

2 REGULATORY ARRANGEMENTS FOR THIS REVIEW

2.1 Regulation governing application

Transend's transmission network service provider (TNSP) revenue is currently regulated in accordance with the Tasmanian regulatory regime.¹ Under this regulation, Transend's maximum allowed revenue is subject to a revenue control that terminates on 31 December 2003.² A revenue control establishes a maximum total revenue allowance for each year of the regulatory period.

Normally, the Tasmanian Energy Regulator (OTTER) would review these arrangements and establish a revised revenue control to succeed the existing one. However, Tasmania's impending entry to the national electricity market (NEM) complicates matters.

Once Tasmania enters the NEM³, Transend's revenue will be subject to regulation by the Australian Competition and Consumer Commission ('the Commission') in accordance with the National Electricity Code (NEC). NEM entry is likely to occur during 2005 – less than two years after Transend's existing revenue control has expired.

If there were no regulatory changes, the Commission would need to review Transend's revenue before Transend could enter the NEM. In other words, OTTER and the Commission would be required, within two years of one another, to review in detail Transend's revenue requirements.

Transend, the Tasmanian Government, OTTER and the Commission recognise the need to avoid duplicating regulatory activities. The Tasmanian Government therefore sought derogations to the NEC, which the Commission approved, subject to conditions, on 14 November 2001. One effect of these arrangements is that the Commission will regulate Transend's revenue after 31 December 2003.

In its final determination on the proposed derogations, the Commission argued that the arrangements for regulating Transend, 'should not dislocate the national market arrangements into the future.'⁴ To achieve this objective, the derogation enables the Commission to re-open or disallow any determination under the Tasmanian regulatory regime if it differs materially from a determination made in accordance with the NEC.

The Commission, the Tasmanian Government and OTTER have recognised that the derogations to the NEC should be supplemented by amendments to the Tasmanian regulatory regime. These amendments are needed to clarify the roles of the Commission and OTTER, and to better align the Tasmanian and the national regulatory regimes.

At the time of writing, the proposed amendments to the Tasmanian regulatory regime have not been finalised. Therefore, this submission is presented on the basis of the following assumptions:

- Transend's revenue requirements will be determined by the Commission in accordance with the Commission's draft *Regulatory Principles*.
- The submission timeframes and consultation processes will be consistent with the Commission's revenue determinations for other TNSPs.

¹ The Tasmanian regulatory regime includes the Electricity Supply Industry Act 1995, the Electricity Supply Industry (Price Control) Regulations 1998 and the Tasmanian Electricity Code.

² The Tasmanian Energy Regulator's 1999 electricity pricing determination was originally intended to end on 31 December 2002, but was extended to 31 December 2003.

³ NEM entry is conditional on the completion of Basslink. This is a project to install a DC interconnector cable from Loy Yang in Gippsland, Victoria, across Bass Strait to Bell Bay in northern Tasmania.

⁴ ACCC, Tasmanian Derogations and Vesting Contract, *Tasmania's NEM entry, November 2001*, p72.

- The Commission will give due consideration to the new responsibilities and costs facing Transend as Tasmania enters the NEM.
- To align Transend's financial and regulatory reporting, the Commission will determine a revenue cap for a period of 5.5 years from 1 January 2004.

On the basis of these assumptions, this document is Transend's principal submission to the Commission's pricing investigation of transmission services in accordance with the Tasmanian regulatory regime ('the revenue determination'). This submission contains the type of information that would be in a revenue application to the Commission in accordance with the NEC.

It should be noted that the revenue determination is expected to establish Transend's maximum allowed (transmission) revenue for each year of the regulatory period. Transend must subsequently set transmission prices so that its actual revenue does not exceed the regulated maximum. Transmission prices are established in a separate exercise, in accordance with the requirements of the TEC and the NEC⁵; the issue of transmission pricing is therefore not considered in this submission.

2.2 Principles and approach

Revenue determinations typically look back at a company's past performance in order to assess future revenue requirements. This approach is less prone to error if the scope of the company's activities is substantially unchanged over the two regulatory periods.

Inevitably, however, the environment in which a transmission company operates will change during a revenue control period. These changes will typically relate to the general level of economic activity within the jurisdiction and, more specifically, the location and quantum of new generation and load. There may also be substantial regulatory changes arising from reviews of market arrangements.

In Transend's case, the completion of Basslink and the landing of reticulated gas are major developments that will fundamentally affect the transmission network. For example, Basslink and NEM entry will create a larger market for Tasmanian generation and therefore facilitate substantial growth in wind generation. This potential growth in wind generation will bring new challenges for the transmission system.

While NEM entry will bring benefits to Tasmania, it will also bring new costs and responsibilities for Transend, and place greater demands on the transmission system. Critically, the benefits from greater diversity in generation, and the new trading opportunities with the wider Australian market, depend on the transmission system. Transend therefore has an important role in bringing these potential benefits to fruition.

The substantial changes over the forthcoming regulatory period mark a significant break with previous performance. Therefore, it is essential that this revenue determination anticipates the challenges ahead by looking forward to the next regulatory period, rather than looking back to the previous period. For Transend, past costs are generally a poor and inappropriate guide to future revenue requirements.

Transend recognises that the uncertainty in the forthcoming regulatory period must be handled responsibly. In particular, revenue cannot be set on the basis of Transend's 'worst case' projections. Such an approach would not take account of customers' expectations of future transmission charges. However, it would be equally imprudent to under-estimate the potential challenges ahead.

⁵The Tasmanian Energy Regulator and the Tasmanian Government are working towards aligning the TEC and NEC for the purposes of transmission pricing. However, the final form of the NEC's transmission pricing requirements is still uncertain. Transend will continue to monitor these changes to ensure, as far as possible, that its prices are set on a basis that is consistent with the NEC.

To minimise the uncertainty, Transend proposes a number of regulatory mechanisms to balance risks fairly between the company and its customers. These regulatory mechanisms are discussed in this submission, and their formal application is presented in Appendix 1. In addition, the forecasts presented in this submission take a balanced view of Transend's future requirements. Each chapter presents the reasoning that underpins Transend's projections.

2.3 Services to be capped

An objective of regulating transmission services is to promote competition, where economically feasible⁶, in the provision of network services. This objective is best achieved by ensuring that only non-contestable services are subject to price regulation. In this way, competition can develop in services in which the TNSP does not have a natural monopoly.

This regulatory approach is reflected in Clause 6.2.3(f) of the TEC [and Clause 6.2.4(f) in the NEC] which states:

Price controls [Revenue caps] set by the Regulator are to apply only to those services, the provision of which in the opinion of the Regulator are not reasonably expected to be offered on a contestable basis.

The TEC [and NEC] define *contestable* as:

A service which is permitted by the laws of Tasmania [the relevant participating jurisdiction] to be provided by more than one Network Service Provider as a contestable service or on a competitive basis.

Therefore, the TEC and the NEC both appear to adopt the same principles for defining the scope of price or revenue regulation. The key principle is that revenue regulation should relate only to those services that are non-contestable.

It is also noted, however, that the *Electricity Supply Industry (Price Control) Regulations 1998 (Price Control Regulations)* adopts the concept of declared services. The Regulator is required to investigate the pricing of declared services in accordance with Clause 10 of the *Price Control Regulations*. Transend understands that the Commission will be conducting Transend's revenue determination in accordance with these regulations.

In practice, the considerations involved in *declaring* a service are very closely aligned with the definition of non-contestable services. In particular, Clause 5.1 of the *Price Control Regulations* states:

The Regulator, by notice published in the *Gazette*, may declare a good or service provided by an electricity entity to be an electrical service if the Regulator is of the opinion that:

- a. the electricity entity has substantial market power in respect of that good or service
- b. the promotion of competition, efficiency or the public interest requires the making of the declaration.

At the time of writing, OTTER has deferred its decision on the declaration of transmission services until the legislative framework has been settled between the Tasmanian Government and the Commission. However, for the purposes of this submission, Transend must make some working assumptions about the services that will be regulated in the revenue cap.

At present Transend undertakes a small amount of external work (\$926,000 in 2001), which would be considered to be contestable according to the definition in the TEC and NEC. Transend does not currently provide any other contestable services. In the forthcoming regulatory period it is envisaged that certain services will be provided on a contestable basis. For example, the provision of non-retail metering at the generator/transmission interface is likely to become contestable.

⁶ NEC, Clause 6.2.2(h)

Transend also supports the future contestability of new connections so that customers can benefit from market-based pricing. These future developments should increase the number of services that fall outside the revenue control.

In this submission, Transend's cost projections exclude:

- the costs of providing contestable services
- the costs of connection applications (presently recovered through application fees).

It is noted that Clause 5.3.3(c)(5) of the NEC and TEC regulate connection application fees by requiring that they must be set to cover 'the reasonable costs of all work anticipated to arise from investigating the application to connect and preparing the associated offer to connect'. Appendix 1 to this submission provides a detailed description of Transend's proposed form of revenue cap and the services that are to be capped.

In the forthcoming regulatory period, Transend will allocate costs to contestable services on the basis of avoidable costs. This will ensure that costs are appropriately and continuously allocated between contestable and non-contestable services. Transend notes that the Commission, in its final decision on SPI PowerNet's revenue cap⁷, considered an avoidable cost approach to be reasonable.

This submission excludes the costs of providing the System Controller function, which was transferred to Transend on 1 July 2000. The System Controller is presently a ring-fenced entity in Transend that is subject to separate fee arrangements under the TEC. However, NEM entry will require the transfer of some of the System Controller's current activities to Transend in its role as TNSP. This issue is discussed in detail in Chapter 7 of this submission.

⁷ ACCC, Victorian Transmission Network Caps 2003-2008, *Decision 11 December 2002*, p. 80