



Our ref: D04/6885

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Mr Sebastian Roberts
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Regulatory Affairs, Electricity
Australian Competition and Consumer Commission

By email c/-: electricity.group@accc.gov.au

Dear Sebastian

ACCC's review of the regulatory test

Transend would like to thank the ACCC for the opportunity to provide comment on its *Draft Decision: Review of the Regulatory Test for network augmentations*.

While Transend is presently operating under the Tasmanian Electricity Code (TEC) and regulations, which adopt a slightly different regulatory test, the ACCC's test will become applicable to Transend when Tasmania joins the National Electricity Market (NEM).

Reliability standards are yet to be established by the Tasmanian jurisdiction or by the Inter-regional Planning Committee (IRPC). This places Tasmania in the unique position of having to justify all augmentations to its network using the market benefits arm of the Regulatory Test. In anticipation of reliability criteria being finalised for Tasmania in the future, Transend has extended its comments to issues associated with both arms of the regulatory test. Comments are also provided which illustrate problems with using the market benefits arm of the test to justify all augmentations.

Transend's submission follows the structure of the ACCC's Draft Decision and is set out as follows:

- Comments on Option 1: Minor Amendments
- Comments on Option 2: Definitional Changes
- Comments on Option 3: Competition Benefits
- Comments on other issues related to the regulatory test.

Comments on Option 1: Minor Amendments

Replacement versus augmentation

Page 18 of the ACCC's draft decision states that:

“... the regulatory test is only required to be applied to network augmentations, not to replacement or refurbishment projects. In instances where an asset replacement or refurbishment simultaneously augments the network the Commission believes that the Code is clear and requires that the regulatory test must be applied to that part which augments the network.”

Transend considers that the ACCC must consider materiality in making the distinction between a replacement and an augmentation project, and whether the regulatory test needs to be applied to “that part which augments the network”. Given the long life of transmission assets and advances in technology, it is often impossible to replace an asset without some form of minor augmentation.

As Transend indicated in its earlier submission to the ACCC, the replacement and refurbishment of assets may even result in the capacity of the network being incidentally increased without there being any requirement to do so. This is because in replacing an existing asset the “modern equivalent” may deliver enhanced services as a result of the following:

- technology developments
- electricity industry practice may dictate the use of higher capacity plant (for example, to ensure compatibility with similar plant in a network), and/or
- additional capacity may available at small or negligible cost (for example the addition of cooling fans on transformers). (*page 10, Transend submission, April 2003*).

TNSPs should therefore be required to make assessments as to the materiality of any augmentation, relative to the project cost as a whole. Where the additional cost is not considered to be material (in terms of the overall project) it should not be subject to the Regulatory Test process.

Transend accepts where a TNSP decides not to apply the regulatory test, it bears the risk that the ACCC may optimise a portion of the investment. The onus will be on the TNSP to justify that sufficient analysis was undertaken and that their investment decision was prudent.

New small and new large network assets threshold

Transend notes that the issue of redefining thresholds for “small” and “large” network assets has been deferred. Transend reiterates that the present thresholds are too low and should be reconsidered.

Option 2: Definitional Changes

Transend supports the clarification made by the ACCC with respect to definitions of reliability and other augmentations.

Transend considers that further ambiguity would be removed if the ACCC made it clear that for *alternative projects*:

- where this project has no proponent
- and is ranked most highly in the regulatory test assessment
- and a TNSP makes reasonable endeavours to locate a proponent
- but no proponent is forthcoming within a reasonable timeframe
- subject to no proponent being found in accordance with the process above, the next highest ranked project shall be deemed to satisfy the regulatory test .

While this is the logical assessment of how such a situation would proceed, clarification would remove any ambiguity.

Discount rate

Transend does not consider that introduction of a formula for calculation of the discount rate is helpful. Transend considers that use of a discount rate based on regulatory WACCs, with sensitivity analysis around the chosen rate, provides sufficient rigour to this aspect of the regulatory test.

VoLL

Transend strongly supports the ACCC's move to recommend measures other than VoLL to assess market benefit. Transend notes that the ACCC has used the term "VCR" as an alternative measure. VCR is a specific measurement technique used by VenCorp in Victoria. There may be other measures of the cost of supply reliability that are more appropriate to a particular situation. Transend therefore suggests that the term "VCR" be replaced with "cost of supply reliability", as follows:

In determining the market benefit, the following information should be considered:

...

b) reasonable forecasts of:

- a. the value of energy to electricity consumers, as reflected in either the cost of supply reliability and/or VoLL...

Market development scenarios and sensitivity analysis

In assessing sensitivity analysis for market benefits, the ACCC proposes

- ii. Using all reasonable methodologies, including levels of customer reliability ie VoLL and VCR

In line with the comments made by Transend above, this reference to VCR should be amended to "cost of supply reliability measures". Further, given that there may be a number of reasonable methodologies for calculating market benefits, the requirement for sensitivity analysis to be undertaken on all may prove cumbersome. Transend

suggests that the ACCC remove the requirement for “all” to be subject to sensitivity analysis.

The final sentence of the proposed amendment (page 41) states:

The sensitivity testing should always ensure that the relevant reliability standards are met.

Sensitivity testing *per se* cannot ensure that reliability standards are met. Presumably the intention of this sentence is to ensure that, where sensitivity testing for a particular alternative project indicates that reliability standards will not be met, this outcome is likely to remove the alternative from contention. If this is not the ACCC’s intention, then further clarification is required.

Option 3: Competition Benefits

The issue of “competition benefits” is complex, and Transend agrees that there are widely differing interpretations of what this term means. Given that the MCE has asked the ACCC to specifically address this issue, Transend considers it appropriate for the MCE to provide further guidance as to its definition of competition benefits, and whether it concurs with the ACCC’s interpretation.

Having resolved exactly what constitutes competition benefits from a policy perspective, more thought can be directed to measurement.

Transend suspects that the approach proposed by the ACCC for measuring competition benefits may be difficult to implement. Further, with respect to the amendment proposed by the ACCC (page 53), Transend notes that the ACCC seeks to measure the costs and benefits of:

- the “augmented network” with bidding which accurately and fully reflects any market power in the augmented network.

A TNSP will only be able to provide a reasonable assessment of the likely market power in the augmented network, based on information available at the time the regulatory test is undertaken. The clause should be amended to reflect this.

Other issues

Other issues: Drafting

Some of the proposed amendments would benefit from improved drafting. For example on page 32 of the Draft Decision, Transend suggests the following deletions and additions:

... the Commission proposes to amend the definition of market benefits in the regulatory test as outlined below:

~~... In determining the *market benefits*, the analysis may include, but not be limited to, the following *market benefit*:~~

- (1) In determining the market benefit, the analysis may include, but not be limited to, the following market benefits:
 - (a) benefits of savings...

Other issues: The regulatory test and regulated revenue

On page 13 of the Draft Decision there is a discussion of the role of the regulatory test in determining the prudence of completed projects.

Transend has prepared a submission in response to the ACCC's paper on the capital investment framework, which includes discussion of the role of the regulatory test. Transend wishes to reiterate that the regulatory test as it stands is primarily a project-ranking tool: it selects the project that should proceed, based on information (including cost information) and analysis at the time the test is undertaken. The regulatory test should not be used in isolation to determine the prudence of final project costs.

Other issues: Recognition of any differences between Tasmanian Regulatory Test and National Regulatory Test

For as long as there are differences between the Tasmanian and national tests, the ACCC should recognise that prior to NEM entry, the Tasmanian regulatory test is the appropriate test for Transend to apply.

Other issues: Analytical effort required

The Tasmanian Regulatory Test's interpretation notes, include the following (page 11):

4.1.1 Analytical effort to be commensurate with project value

Consideration needs to be given to the value of a project and the likely impact on the end result when determining the effort to be devoted to project analysis and assessment. It is acknowledged that, in some instances, the full application of the regulatory test may require expenditure on project analysis that represents a relatively large proportion of the total project value. Projects should be assessed on a case-by-case basis and judgement regarding the extent of analysis will need to be exercised in individual circumstances.

It may not be necessary to undertake a detailed assessment of all parameters for all project options. In many cases, parameter values will be relatively constant for each option. An initial appraisal should identify which parameters will have a material impact on outcomes, and efforts should be focussed on evaluation of those parameters.

Transend considers that a similar note would add value to the national test.

Other issues: Reliability criteria

In the absence of reliability standards or criteria, the market benefits test must be used to justify any augmentation. This may cause problems when the market benefits analysis does not produce outcomes that are consistent with community expectations or NEMMCO operating requirements. Transend does not believe that this is the desired model for development of the NEM or for application of the market benefits test. These problems are discussed below.

A fundamental requirement for justification of a market-benefits-augmentation is the presence of load at risk. An issue arises under this model, where load at risk becomes the norm. This may occur where market benefits analysis supports load at risk ahead of augmentation, even when the community expectation is that this load should *not* be at risk. The increasing presence of load at risk as the ‘market benefit’ solution has the potential to stifle economic development.

Market benefits analysis may also conclude that it is not ‘worth’ upgrading the system to achieve N-1 security. However, NEMMCO must operate the system according to N-1 principles. This introduces a further disconnect between the market benefits outcomes and the operating rules NEMMCO must follow.

Transend therefore recommends that deterministic reliability criteria be developed for all jurisdictions, to improve implementation of the regulatory test. Transend will continue to raise this issue with the Tasmanian government but notes that it is a national issue.

Transend welcomes the opportunity to discuss these comments further with the ACCC and is happy for this submission to be placed on the ACCC web site. Should you have any questions, or seek further clarification, on any of the matters raised please contact Ms Bess Ramsay on 03 6274 3909.

Yours sincerely

Bess Ramsay
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