation mechanism enshrined in the Regulatory Test.

4.5. ACCC Section 4.2.1 – Definitional Changes – Alternative Projects - Reliability Augmentations

EECL refers to our comments above in our section 4.2 – that DNSPs will not be considering a *reliability augmentation* (unless they own *transmission networks*) since it relates only to *transmission networks.*

[3] NEDF Submission to ACCC re Review of the Regulatory Test dated 18/4/03 page 2.

4.6. ACCC Section 4.3.1 – Alternative Projects – Non-Reliability Augmentations

EECL notes the ACCC's intentions:

> … the Commission is of the view that for non-reliability augmentations, it is inappropriate to exclude a possible alternative project on the basis that it does not have an identifiable proponent.
>
> Therefore, for the purposes of non-reliability augmentations more emphasis will be placed on the substitutability and practicability of alternative projects.

See out comments in section 4.2 above – we do not (at this point in time at least) envisage that we would ever be undertaking augmentation for non-reliability purposes – therefore the *market benefit* analysis will not be a requirement of us.