

1 April 2003

Mr Sebastian Roberts
Acting General Manager
Regulatory Affairs
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2606

Dear Mr Roberts,

Discussion Paper – Review of the regulatory test - Comments

The Commission has sought comments from interested parties on the options outlined in their Discussion Paper dated 5th February 2003. Hydro Tasmania is pleased to be able to provide its input, given Tasmania's impending entry into the National Electricity Market.

Overall, we are pleased that the Commission is proposing changes to the regulatory test that will assist with the promulgation of efficient investment in the sector. By way of background, we consider that the direction that the regulatory test is moving will help to enhance the consistency between the gas sector, where recent reports have supported, for example, the inclusion benefits of competition in investment decisions¹, and the electricity sector.

Furthermore, while the NEM Minister's Forum review of the role of transmission is yet to report, there appears to be growing consensus that in practice the primary vehicle for network augmentation in the medium term will be regulated investment providing a means to market. Indeed the recommendations of the Parer Report, while yet to be adopted, reflect this reality. As such, the proposed changes to the regulatory test will help ensure that this investment is timely and efficient. We note that the Commission has undertaken to consider optimisation for augmentations that have passed the regulatory test as it finalises the Statement of Regulatory Principles. At that time, we would encourage the Commission to adopt a position that provides a, say, 25 year safe harbour for augmentations that demonstrably pass

¹ Both the ACT in its decision on the Eastern Gas Pipeline and the NCC in its recommendation on the application for the revocation of coverage of the Moomba to Sydney (MSP) pipeline have highlighted the importance of including the benefits of competition in one of the markets connected in an assessment of a network asset. The work commissioned by the NCC from Janusz A Ordover and William Lehr on the MSP is of particular relevance in this regard.

the regulatory test. Again, we note that this would be consistent with recent Guidelines for Greenfields Gas Pipeline development published by the ACCC.

The Policy Context:

In its deliberations on the Regulatory Test, we believe the Commission should address the benefits and aims of the National Electricity Market (NEM) as enunciated by the ACCC in its 1997 and 1998 Determinations. The regulatory test needs to demonstrate that it will achieve these objectives if it is to be relevant and not open to ongoing challenge and debate. For the record the benefits and aims identified by the ACCC in 1997 and 1998 were:

- The need to incent the interconnection of new regions (i.e. of the States and Territories);
- Strengthening existing interconnection of the regions;
- Better use of existing infrastructure;
- Exploiting the complementarities of different State based generation technologies especially hydro and thermal generation; and
- Balancing efficiency and equity objectives.

Our detailed comments are grouped under the Commission's Options 1, 2 & 3.

Option 1 – Minor Amendments

Alignment with the Code

Hydro Tasmania supports the alignment of the regulatory test with the Code to remove the potential for confusion and delay in transmission investment. Indeed, in the future, the Commission should give consideration to revising the regulatory test in concert with Code change authorisations. For example, as part of the authorisation process, the Commission could give consideration to any need for the regulatory test to be revised in line with the proposed Code changes. This would remove all such potential confusion.

Replacement and refurbishment

The Commission has proposed that where a refurbishment or replacement provides additional capacity, it should be subject to the regulatory test, whereas if it is a simple like-for-like replacement, then the TNSP would not have to apply the regulatory test. In practice, replacements often provide the opportunity for enhanced capacity at a

very low incremental cost, due to the economies of scale associated with transmission, and changes in standard equipment sizes. It would be unfortunate if the Commission's proposal were to cause a TNSP to carry out sub-optimal investment, simply to avoid the application of the regulatory test. Instead, it would appear appropriate to allow some flexibility in the replacement of assets that happen to provide additional capacity. For example, the TNSP could be required to demonstrate during its Revenue Reset Review that the increase in cost due to the increased capability was less than some threshold.

Option 2 – Definitional amendments

Market benefits

We note that the Commission is adding the list of 'market benefits' to the regulatory test, as an example to guide parties in their application of the test. Item 1 in this list is 'benefits of savings in fuel consumption'. We consider that this benefit should be made more general to incorporate the benefits that result from increased efficiency in the operation of hydro plant and other renewable generators. We would suggest that this be redrafted to read:

1. *benefits of savings from more efficient operation of generators*
 - a. *Differences in dispatch patterns*
 - b. *Differences in fuel costs*
 - c. *Differences in hydrological values and renewable operation*

Nevertheless, the Commission has argued that the examples should not be considered prescriptive or exclusive, that the benefits used should take into account the particular benefits of a particular project, and we would endorse that position.

VoLL

The Commission has considered that the value of VoLL should be consistent with the value adopted in the Code as a price cap to be applied to dispatch prices. While there is some relation between these uses, there may well be particular customers for whom the value of lost load is greatly in excess of \$10,000/MWh (as shown, for example, in VENCORP's recent research). By adopting the energy market value in the application of the regulatory test, the regulatory test will be skewed against network investments for customers whose VoLL is higher than the market price cap, with the potential for inefficient outcomes. We suggest that the VoLL figure generally be as specified in clause 3.9.4, except where there is specific information that indicates that a higher figure is more appropriate.

Option 3 – Competition test

The Commission has recognised that one of the biggest criticisms of the regulatory test is that it does not recognise competition benefits.

However, the Commission has indicated that one of its key objectives is that any competition based test is objective and robust over a range of market development scenarios. As such, the Commission has concerns about many of the approaches that it discusses due to the risk of project delays through disputes. Equally, the Commission has concerns about the economic rigour of some of the simpler approaches.

On balance, given that it is projects that have real competition benefits that will be most vigorously contested, it would appear appropriate for the Commission to favour a simpler approach over one that offers more scope for dispute, even at some cost to economic rigour. In this sense, an approach that looks at historic IRSRs may have some appeal. Equally, and at a further cost to economic rigour, it may be possible to derive equivalent information for intra-regional investments, by studying simple simulations of historic price outcomes with the proposed intra-regional investment. Before adopting this or a similar approach, it would be necessary for the Commission to assure itself that the failure to model changed bidding behaviour would not totally undermine the approach.

However, we strongly believe that it is practical and desirable for the Commission to develop a robust approach to the inclusion of the benefits of competition in the regulatory test in line with the work of the ACT and the NCC on gas pipeline infrastructure. It would not be acceptable, for example, for the Commission to conclude that a satisfactory approach could not be developed due to concerns over the process. This would represent a significant failure in the development of efficient transmission in the NEM.

In conclusion, Hydro Tasmania strongly supports the adoption of the Commissions' options 1, 2 and 3, subject to the detailed comments above. If you wish to discuss these matters further, please do not hesitate to contact me or David Bowker on 03 6230 5775.

Yours sincerely,

G L Willis
Chief Executive Officer