



**TransGrid**

---

ACCC review of the Regulatory Test

---

TransGrid Submission

*14 June 2002*



## Table of Contents

---

<i>Section</i>	<i>Page</i>
<b>1. Introduction</b> .....	<b>1</b>
<b>2. Clarification of possible ambiguities</b> .....	<b>1</b>
2.1 Scenarios .....	2
2.2 Reliability augmentations .....	2
2.2.1 <i>Relevant limb of Regulatory Test</i> .....	2
2.2.2 <i>Sensitivities</i> .....	3
2.3 Specific comments on ACCC Issues Paper .....	3
2.4 Glossary.....	5
<b>3 Improving the Regulatory Test</b> .....	<b>7</b>
3.1 Maximising net market benefits and scenarios .....	7
3.2 “Design freeze” .....	8
3.3 Competition benefits .....	8
3.4 “Market failure” test .....	11
3.5 Optimisation policy .....	12
<b>4 Clarification outside the Regulatory Test</b> .....	<b>12</b>
<b>5 Conclusion</b> .....	<b>13</b>

---

## 1. Introduction

TransGrid welcomes the Australian Competition and Consumer Commission’s (ACCC’s or Commission’s) commitment to review the “Regulatory Test for New Interconnectors and Network Augmentations” (Regulatory Test or Test) and appreciates the opportunity to make this submission to the Commission.

TransGrid is a strong supporter of the fundamental principles embodied in the Regulatory Test. TransGrid acknowledges that particularly in a market such as the NEM, where profit-maximising investors are operating alongside regulated transmission entities, it is crucial that decisions regarding regulated network investments are made on a rigorous basis with the aim of increasing the overall efficiency of the market. The intent of the Regulatory Test is clearly in line with this objective. For this reason, most of TransGrid’s comments on the current Regulatory Test are focussed on improving the clarity of the Test where it believes ambiguity exists. There are also a number of areas where TransGrid believes real improvements to the Test can be made, to increase the likelihood that its application will enhance economic efficiency and minimise disputation.

TransGrid also wishes to make some comments on the recent Network and Distributed Resources (NDR) Code changes. TransGrid is of the view that a better understanding of the NDR changes could improve the development of the Regulatory Test.

This submission is set out as follows:

- Clarification of possible ambiguities in the Regulatory Test (section 2);
  - Scenarios (section 2.1);
  - Reliability augmentations (section 2.2);
  - Specific comments on ACCC Issues Paper (section 2.3);
  - Glossary (section 2.4);
- Improving the Regulatory Test (section 3);
  - Maximising market benefits and weighting of scenarios (section 3.1);
  - “Design freeze” (section 3.2);
  - Competition benefits (section 3.3);
  - “Market failure” test (section 3.4);
  - Optimisation policy (section 3.5).
- Clarification of issues outside the Regulatory Test (section 4); and
- Conclusion (section 5).

## 2. Clarification of possible ambiguities

TransGrid is of the view that there are a number of parts of the Regulatory Test that could benefit from confirmation or clarification of meanings of terms and expressions. Following the NDR Code changes, clause 5.6.6(h), for example, allows parties to dispute virtually any aspect of application of the Regulatory Test to a proposed regulated large network asset. Our understanding is that in the worst case, such a dispute could take up to two years to resolve. The best way, within the scope of this review, to minimise the potential for such delays is to make sure that any sources of ambiguity are minimised.

---

## 2.1 Scenarios

There are two places in the Test where there is reference to ranking or assessing options “in most (although not all) credible scenarios” (see parts (a) and (e) following “For the purposes of the test”).

It is submitted that these clauses should read: “in most (although not *necessarily* all) credible scenarios.”

TransGrid has further, more substantial comments, on the construction of scenarios below in Section 3, Improving the Regulatory Test.

## 2.2 Reliability augmentations

### 2.2.1 Relevant limb of Regulatory Test

TransGrid believes that the interaction of the Code and the Test creates some ambiguity over the appropriate treatment of reliability-driven augmentations. In particular, TransGrid seeks to understand whether “necessary augmentations” and “reliability augmentations” mean the same thing.

Clause 5.6.2(c) of the Code refers to a “necessity for augmentation or a non-network alternative”. TransGrid is unsure whether this refers to:

- an augmentation (or non-network alternative) that is required to meet an objectively measurable service standard linked to Schedule 5.1 of the Code (assessable under limb (a) of the Test); or
- an augmentation or alternative that either is required to meet an objectively measurable service standard linked to Schedule 5.1 of the Code (assessable under limb (a) of the Test); or could lead to a maximisation of net market benefits (assessable under limb (b) of the Test).

Furthermore, are “reliability augmentations” (as defined in the Code Glossary) and “necessary” augmentations (as referred to in clause 5.6.2(c)) the same.

TransGrid would appreciate it if the Commission would make a comment in the revised Test that clarifies whether or not the net market benefit limb of the Test (limb (b)) can be applied to augmentations identified under clause 5.6.2(c) of the Code and whether the status of a proposed augmentation as “reliability” or not has any bearing on whether limb(a) or limb(b) should be used.

TransGrid would also appreciate the Commission making a similar clarifying comment on regulated projects still being considered under the grandfathered provisions of the Code prior to the recent NDR changes. Under the previous Code provisions, clause 5.6.2(g) referred to all NSPs – not just DNSPs, as it does now. Clause 5.6.2(g) required all NSPs to conduct cost effectiveness analysis over augmentation options identified in the annual planning review. This suggests that under the previous Code provisions, “necessary augmentations” identified under clause 5.6.2(c) must be assessed under the reliability limb of the Test (limb (a)).

### **2.2.2 Sensitivities**

TransGrid believes that it is inappropriate to require sensitivity analysis in relation to the timing of certain augmentations, where the commissioning date is determined by the need to meet an objectively measurable service standard.

Therefore, part (d) of the Test should be amended to confirm that sensitivity of commissioning dates should only be required for augmentations where the commissioning date is not determined by a technical requirement.

### **2.3 Specific comments on ACCC Issues Paper**

TransGrid wishes to respond to some issues raised by the ACCC in its Issues Paper on the Review of the Regulatory Test (Issues Paper). However, two of the issues raised in the Issues Paper – clarification of the Commission's optimisation policy and the weighting of outcomes – are discussed in Section 3, Improving the Regulatory Test.

#### Correct application of the Regulatory Test

The Commission notes in the first paragraph of page 5 of the Issues Paper that there have been some concerns expressed about how the Regulatory Test is being applied and whether more oversight or transparency is required.

TransGrid submits that the Regulatory Test and the NDR Code changes import a great deal of oversight and transparency on NSPs considering augmentations to their networks. The Code now provides, even more than previously, for extensive opportunities for interested parties to be consulted and to dispute NSPs' assumptions and reports regarding proposed network augmentations.

#### Disputes

Following the NDR Code changes there is potential for ambiguities in the Code and the Regulatory Test to create lengthy delays for the assessment of regulated projects. Interested parties have 30 business days to exercise their right to dispute any aspect of a large new network asset application. Interested parties may then request a meeting with the applicant. Following the meeting, the applicant must submit a final report to NEMMCO, which interested parties may again dispute. This triggers the Code's lengthy dispute resolution process, culminating in a determination by the Dispute Resolution Advisor and possibly a reapplication of the Regulatory test by the applicant. The outcome may be disputed a second time by (possibly different) interested parties, leading to the second dispute being taken to the ACCC for a second or possibly third application of the Regulatory Test. Therefore, it is important that interpretation difficulties with the Regulatory Test not contribute to the risks of lengthy disputes.

#### Inappropriate use of reliability limb of the Regulatory Test

There is a suggestion in the second paragraph of page 5 of the Issues Paper that TNSPs may be inappropriately labelling regulated proposals as reliability augmentations when they shouldn't be, based on the observation that the majority of augmentations to date have been reliability augmentations.

The high proportion of so called reliability augmentations simply reflects the fact that load growth eventually results in reliability or other technical standards being breached. In geographically diverse networks, these situations occur in many separate locations. Hence numerous augmentations can be required to ensure these standards are maintained throughout the network. To date, TransGrid has taken the view that Clause 5.6.2(c) of the Code makes it obligatory to establish a “need” for an intra regional augmentation. Therefore all such proposals will include a needs statement.

Any changes to the test must ensure that accountability for delivering transmission reliability remains linked to the ability of the accountable party to invest and plan to ensure ongoing transmission reliability. To do otherwise would be poor public policy.

#### Level of TNSPs’ forecast capital expenditure

There is a comment in section (ii), first paragraph, on page 5 that the level of TNSPs forecast capital expenditure is some indicator of whether or not the Regulatory Test impedes or streamlines the process for assessing regulated network investment. This is an invalid conclusion – the absolute level of investment taking place, without such context as load growth and location or level and location of supply-side investment, says little about the merits or flaws of the Regulatory Test. Indeed, the potential for problems with the Code procedures for the development of networks and the Regulatory Test to delay or block this expenditure is one of the primary drivers for TransGrid’s submission.

#### Benefits of interconnector

The Issues Paper asks (page 9) whether the benefits associated with additional capacity to meet peak demands in a region be included in the assessment of a new interconnector.

It is TransGrid’s view that the benefits of deferring new capacity are already assessed as a benefit attributable to a network augmentation. Note (5), in particular, states that market development scenarios should include developments undertaken to ensure that relevant reliability standards are met. Further, Notes (1)(b), (5), (6) and (8) require that the assessment of an option in light of the other developments that are expected to take place in the market. This would include developments expected to take place in response to peak demands. Therefore, to the extent that an option leads to the deferral or avoidance of such developments, that benefit should (continue to) be included in the Regulatory Test calculations.

If the Commission believes that such benefits should not be included in assessing a network augmentation, TransGrid would seek to understand the Commission’s reasoning and be given an opportunity to comment before a decision to implement this change is made.

#### Competitive tendering

TransGrid does not understand the Commission’s question regarding specific requirements for competitive tendering that could form the basis of some form of Safe Harbour provisions.

Competitive tendering of supply of equipment and, in most cases, construction of network assets is already standard practice, so any safe harbour provisions based on this principle would already apply to all of TransGrid’s projects.

If the ACCC is referring to obtaining cost estimates via a competitive tendering process, the following should be considered:

- There is an overhead in preparing, publishing and advertising tender documents.

- Suppliers quickly tire of responding to projects that do not eventuate. They too have limited resources and, unless they consider the project to have a good chance of proceeding, they will either not respond or give limited information. In this case the information provided may be simply “budget estimates” which are qualified by numerous caveats.
- There are many methods for developing cost estimates (of which competitive tendering is one). Depending on the circumstances, any one of these can be the most appropriate. For example, using costs from a recent project or a current period order would be simpler, quicker and most probably more accurate than calling competitive tenders. TransGrid does not believe it is appropriate for the Regulatory Test to favour one method of cost estimation over another.

The process of tendering for equipment and services is a matter for the proponent and has nothing to do with the Regulatory Test.

In addition, TransGrid asks whether the Commission is suggesting that entire solutions to forecast constraints or meeting a network performance standard should be competitively tendered out to the market for a lowest cost solution, as TransGrid understands occurs in Victoria. If the Test were to be changed to require this, TransGrid would also ask whether such tendering would insulate the project from subsequent regulatory optimisation. This question must be answered satisfactorily before the Test could reasonably be changed.

Further, if this is the correct interpretation of the Commission’s position, TransGrid believes that such broad competitive tendering of asset ownership and operation would lead to fragmentation of networks, interface issues, and accountability disconnects, to name but a few problems. Therefore, TransGrid is unsure whether such a form of competitive tendering would achieve anything meaningful. In any case, if this were pursued, TransGrid would argue that it should be a matter for the NEM jurisdictions, rather than the ACCC, to resolve the appropriate future role and governance of networks in the NEM.

## **2.4 Glossary**

As a general comment, TransGrid would recommend the insertion of a glossary in the Regulatory Test, as proposed in the Issues Paper. Some of the terms that could benefit from a precise definition are discussed below.

### Augmentation

The Test defines “augmentation” as a proposal in accordance with the (pre-NDR) Code clause 5.6.2.

### Augmentation option

The Test defines “augmentation option” as a proposal in accordance with the (pre-NDR) Code clause 5.6.5. (The current clause 5.6.5 refers to augmentations identified as part of the IRPC’s annual Interconnector review.)

### Proposed interconnector

The Test defines “proposed interconnector” as a proposal in accordance with the (pre-NDR) Code clause 5.6.6.



---

### Proposed augmentation

The Test defines “proposed augmentation” as any of the above.

However, the above definitions are inappropriate following the NDR Code changes, except that “proposed solution” could perhaps be used to cover any proposal under clauses 5.6.6 and 5.6.6A.

TransGrid notes that the definition of “augmentation” in the Code is defined as “works to enlarge a network or increase the capacity of a network to transmit active energy”. This would lead to the strict legalistic conclusion that, for example, certain energy efficiency DSM schemes may not be augmentations and therefore may not be proposed as new network assets (because these must be augmentations). Clearly this is not the intention of the NDR changes. Definitional problems such as these in the Code and the Regulatory Test could prevent TNSPs from assessing embedded generation or DSM solutions to constraint or reliability problems under the Regulatory Test, even though, presumably, the intention behind the NDR Code changes is that TNSPs could implement and receive regulated funding for such proposals if they turned out to be more net beneficial than a network option.

Although the key definitional problems are contained in the Code, to maintain neutrality between network and non-network alternatives, it would be desirable to replace the term “proposed augmentation” in the Test with something like “proposed solution” to indicate that the Test could apply to any option to deal with a constraint or reliability problem.

### Project

The term “Project” is currently used in two contexts:

1. As an “option” for addressing a potential constraint or reliability problem – for example, twice in the body of the Test, as well as in Notes (1)(c) (construction dates), (3), (5) (in relation to alternative project commissioning dates) and (7)(c).
2. As a “development” in the setting up of market development scenarios – for example, wherever committed, anticipated or modelled projects are discussed, such as Notes (1)(b)(iii), (iv) and (vi), (5) (in relation to reliability projects), (5)(a), (b)(c) and (d), (6) and (8)(a).

It is suggested that “project” be eliminated from the Test and replaced with “option” or “development” as appropriate.

### Start of Construction

It is unclear whether this term refers to project “commitment”, start of a significant activity such as an EIS, or start of physical construction. TransGrid believes that this should refer to the commitment of any significant quantity of resources by the proponent, rather than merely investigating the project. Perhaps an alternative expression could be “start of work”.

### Committed and Anticipated

These terms are crucial under the Regulatory Test as they affect the environment in which regulated proposals are assessed. TransGrid supports the proposal that for an MNSP project to be regarded as “committed”, the proponent should be required to lodge some form of non-refundable bond (say 5% of expected project costs) unless it has reached some irreversible stage of development, such that it can unambiguously be said that it would be more economic for the project to be completed than left incomplete. TransGrid understands

the ACCC's concern that if an MNSP is to be required to lodge some form of bond, all projects that are on the committed list should be required to do the same. TransGrid agrees that there is little basis for distinguishing between say, generator, and MNSP projects in this respect and would support a universal bond requirement where a project has not moved to an irreversible stage.

"Anticipated" projects should also be required to lodge some form of deposit if they wish to be regarded as "anticipated". However, this bond should be smaller than required for committed projects, perhaps 1% of expected project costs.

Bonds should be forfeited if the project is not commissioned within 12 months of the nominated date of commissioning.

Of course, there should be no requirement for any sort of bond if the proponent does not wish to be on the "committed" or "anticipated" projects list. A prudent proponent of a regulated augmentation may nevertheless consider, at its own discretion, planned projects as committed or anticipated in any case, even without formal recognition of these projects, if it believed that these projects would actually go ahead, in order to minimise its risk of optimisation. Therefore, the purpose and even the effect of a bond would not be to create a barrier to entry for unregulated projects, but to reduce the risk of gaming of the Regulatory Test by vested interests.

### Interconnector

The term "interconnector" can be dropped from the Test altogether because the NDR Code changes dispense with this term for augmentation proposals. Curiously, the NDR changes refer to an "Annual Interconnector Review", but this is only for the purposes of identifying future constraints on power transfers between regions and identifies options – both network and non-network – for alleviating these constraints. If a proponent comes up with a proposal based on an opportunity identified in the interconnector review, it is not called an "interconnector", but a new network asset that is, presumably, likely to have a material inter-network impact.

## **3 Improving the Regulatory Test**

### **3.1 Maximising net market benefits and scenarios**

As stated in Section 1 above, TransGrid supports the fundamental principles embodied in the Regulatory Test, including the focus on maximising net market benefits or minimising costs, depending on the driver for the proposal.

However, the NDR Code changes now define separate Regulatory Test processes for large and small new network assets. This means that the Regulatory Test, or at least its principles, must be applied to assets worth as little as \$1 million. This is roughly the cost of one 330 kV circuit breaker. The threshold for a large network asset is \$10 million, roughly the cost of two large power transformers, and is considered too low a threshold.

In this context, TransGrid believes that it would be helpful to those who apply the Test to be given some guidance on what constitutes a reasonable application of the requirement for market development scenarios in different circumstances. In particular, the requirement for considering market-driven expansion market development scenarios requires pool modelling based on non-competitive (ie. in general, above short run marginal cost) bidding (unlike the least-cost expansion market development scenario which is based on marginal cost bidding), which in turn depends on a number of assumptions that are potentially open to dispute.

---

TransGrid suggests that the regulatory test should include guidelines for the degree of sophistication that is required in applying the test in different circumstances, such as different:

- Size and importance of options between, and within, the large and small network asset categories.
- Types of options.
- Locations of options.

This provides an opportunity for the Commission to provide some basic guidance on the number of alternative projects and scenarios for large and small assets. TransGrid understands that the Commission would prefer to keep these requirements as flexible as possible, so that different circumstances can be dealt with appropriately. However, without any guidance, the process for applying the test may become unnecessarily long and complex as NSPs strive to avoid leaving out any possible options or scenarios that could lead to disputes and delays.

### **3.2 “Design freeze”**

From TransGrid’s perspective, one key problem with the application of the Regulatory Test to date has been a need to re-work assumptions and modelling due to continual changes to data and alternative options. TransGrid believes that the Test should include a cut-off (“design freeze”) principle beyond which it would not be reasonable to change data or alternative options. This would be relevant to the discussion of sensitivities (Part (d) of the Test), alternative options (several places in Test) and developments identified in the consultation process as being part of market development scenarios (Note (5)(d)). The lack of such a design freeze could render the Test unworkable by allowing third parties to delay a decision by constantly releasing information prior to a critical period in a regulated project decision.

### **3.3 Competition benefits**

TransGrid argued in its submission on the original Regulatory Test that competition benefits should be taken into account in assessing proposed regulated interconnectors. Increased competition can reduce prices and assuming a demand curve for electricity that is not completely inelastic, would lead to increases in the sum of consumer and producer surplus. TransGrid does not argue for competition to be considered as a previously unallowed benefit in assessing a proposed solution, but as a means of more accurately calculating a higher market benefit.

TransGrid also believes that the opportunity for incorporating demonstrable dynamic efficiency and general equilibrium benefits arising from enhanced energy market competition should be provided by the regulatory test in some form. At this stage, the ACCC could simply put the onus on the proponent of the project to quantify these benefits but could reserve for itself the right to ultimately allow or disallow inclusion of these benefits on a case by case basis.

A problem with the current Regulatory Test is that it assumes that the market is already competitive – that participants supply at marginal cost – and hence that greater competition will only affect the distribution of surpluses rather than the size of the overall surplus. For example, Note (1)(b)(iii) refers to “the efficient operating costs of competitively supplying energy to meet forecast demand...” This is reasonable from a modelling perspective, because attempting to model the bidding patterns of participants with some degree of market power can be a highly complex and difficult exercise. Moreover, the market benefit as measured by the Regulatory Test is indifferent as between gains to producers and gains

to consumers. The object of competition analysis should not be to increase consumer surplus at the expense of producer surplus, but to measure the impact on prices, demand and surpluses of increased competition. This analysis should also allow scope to include demonstrable dynamic efficiency and general equilibrium benefits.

The theoretical purpose of competition analysis can be explained in Figure 1 below.

**Figure 1: Net market benefit**

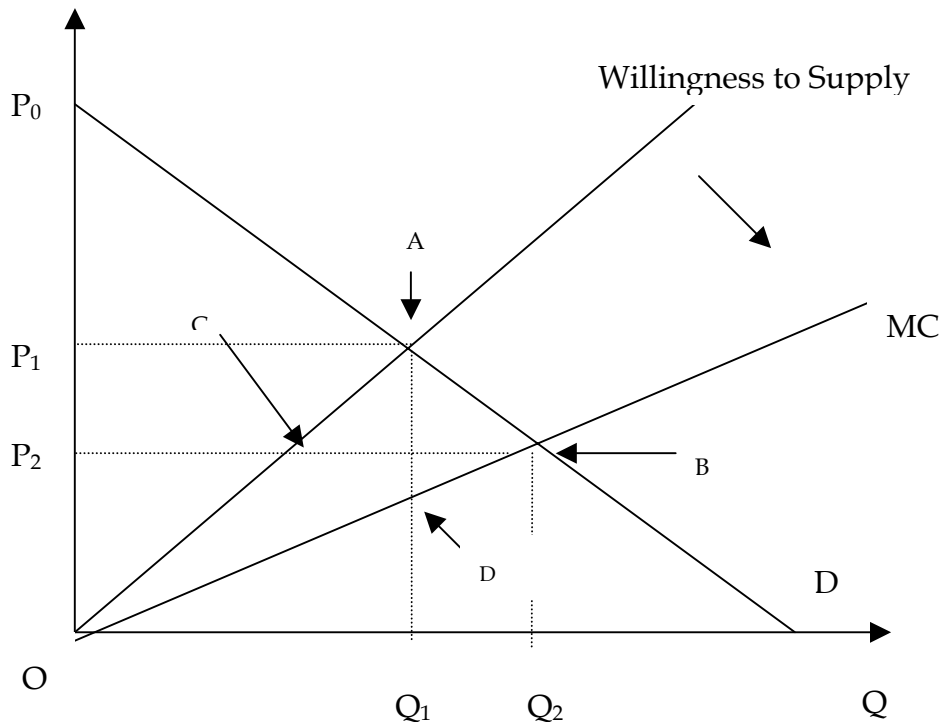


Figure 1 shows a market with a demand curve of  $D$  (clearly responsive to price) and a willingness to supply (WTS) curve that is higher than the marginal cost of the industry (assume fixed costs are nil). The WTS curve is higher than marginal cost because of the presence of market power on the supply side of the market. An increase in competition could have the effect of rotating the WTS curve clockwise so that it moves closer to, or coincides with, the MC curve for the industry. This would increase the sum of consumer and producer surplus. Initially, consumer surplus is  $P_0A P_1$  and producer surplus is  $P_1ADO$ . The sum of market benefit is  $P_0ADO$ . After the increase in competition, price falls, demand expands and consumer surplus becomes  $P_0B P_2$ , while producer surplus becomes  $P_2BO$ . The sum of consumer and producer surplus becomes  $P_0BO$ , which is unambiguously larger than  $P_0ADO$  (by  $ABD$ ).

The problem is to work out a reliable way of determining the WTS curve and the extent to which it rotates due to increased competition caused by an interconnector vis-à-vis the extent to which it rotates due to the development of an alternative unregulated project (which would presumably have *some* effect on competition). At the least, it could reasonably be said that, other things being equal, a regulated interconnector would be likely to increase competition in an area by more than an equivalently sized unregulated option. This is because a regulated interconnector effectively bids at a zero marginal cost at all times and thereby provides a free-flowing link to a number of other participants, whereas an

unregulated option typically only adds one more participant to the level of competition in the relevant region. For example, a 200 MW regulated link from a low-price region to a high-price region would be expected to have a greater effect on competition than a 200 MW new generator in the high-price region. The ability of the unregulated options (whether it be generation, demand side management or market network services) to restrict output to maintain prices means that the equilibrium price is likely to be higher than if a regulated interconnector were to be introduced into the market. This implies that, *estimated* net market benefit being equal, the Regulatory Test should, *prima facie*, favour a regulated augmentation over an unregulated project of the same capacity, due to the likely larger *actual* net market benefit that would ultimately flow from the regulated option. A proponent of an unregulated option could perhaps be able to refute this *prima facie* presumption by disclosing a binding physical agreement to run at full capacity, although this should be subject to a reasonableness test whereby the parties to the agreement should not have a mutually beneficial interest to subsequently break the agreement, and thus deprive the market of the benefits which would have been realised from an alternative regulated option.

Given that it would only be by coincidence that the estimated net market benefits of a regulated project and an unregulated alternative were equal, the next question to ask is whether competition benefits can be taken into account for a proposed regulated interconnector over an unregulated alternative that has higher measured net market benefits. This would require modelling of forecast market outcomes in the presence of market power, which could arguably introduce scope for arbitrary assumptions and dispute – the problems that the existing Regulatory Test seeks to avoid. However, in light of the NDR Code changes, with all their associated consultation periods and provision for the ACCC as final arbiter, it would seem reasonable to allow regulated project proponents to include competition benefits if such benefits would be pivotal in the assessment. The key point to note, once again, is that the proponent will be accountable for the decision to invest, through the optimisation/regulatory reset process.

An example of how competition benefits could be derived is as follows:

- NPV of net market benefit of regulated augmentation = \$100 million
- NPV of net market benefit of unregulated generation alternative = \$105 million
- Forecast actual market price without any change = \$40/MWh
- Forecast actual market price with regulated augmentation = \$36/MWh
- Forecast actual market price with unregulated generation = \$38/MWh
- Long run elasticity of demand = -0.5
- Forecast regional demand without any augmentation = 17,520 GWh pa (2000 MW per hour)
- Demand with regulated augmentation = 18,396 GWh pa
- Demand with unregulated generation = 17,958 GWh pa
- Marginal cost of supply at 17,520 GWh pa = \$32/MWh
- Marginal cost of supply at 17,958 GWh pa = \$34/MWh
- Marginal cost of supply at 18,396 GWh pa = \$36/MWh (ie no market power)
- Increase in net market benefit due to regulated augmentation = \$4/MWh \* 0.5 \* 438 GWh = \$876,000 pa
- NPV of increase in net market benefit @ 10% over 20 years = \$7,457,882

In this example the competition benefits attributable to the regulated option are enough to make the regulated augmentation the most net beneficial option.

As can be seen from the data used, there are a number of assumptions required to generate an estimation of the net market benefits from increased competition. In particular, the impact of various investments on market outcomes could be the subject of considerable conjecture. This may require sophisticated game-theoretic modelling of the NEM. However, this type of modelling is already required to develop the market-driven market development scenarios in the Regulatory Test (see Notes (5) and (6)).

Further, as discussed above, in light of the onus on the proponent to assess a regulated project, it would appear reasonable to allow the proponent to explore the competition benefits of proposed investments. The evaluation would, under the NDR process, be open to public consultation and ultimately, ACCC adjudication. This also provides an appropriate process for inclusion of demonstrable dynamic efficiency and general equilibrium benefits.

Therefore, TransGrid recommends that the ACCC amend the Test to allow the proponent to include, in the measurement of net market benefit, a reasonable estimate of the increase in net market benefit that could be expected to flow from an increase in the competitiveness of the NEM, due to the proposed augmentation, as against an alternative option. This requires a counterfactual or incremental analysis to be undertaken – competitive benefits are only relevant in so far as they lead to a *greater increase* in net market benefit than the alternative options.

TransGrid further recommends that the test allow for the inclusion of demonstrable dynamic efficiency and general equilibrium benefits by the proponent. The ACCC would have the right to allow or disregard these benefits based on the merits of each case.

In addition, there is no reason why regulated augmentations that pass the Regulatory Test on the basis of competition benefits should be treated any differently from a funding perspective from regulated augmentations that satisfy the test without taking into account competition benefits. In all cases, TransGrid has argued on numerous occasions that the beneficiary pays proposal for funding regulated network options is highly problematic and would lead to serious delays in the development of regulated augmentations.

As already noted, a more comprehensive way to take account of the competition benefits of network options would be to include the general equilibrium (or indirect) benefits of lower electricity prices. This, together with dynamic efficiency benefits, is presently expressly excluded from the Regulatory Test and TransGrid appreciates the complexities of considering relative general equilibrium effects from different electricity projects. While consideration of general equilibrium effects would run counter to standard cost-benefit analysis on which the Regulatory Test is based, these benefits should nevertheless be allowed where the ACCC is satisfied with the rigour of the underlying quantifying analysis provided by the proponent. This would also be consistent with the approach taken to measure the benefits of electricity market reform by the architects of that reform.

### 3.4 “Market failure” test

In the development of the current Regulatory Test, the Commission considered the inclusion of an explicit “market failure” criterion for regulated augmentations. Ultimately, the Commission developed Note (7) to the Test, which states that:

- (a) a *proposed augmentation* must not be determined to satisfy this test more than 12 months before the *start of construction* date;
- (b) a *proposed augmentation* will cease to satisfy this test if it has not commenced operation by 12 months after the *commissioning* date unless there has been a delay clearly due to unforeseen circumstances;

- (c) unless there are exceptional circumstances, *new interconnectors* must not be determined to satisfy this test if *start of construction* is within 18 months of the project's need being first identified in a network's annual planning review or NEMMCO's statement of opportunities (or in some similar published document in the period prior to 13 December 1998).

This effectively means that:

- There must be at least a 6 month period between publication of the need for regulated project and the application of the Regulatory Test in relation to that project; and
- The Test cannot be applied more than 12 months from the proposed start of construction date.

However, TransGrid notes that in the past, the market has been informed of impending constraints in Annual Planning Statements. Following the recent Code changes, there is now a requirement to publish Annual Planning Reports with details of constraints expected in one, three and five years (clause 5.6.2A(3)). This suggests that the limitation on application of the Test within 12 months of the start of construction date is redundant and should be removed.

### 3.5 Optimisation policy

TransGrid strongly supports the ACCC articulating its policy on optimisation of network investment that has been assessed in accordance with the Regulatory Test, as set out in the Issues Paper. The Commission's approach to optimisation is absolutely crucial to the way in which NSPs and other parties will approach the assessment of new network augmentations and the incentives that the Regulatory Test and the NDR Code changes create.

TransGrid can only urge the Commission to address this issue as a matter of urgency.

## 4 Clarification outside the Regulatory Test

TransGrid understands that the present consultation process is not an ideal opportunity to raise concerns about deficiencies in the Code. However, we have already suggested that ambiguities or shortcomings in the Code following the NDR Code changes could create serious disputes or problems for regulated network projects. We have suggested that aspects of the Test (as discussed in section 2) should be clarified to the extent possible to avoid these problems.

One area where clarification of the Test may not be able to help address an uncertainty for regulated projects is regulated funding for demand side management (DSM) projects, where these are found to be the best option. For example, clause 5.6.2(m) of the Code refers to including the cost of a generation option in a TNSP's prices in accordance with chapter 6 of the Code. However, there is no mention of DSM.

TransGrid understands that as a condition of its authorisation of the NDR Code changes, the Commission has required NECA to review the Code to ensure symmetry of network and non-network options in relation to, *inter alia*, cost recovery through regulated revenues. However, in the meanwhile, uncertainty as to the regulatory treatment of DSM-related expenditure by TNSPs exists and has the potential to undermine the practical consideration of such alternatives.

---

TransGrid suggests that the ACCC includes a comment in its Final Statement of Regulatory Principles to the effect that TNSPs' appropriate expenditures on DSM options will be recoverable through regulated charges. Indeed, it would be helpful for the Commission to flag this approach in its revised Test.

## **5 Conclusion**

In general, the Test reflects a sound ideological framework. TransGrid seeks clarification and guidance on a range of matters relating to practical application of the Test with a focus on minimising the risk of disputes and delays that may be caused by ambiguities in the Test and the Code and apparent conflicts between them.