SPI POWERNET
A subsidiary of Singapore Power International

Mr Michael Rawstron
General Manager
Regulatory Affairs - Electricity
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2602

14 June 2002

Dear Michael,

REVIEW OF REGULATORY TEST

SPI PowerNet appreciates the opportunity to submit its views to the ACCC's review of the Regulatory Test.

Your letter of 10 May 2002 inviting submissions notes the commitment of NECA and ACCC to review the current framework for essential new development. SPI PowerNet is strongly supportive of such review, however we submit that a review considering the Regulatory Test specifically should not proceed in isolation of the broader debate on the overall role of transmission in the NEM framework. Submissions to the COAG Energy Market Review identified the role of transmission as one of the major issues that needs to be addressed. Criticism levelled at the Regulatory Test is often also an indication of the level of confusion surrounding the overall transmission planning and investment processes and the role of the regulatory test within this framework. SPI PowerNet believes that many of the issues raised by the debate arise as a result of the current NEM design relating to transmission.

SPI PowerNet supports a role for transmission that includes a more competitive environment for the provision and augmentation of transmission services in the NEM. With this approach new transmission services would be integrated into the market, being initiated by TNSP's developing proposals for new transmission investment aimed at meeting the needs of participants and achieving their agreement to the proposal, including meeting the costs. This approach would introduce competition into the transmission planning function.

Revenues for resulting investment would be subject to contractual arrangements delivered by the competitive process and the Regulatory Test would not be applied. A role for centrally planned investment may still be required, but this should be limited to provision of a "last resort" function, and the Regulatory Test would take on much reduced prominence in the overall investment environment.

Whether the primary framework for transmission investment follows this more competitive approach, or remains primarily regulated as at present, SPI PowerNet considers that the present "market benefit" based component of the Regulatory Test should be retained. The test as currently applied is intended to capture the range of

SPI PowerNet Pty Ltd ABN 78 079 798 173
Level 17, 452 Flinders Street Melbourne Victoria 8007 Australia PO Box 222, Collins Street West, Melbourne Victoria 8007 Australia
Tel 61 3 8635 7333 Fax 61 3 8635 7334 www.spipowernet.com.au

benefits that flow from a proposed investment, and in our view provides the necessary consistency between proposed regulated solutions being assessed by a central planner, and investors considering alternative unregulated developments. However, we consider that a nationally consistent approach to the application of the Regulatory Test in totality is necessary. This should include development of consistent criteria to satisfy the technical requirement component of the test.

SPI PowerNet acknowledges the significant debate that is emerging regarding the need to capture competition benefits in the application of the regulatory test. In addressing this issue it is important to recognise that the "market benefit" test was specifically developed assuming an inherently competitive electricity market to ensure that benefits accruing to the supply side would ultimately be competed back to customers. The concern regarding this issue arises fundamentally because this assumption is not met.

The issue of market power was identified in submissions to the COAG Energy Market Review as one of the major NEM issues that needs to be addressed. In our view this issue needs to be addressed separately before any decisions are taken with respect to the inclusion of such benefits in the regulatory test, and it is not appropriate to modify the regulatory test as the primary mechanism for addressing the market power issue. We consider these broader concerns are best resolved through changes to ownership structures and/or market design. In any case there would not appear to be any evidence applicable to the NEM to allow the conclusion to be drawn that transmission investment will materially impact entrenched market power such that overall NEM efficiency improvements would be achieved.

However we acknowledge that even when this issue is addressed to the maximum extent practically possible there are likely to be circumstances where it will be appropriate to include the benefits achieved through additional competition in the assessment of the benefits of proposed new regulated transmission. SPI PowerNet would favour a pragmatic approach outside the market benefits analysis to incorporate these benefits, and ensure that they are treated in a transparent manner.

In addition to the above broad comment, SPI PowerNet has prepared detailed responses to the specific issues raised in the Issues Paper to assist your consideration. This document is attached.

In conclusion, SPI PowerNet supports the basic design of the Regulatory Test, but believes that addressing the inherent problems in the NEM is a first and necessary step to address many of the concerns levelled at the test. In particular, a review of the framework for the participation of transmission in the NEM is a priority issue that must be addressed to ensure that efficient levels of investment occur.

If you would like to discuss our views presented in this submission we would be pleased for you to contact myself (ph 03 86357336), or our Manager Strategic Development, Kelvin Gebert (ph 03 8635 7322).

Yours sincerely

[signed]

Charles Popple
Executive Manager Transmission Services

ACCC Issues Paper: Review of the Regulatory Test

14/06/02

SPI PowerNet Responses to ACCC Issues

Preamble

SPI PowerNet holds strongly to the view that network augmentation should by default be driven by TNSPs engaging with the market itself, with generators requiring access to achieve an improved competitive position, and with retailers seeking competitive advantage in offers to customers or to manage the impacts that are imposed by inadequate transmission capability. Developed in this way, the beneficiaries would pay directly for augmentation, and logically this would occur outside of economic regulation.

The National Electricity Code is accepting of market driven network augmentations, however the concept is not "embraced" within the NEM framework such that there is a vision for the co-existence of regulated (predominantly existing) transmission and competitively driven transmission investment. There is an urgent need for a broad review of the role of transmission and SPI PowerNet believes this should precede further review of aspects of the NEM design (such as the Regulatory Test) in isolation. In SPI PowerNet's view, many of the issues raised by the debate on the Regulatory Test in fact arise because of the current design relating to transmission, and the review therefore does not focus on the root cause of the problem.

In providing responses to the questions raised by the ACCC, we have also addressed what we believe to be the broader issues at hand. Where alternative structural arrangements for transmission may assist resolution of specific issues raised in the Issues Paper this is noted.

Answers to ACCC questions

1. Maximising net benefits

ACCC Question	SPI PowerNet Response
Is the current maximising market benefits test a hurdle that is too high?	SPI PowerNet supports market-based transmission solutions as the primary means for delivering network investment, with regulated augmentation providing a "last resort" function. Whether as a "last resort" function, or within the current NEM arrangements where regulated transmission is the default investment approach, the Regulatory Test should seek to replicate the result that would be delivered in a competitive environment. The alternative options included for assessment by the proponent and those identified during the consultation phase represent the competing options that would be tested within a market environment, and should

Responses to ACCC Issues (cont…)

ACCC Question	SPI PowerNet Response
	be inclusive of all such options that may be available. In SPI PowerNet's view only one option can be selected from the test, the option that maximises benefits. We understand that the Regulatory Test seeks to approve only the project delivering the greatest net benefit, which project may be a transmission project, demand side project, or generation project. Accordingly, the methodology for application of the test aims to make competitive neutrality a feature of the comparative assessment of options. The approach appears to protect against the approval of sub-optimal solutions and we support such an objective for the test.
Should the test simply refer to a nominated Net Present Value hurdle	In the market-based approach to planning and investment, it would not be logical for investors to commit to the project that does not maximise benefits. The regulated project delivered by the Regulatory Test should be treated with no less consideration to economic efficiency. Further, a sub-optimal regulated option should not be able to displace a more efficient option in the un-regulated sectors of the NEM. The present criteria of maximising market benefits should be retained.
If so, what should the nominated hurdle be?	The proposal should not be adopted.
If adopted, how should the industry/users be protected from inefficient investment options i.e. high cost/low benefit solutions?	The proposal should not be adopted. Industry and users would be well protected from inefficient solutions if investment decisions are driven by those parties. This form of industry response should be expected in a competitive market. The NEM should facilitate this. Adoption of sub-optimal approval criteria for new regulated projects will only create further obstacles to efficiency in the competitive market.
What other alternatives should be considered?	Investment driven by the market, and provided on a non-regulated basis, should be the principal means of network investment in the transmission sector. Regulated augmentation should be provided as a last resort only. As noted above, this approach would ensure that all alternative projects have the opportunity to be considered ahead of the regulated option. If an option that is more efficient than the

Responses to ACCC Issues (cont…)

ACCC Question	SPI PowerNet Response
	regulated option exists the NEM should provide participants with the opportunity to find it. As a last resort option, the Regulatory Test should not be so encumbered by comparative assessment and dispute. Alternatives will be less likely to be directly competing with the regulated proposal, having had prior opportunity for assessment. Integration of trading market and transport investments should precede changes to the Regulatory Test. The Regulatory Test would then include an objective assessment as to whether the market had failed, and a regulated solution was necessary.
Does the Regulatory Test need to differentiate between TNSPs and DNSPs?	The test for distribution networks should be consistent in principle, as the same economic objectives apply. However, the nature of distribution networks is such that the test would automatically be more pragmatically applied.
If so, should different approaches apply to each?	Refer response to previous question
Is the current test dealing with reliability driven augmentations appropriate?	The test dealing with reliability driven augmentation does not place sufficient accountability on the proponent. The reliability criteria need to be justified in their own right. Currently reliability investment is generally carried out using a central planning view of a reliability need, not a customer view, and with no consistency across the NEM. Use of consistent criteria is essential if this form of investment is to be argued as being representative of industry need. Some consideration will need to be given though to the difficulty in quantifying all of the reliability benefits, e.g. the need for maintenance windows to carry out essential work on transmission equipment. In some cases it is apparent that application of the market benefits test does not capture a number of these critical benefits.
Should reliability driven augmentations be required to follow a similar process to market driven augmentation?	SPI PowerNet supports the integration of benefits arising from reliability criteria and market benefit. Whilst the reliability criteria must be met, the approved option should then be the one whereby net benefits are maximised. Competitive neutrality should also be a feature. Reliability is a major concern of market participants. In SPI PowerNet's view the NEM should provide for both this investment objective and capacity investment to be met by market forces in the first instance, with regulated augmentation fulfilling the last resort concept.

Responses to ACCC Issues (cont…)

2. Competitive impacts of network investment

ACCC Question	SPI PowerNet Response
Should the test be altered to reflect greater competition in a region from the introduction of network investment?	Increased competition that delivers greater overall ESI efficiency is an objective of the NEM. Permitting the benefits of increased competition, which come via lower prices to consumers, appears on the surface to be a worthy principle. However, the issue of market power is a critical issue that demands review in its own right, and must be addressed at its root causes – structural and organisational issues. The market benefits test assumes a competitive market. If this is not the case the test will not alleviate such entrenched inefficiency. In our view the problem that must be addressed in that case is market power, not the Regulatory Test. In addition to regional market power issues, localised market power may also need to be addressed. SPI PowerNet considers that these could be addressed through market design improvements, but that they have a market impact significantly lower than in the case of exercise of regional market power.
If so, how should the benefits of greater competition be captured by the test?	When the fundamental issues relating to the market power have been addressed it is likely that there will be circumstances where additional competition will result in customer benefits, and these should legitimately be captured. However, we suggest that analysis based on prices delivered by the market rather than the underlying cost of production/service is very subjective, leading to volatility in the outcomes of the evaluation, and a consequent high level of disputation and disenchantment with the process (as was previously experienced under the “Customer benefits” test). Additionally, SPI PowerNet would have concern that an attempt to capture the benefits of competition could tend to under-estimate the capability of entrenched market power to create protective mechanisms to counter the potential competition benefits. A further issue that needs to be considered in evaluating the actual benefits of competition is the hedge contract situation prevailing in parallel with the observed spot market pricing. Overall SPI PowerNet cannot offer a detailed approach for consideration, however we conclude that in principle the benefits of competition should be assessed and weighted separate from the Regulatory Test, in a process that is transparent and pragmatic.

Responses to ACCC Issues (cont…)

ACCC Question	SPI PowerNet Response
	In an alternate market based network investment framework the benefits of competition would be factored into the decision making of the parties underwriting the investment, market participants, who are best able to identify and manage the risks associated with potential of competition benefits.
If a proposed network investment is marginal, should a competition test be included that allows the proposal to pass the test?	Consideration of competition benefits would be appropriate in the situation where the benefits are otherwise assessed to be marginal. As noted above, SPI PowerNet concludes that a pragmatic approach outside of the market benefits analysis would be preferable.
If so, what form should the competition test take?	Possibly the competition benefits could be incorporated via some scenario based assessment of average prices. Total reliance on pool price modelling would be inappropriate.
Should the benefits associated with additional capacity to meet peak demands in a region be included in the assessment of a new interconnector?	Yes, but the benefits should already be captured through the normal categories applied for benefits analysis, such as cost of energy at risk, reduced losses, and if the benefits of competition are included, lower prices.
If so, what form should this benefit take and should any limitations apply?	N/A
If a new interconnector results in lower prices in one of more regions (e.g. importing regions), should the benefits of lower prices be included in the test?	The inclusion of competition benefits for interconnectors is even more difficult to justify for interconnectors, as it implies significant market power in a region. In this case there would appear to be every reason to deal with the underlying reasons for the existence of market power. The inherent volatility in the outcomes of the assessment, in particular the subjectivity in modelling market behaviour in an environment where market power may be exercised, would make it difficult to draw clear conclusions of real benefits that are achievable.
Similarly, if a new interconnector results in higher prices in one or more regions (e.g. exporting regions), should the costs of the higher prices be	No, per above

Responses to ACCC Issues (cont…)

ACCC Question	SPI PowerNet Response
included in the test?	
How will taking into account competition benefits interact with who pays for the augmentation?	Customers should benefit in general from competition benefits. It would be expected that any competition benefits that can be identified via the Regulatory Test should identify the beneficiaries. Consistency with the beneficiary pays allocation of transmission charges should be sought.
Should the test ensure an alignment between the beneficiaries of the investment with those who pay for it?	Per above
If so, what approach should be adopted?	N/A
Should regulated and unregulated network alternatives be treated in the same way in terms of the benefits (or detriments) associated with them?	We assume that the question relates to the treatment of unregulated network alternatives as options in the comparative analysis for the regulated proposal. The treatment of the alternatives should be consistent in terms of the criteria by which benefits are identified.

3. Network and distributed resource code change package

ACCC Question	SPI PowerNet Response
Should the Regulatory Test be more prescriptive?	If regulated augmentation remains the primary model to deliver network investment it will be necessary for the test to retain a degree of flexibility, in particular it should not preclude the necessary scenario analysis to evaluate the range of alternative projects.
Should the test define which costs and benefits should be taken into account?	This approach would enhance consistency and thereby improve the process
Should the test include a glossary of definitions?	This would enhance consistency of interpretation and thereby improve the process.
Should a market test period, in which	We preface our response to this question by noting again our view that framework wherein

Responses to ACCC Issues (cont…)

ACCC Question	SPI PowerNet Response
unregulated alternatives to network investment are given a specified time to respond to constraints identified by the network, be introduced into the test?	NEM investment is driven by the market will deliver the most efficient outcomes. The answer accordingly varies depending on the market framework. In a market based planning and investment framework, where regulated investment fulfils the back-stop function and occurs under a "market fail" situation, then the market-driven process should be exhausted before reversion to the Regulatory Test to assess a regulated option. If the dominant regulated transmission planning and investment arrangements persist, then a period should also be provided, on the basis that the test aims to maximise the net benefits – which could be provided by the non-regulated option.
What special provision should be introduced for DNSPs to assist them and the market to ensure that the most appropriate investment is pursued?	As noted in response to an earlier question SPI PowerNet would expect a generally simpler assessment within the DNSP environment, based on a similar market benefits test.

4. Timing delays

ACCC Question	SPI PowerNet Response
Have the problems of time delays been sufficiently addressed in the network and distributed resources code change package?	SPI PowerNet supports the changes as a positive move to tackle the problem of time delays, in particular the notion that the proponent has the correct incentives and is best placed to manage the project approval process and timetable. However, some experience will be necessary to demonstrate the effectiveness of the package.
If not, how can the test be modified to overcome future delays while still ensuring that only appropriate investment proposals go forward?	In SPI PowerNet's view the time delays that have been experienced occur largely because the regulated transmission proposals are not directly agreed between the TNSP and market participants the proposals will serve. A competitive transmission augmentation framework would significantly reduce reliance on the Regulatory Test, avoiding the potential associated delays. The role of transmission in the NEM is one of the most pressing issues that must be addressed by NEM policy makers.

Responses to ACCC Issues (cont…)

5. Other issues for consideration

ACCC Question	SPI PowerNet Response
Should the Commission clarify its optimisation of network investment that has been assessed in accordance with in the Regulatory Test?	It would be appropriate for ACCC to clarify how it would apply its principles to new investment that has passed the test, in particular whether risk of benefits being realised lies with proponent or consumers. The issue of risk allocation is relevant to investment decisions in all NEM jurisdictions, however the particular circumstances in Victoria (where the network augmenter does not possess the network ownership balance sheet) specifically needs to be addressed. In clarifying optimisation objectives, it will hopefully also become clearer whether it is appropriate for the ACCC to perform the role of final adjudicator for regulatory approval under the Regulatory Test.
Should the test address the weighting of outcomes? If so, how can this be achieved?	The weighting of outcomes must be a judgement made by the proponent, relating to the specific case, to ensure that the necessarily representative scenarios properly address the complete population of alternatives. Generic weighting rules are unlikely to permit the flexibility necessary for case-by-case treatment.
Is the choice of discount rate, being the rate appropriate for the analysis of a private enterprise investment in the electricity sector, still appropriate?	The principle appears integral to competitive neutrality in assessment of alternatives.
Should there be specific requirements for competitive tendering that could form the basis of a safe harbour provision?	Competition in the provision of transmission services is a first step toward delivering competitive and market integrated transmission augmentation and on this basis is supported by SPI PowerNet. However, the question of competition within the planning process remains. Only a market led investment regime will provide truly competitively valued solutions.