

22 April 2004

Mr Sebastian Roberts
General Manager
Regulatory Affairs – Electricity
Australian Consumer and Competition Commission
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Dear Mr Roberts

Review of the Regulatory Test for network augmentations.

Loy Yang Marketing Management Company (LYMM) is pleased to have the opportunity to comment on the review of the Regulatory Test. Our concern as a participant in the competitive energy market is that regulated investment does not distort or impact this market in a manner that would discourage private capital investment in gas and electricity assets.

The regulatory test plays an important role in the overall legal and regulatory framework governing the NEM because it determines how and where investments in regulated services will interface with investments in the competitive sectors of the industry and as such will have an important impact on private investment in the NEM.

Our comments on this consultation relate specifically to note 7 of the Regulatory Test which includes the market failure test.

Note (7) says in the preamble, *“In determining the market benefit, the proposed augmentation should not pre-empt nor distort potential unregulated developments including network, generation and demand side developments”*.

Note 7 forms part of the overall market framework as it recognizes the interaction between the regulated and competitive markets and that there is the potential for non regulated solutions to substitute for regulated network developments. The objective of the note is to promote, or at least provide an opportunity for, competitive market development in an area where there is significant information asymmetry in relation to transmission developments and their alternatives. Also it is important to recognize that note (7) refers to all unregulated developments (network, generation and demand side) not just unregulated transmission development. This is a fundamental provision of a robust regulatory test and is essential in maintaining a regime which is conducive to market based investment.

LYMM notes that the scope of the current consultation is in regard to the mechanics of the regulatory test. Note (7) does not deal with the mechanics of the test, it acknowledges the framework within which the test sits, ie the relationship between the regulated and the competitive market, and therefore it is outside the scope of this consultation and should be the subject of a separate consultation.

The Commission has recognised that regulated transmission investment sits within the framework of a competitive market and that adverse impacts on this market need to be limited and has previously stated that;

*'the Commission has based the regulatory test on the traditional cost benefit analysis framework but with a number of clarifications to limit any adverse impacts that regulated network investments might have on the competitive processes in the contestable parts of the industry'*¹

The list of objectives of the transmission revenue regulatory regime contained in Clause 6.2.2 of the Code and item (h) , refer below, places an obligation on the Commission, in regulating the transmission regime to promote competition;

'(h) promotion of competition in upstream and downstream markets and promotion of competition in the provision of network services where economically feasible.'

The Commission proposes to remove Note (7) from the regulatory Test to 'avoid confusion'. This proposition is inconsistent with the Commissions previous position and inconsistent with National Electricity Code requirements.

The Commission has stated that the note (7c) has been misinterpreted by interested parties. LYMM is not aware of any misinterpretation of this clause and the Commission has not provided any evidence that this is the case. The Commission refers to comments by Powerlink who note in their view that note (7c) "is an unjustified bias towards non-regulated interconnectors." It is clear that Powerlink has not misinterpreted the note except that the bias is towards all unregulated developments. Powerlink are merely venting their frustration with a provision which is consistent with the Code requirement to promote competition, as referred to above, and the Commissions objective that regulated investments "should not pre-empt nor distort potential unregulated developments"²,.

If this provision has been misinterpreted, rather than deleting the whole clause, the sensible course of action would be to revise the note and clarify the intent to 'reduce uncertainty and ambiguity'³. This is the approach that has been adopted in this draft decision for other sections of the regulatory test to overcome the potential for misinterpretation. Clarifying the intent of the clause would also be consistent with the code objective of promoting competition.

In the draft report the Commission notes that it believes that the market will be informed in advance of emerging network limitations through a variety of sources which include:

- TNSP's annual planning reports,

¹ (ACCC Regulatory Test for new Inter-connectors and Network Augmentations, 15 December 1999, Regulatory Test executive summary, page 2.)

² Regulatory test note (7)

³ Draft decision review of the regulatory test for network augmentations - Page 14.

- NEMMCO's SOO,
- Code consultation processes which provide opportunities for non network options to come forward, and
- The Annual National Transmission Statement, which will provide opportunities for promoting improvements in planning and information disclosure.

From this it is understood that the Commission is implying that the provision of additional information to market participants will encourage development of unregulated or non network options and note (7) is therefore not required. LYMM does not agree with this view for the following reasons.

It is unlikely that the information to be provided in these documents will be other than very high level general information and potential investors will need access to fundamental system data, held by the TNSP's, and have time to evaluate this information to allow the feasibility of a project to be assessed.

Furthermore the timing of the release of the information, the content of the reports and the level of detail of the information provided is largely controlled by the TNSP's and LYMM is of the view that retention of note (7) is still required to encourage early release of information by the TNSP to ensure that there is a window of opportunity of known duration within which non regulated solutions may develop.

The Commission has previously noted⁴ that *“regulatory approval should be time constrained to ensure that a proponent does not seek regulatory approval well before it is justified in order to get a decision on uncertain information or in an attempt to pre-empt other regulated investments”*. Note (7) contains provisions to this effect and despite the release of additional high level information via the ANTS is still required to minimise behaviour likely to prejudice unregulated developments.

Also, in ANTS⁵ Section 8 – Options for development of major transmission flow paths, when considering options to address future forecast constraints it is stated that *“only network options (will be) considered, non-network options to be considered as part of (a) formal regulatory test.”* This suggests that the information provided in the ANTS will be limited and reinforces the need for note (7) to remain to allow time for the development of unregulated developments.

The Commission also notes (presumably to justify deletion of note (7)), that the code Clause 5.6.6(b)(iii) requires that NSP's consider *“all reasonable network and non network alternatives, including but not limited to inter-connectors, generation options, market network service options involving other transmission and distribution networks”*. The implication is that regulated businesses will consider non network or unregulated solutions to network problems so it is not necessary to encourage a wider range of participants.

While this is not impossible, it is unlikely that consideration of a market based solution by a regulated business would lead to a market based solution because this is generally outside their area of technical and business expertise. Also there is a serious conflict of interest which would inhibit regulated business from proposing a market based solution. It is more likely that an efficient outcome will be developed where a non network solution is synergistic with a market based need. For this

⁴ Regulatory Test for New Interconnectors and Network Augmentations – 15 December 1999
Page 17

⁵ Annual National Transmission Statement as of the working group meeting on the 22nd March 2004.

reason more efficient outcomes are likely to occur when participants in the competitive market are encouraged to develop non network solutions. The objective of the note is to encourage these developments.

For the above reasons LYMM is of the view that note (7) should remain, modified if necessary to overcome any misinterpretation because it is consistent with the objective of limiting adverse impacts of regulated investment on the competitive market and encouraging market based development.

If you require clarification on matters raised in this submission please contact Mr Roger Oakley on (03) 96122211.

Yours faithfully

Roger Oakley
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