

Brisbane Office

17 June 2002

Mr Michael Rawstron
General Manager
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Australian Competition and Consumer Commission
PO Box 1199
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Dear Mr Rawstron

Issues Paper – Review of the *regulatory test* undertaken by the Australian Competition and Consumer Commission (the Commission)

Stanwell Corporation Limited (SCL) welcomes the Review of the *regulatory test* (the test) and would like to take the opportunity to comment on the Issues Paper released 10 May 2002. We understand that this Paper follows the release of a joint statement by the Commission and the National Electricity Code Authority (NECA) announcing their commitment to review the current framework for essential new investment. The statement noted that the existing arrangements for the planning and approval of regulated network investment have been widely criticised. For its part, the Commission undertook to review the test to ensure that it does not result in a complex and lengthy process that delays the development of regulated investment.

As stated in our submission to the COAG Energy Market Review, SCL considers that the clear lack of transmission capacity (both within and between participating jurisdictions) is the number one issue facing the National Electricity Market (NEM). In other words, to ensure the efficient operation of the NEM, it is essential that existing network problem areas are rectified and the associated investment pass the regulatory test with ease. We were also particularly concerned to learn that, to date, most network augmentations have been approved under paragraph (a) of the test, which relates to complying with technical standards rather than maximising market benefits. As a result, correcting a number of fundamental problems with the test will assist in increasing the number of augmentations that pass the market benefits test (paragraph (b)). Our concerns with the test relate to its underlying economic principles as well as process issues. These include:

- the regulatory test and the revenue cap reset process ;
- timing delays; and
- the lack of consideration given to the competitive impacts of network investment.

Each of these issues will be discussed in turn.

The regulatory test and the revenue cap process

Following discussions with the Commission, we understand a Transmission Network Service Providers (TNSP's) application of the revenue test, for both small and large investments, is reviewed at each revenue cap reset period. SCL considers that such a process could discourage efficient network investment. Under such a regime TNSP's might be reluctant to undertake the test, particularly if a proposal is considered borderline, when their decisions could be questioned and the assets removed from their regulated asset base.

SCL appreciates it is difficult to develop a review process that, while reducing uncertainty, also minimises the resources employed by the TNSP and the Commission. However, we believe a change to the process is necessary and propose the following options:

- the Commission review each regulatory test decision prior to the commencement of the augmentation; or
- the Commission could guarantee a significant proportion (e.g. 80%) of the augmentation investment on finalisation of an investment decision made under the regulatory test.

Timing delays

Although SCL believes that the Network and distributed resources Code change package assists in reducing delays, there are still other areas of the test that could be modified to ensure decisions are delivered on a timely basis. In our COAG Energy Market Review submission, we stated that the execution of certain requirements of the current regulatory test often hinders the process. In particular, TNSPs are required to explore all alternative options before new assets are incorporated into their regulated asset base. This often results in wasted resources and time examining non-economic options. Further, as a generator we consider that such a process results in excessive delays, which can only discourage future generation investment. Consequently, SCL supports the suggestion of a time limit being placed on unregulated alternatives when responding to constraints identified by the network.

Competition and the regulatory test

The Paper states that when promulgating the test the Commission argued that it should use the principles associated with cost/benefit analyses. The implication for the test was that market prices would not be incorporated in any assessment of a potential interconnector, particularly where there is reason to believe that the prices are distorted by a market failure. The Paper further indicates that one of the concerns raised in the NEMMCO working group is that the test does not fully recognise competition benefits and that the test be modified to explicitly recognise these benefits.

SCL concurs with the NEMMCO working group view, especially in relation to proposals falling under the paragraph (b), (market benefits) of the test. In particular, we believe that neglecting to include competitive benefits could result in inefficient investment outcomes. While we accept the rationale behind excluding market prices from the test, we consider that there are alternative mechanisms to incorporate competitive benefits. The following

discussion outlines the reasoning behind our views and suggests an alternative method of incorporating competition into the test.

In relation to augmentation options other than those proposed in order to meet an objectively measurable service standard linked to the technical requirements of schedule 5.1 of the Code, Paragraph (b) of the regulatory test states that:

an augmentation satisfies this test if the augmentation maximises the net present value of the *market benefit*.

Market benefit means the total net benefits of the proposed augmentation to all those who produce, distribute and consume electricity in the NEM. That is, the increase in consumers' and producers' surplus or another measure that can be demonstrated to produce equivalent ranking of options in most (although not all) credible scenarios;

From the definition of market benefit, it is our understanding that the test can be applied by examining the changes in consumer surplus (CS) and producer surplus (PS). By taking a rather theoretical viewpoint and if the objective is to maximise the sum of CS and PS, it is not sufficient to measure the changes by simply shifting the supply and demand curves without considering any possible changes to the slope of the curves. For example currently a transmission augmentation would be modelled by shifting the supply curve to the right. However, the proposed augmentation could also result in increased competition among suppliers (both existing and new), which would be captured by rotating the supply curve to the right. Consequently, incorporating the level of competition into the analysis more closely reflects the true changes in CS and PS. In other words, we are concerned that under the current regime sound proposals run the risk of rejection based on incomplete analysis.

As previously mentioned, SCL appreciates that it is inappropriate to use market prices as a proxy for competition levels. Instead SCL proposes the use of a competition level index, which would overcome the problems associated with including market prices. Although SCL is still considering its views on how such a concept could be implemented, as a start we consider that the index should incorporate the following information:

- the number of consumers currently affected by the network limitation;
- the incremental electricity capacity supplied to the market following augmentation;
- the fuel mix of the incremental electrical capacity (indicating underlying cost structure);
and
- the number of independent entities supplying the market following augmentation.

SCL considers that the inclusion of a competition level index will assist in more network augmentations, both within and between regions, passing the test under paragraph (b).

SCL supports the work of the Commission in reviewing the current regulatory test to ensure that it encourages the development of essential new investment on a timely basis. SCL looks forward to providing further comments during the review process.

Yours sincerely

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