



**Australian
Competition &
Consumer
Commission**

Issues Paper

Murraylink Transmission Partnership

**Application for Conversion to a Prescribed Service
and a Maximum Allowable Revenue**

February 2003

1. Introduction

On 18 October 2002, the Australian Competition and Consumer Commission (Commission) received an application from the Murraylink Transmission Company (MTC), on behalf of the Murraylink Transmission Partnership (MTP), seeking a decision by the Commission that:

- the network service provided by Murraylink be determined to be a 'prescribed service' for the purposes of the National Electricity Code (code); and
- for the provision of this prescribed service, MTP be eligible to receive the maximum allowable revenue from transmission customers (through a coordinating network service provider (NSP)) for a regulatory period commencing from the date of the Commission's final decision on MTC's application to 31 December 2012.

The code establishes two frameworks for the development of network services in the National Electricity Market (NEM), regulated and unregulated. Regulated assets earn a regulated revenue determined by the Commission in accordance with Chapter 6 of the code. Unregulated assets earn revenue from trading in the wholesale electricity market in accordance with Chapter 3 of the code. In particular, market network service providers (MNSPs) operate as unregulated interconnectors that rely on the spot price differential between two interconnected regions to earn revenue.

MTC is currently registered with the National Electricity Market Management Company (NEMMCO) as an MNSP. Accordingly, MTC is entitled to earn spot market revenues but is not entitled to any regulated revenue. If MTC's application for conversion to a 'prescribed service' is accepted, it would be entitled to earn regulated revenue set by the Commission.

On 6 November 2002, the Commission accepted an access undertaking submitted by MTC pursuant to Part IIIA of the *Trade Practices Act 1974* (TPA). MTC is required to provide access to the Murraylink transmission cables and associated assets in accordance with the terms and conditions in the undertaking.

MTC's application for conversion and a maximum allowable revenue is published on the Commission's website at <http://www.accc.gov.au>.

2. Purpose of the issues paper

The purpose of this issues paper is twofold. Firstly, to provide guidance on the Commission's views on its administration of the relevant provisions of the code. Secondly, to set out the Commission's proposed approach for assessing MTC's application and, in particular, facilitate discussion on issues such as the opening asset value for determination of transmission revenues.

The Commission is seeking comments on these matters.

The Commission expects that following the current assessment process, there will be further development of the Draft Statement of Regulatory Principles, particularly in relation to guidelines for the conversion from a market network service to a prescribed service. While the Commission intends to deal with conversion applications on a case by case basis, it will further its thinking on the issues regarding conversions through the development the Statement of Regulatory Principles. To this end, the Commission will develop guidelines on prescribed services, including conversion applications.

3. Conversion and the Regulatory Framework

Under the code, the Commission is responsible for determining whether a market network service should be converted to a prescribed service. Clause 2.5.2(c) of the code states:

If an existing network service ceases to be classified as a market network service it may at the discretion of the Regulator or Jurisdictional Regulator (whichever is relevant) be determined to be a prescribed service or prescribed distribution service in which case the revenue cap or price cap of the relevant Network Service Provider may be adjusted in accordance with chapter 6 to include to an appropriate extent the relevant network elements which provided those network services.

Accordingly, the code does not set out specific criteria for conversion and the determination is at the Commission's discretion.

In the absence of specific criteria, the Commission considers that it should exercise its discretion in accordance with the market objectives as set out in the code and the 1996 Council of Australian Governments agreement. In this regard, the Commission is of the view that it may have regard to the test that is relevant to applications to establish new assets which would be regulated – the regulatory test.

The Commission also considers that the application of the regulatory test is likely to require modification when used to assess existing assets. MTC's application and supporting information have been submitted on the basis that the Commission may follow such an approach based on the regulatory test. These issues are discussed further below.

Code provisions for new assets

The following is a summary of the relevant code provisions relating to new transmission assets:

1. The Commission must promulgate the regulatory test (clause 5.6.5A);
2. An applicant who proposes to establish a 'new large network asset' must follow the consultation process set out in clause 5.6.6 and prepare a final report setting out, amongst other things, an assessment of whether the asset satisfies the regulatory test (clause 5.6.6(f)); and
3. A party that disputes the report may apply to the Commission for a determination on whether the asset satisfies the regulatory test (clause 5.6.6(m)).

In particular, clause 5.6.6 of the code requires an applicant that proposes to establish a ‘*new large network asset*’ (interconnector) to consult with interested parties and to provide:

- a detailed description of the asset;
- the reasons for proposing to establish the asset, including the identified potential *constraint* that the asset will address;
- all other reasonable *network* and non-*network* alternatives to address the identified *constraint*;
- all relevant technical details concerning the proposed asset and commissioning date;
- an analysis of the ranking of alternatives;
- an *augmentation technical* report (where applicable); and
- detailed analysis of why the applicant considers that the asset satisfies the regulatory test.

The regulatory test

The regulatory test is essentially an economic cost/benefit analysis of a proposed interconnector or network augmentation. The regulatory test promulgated by the Commission on 15 December 1999 requires the proposed interconnector to:

[maximise] the *net present value* of the *market benefit* having regard to a number of alternative projects, timings and market development scenarios.

The intention of the regulatory test is to limit cost recovery to efficient investments. Regulated investment will only receive a revenue return if it passes the criteria set out in the regulatory test.

Relevance of the regulatory test to conversion to prescribed status

An applicant for conversion to prescribed status is not expressly required to address the matters set out in clause 5.6.6 of the code in relation to new assets, particularly whether the asset satisfies the regulatory test.

Nevertheless, the Commission is of the view that, in the absence of specific criteria under clause 2.5.2(c) it is appropriate for the Commission to have regard to similar matters to those relevant to decisions made under chapters 5 and 6 of the code.

Relevantly, in the ‘Network Pricing and Market Network Service Providers’ authorisation determination of 21 September 2001, the Commission provided preliminary guidance for the treatment of conversion applications:

The Commission will consider any applications to convert from market to prescribed status on a case by case basis. However, the *Draft Regulatory Principles* clearly set out the process that incumbent NSPs must follow at each regulatory review and applicants for conversion of network services to prescribed status will have to follow the same process. The Commission will develop the *Draft Regulatory Principles* to set out the process and guidelines needed to formalise the conversion arrangements.

Further the *Draft Regulatory Principles* set out that a DORC valuation will be used to value (or revalue) the asset base of the NSP. The Commission considers that the DORC valuation allows for consideration of all possible options for replacing existing network services, as well as consideration of current and future utilisation rates. The effect of a DORC valuation will be that the network is valued to reflect the least cost solution to resolve any demand and supply imbalance needing to be addressed. Thus the process of changing status of network services requires the NSP to submit to a valuation process that delivers outcomes consistent with the intent of the regulatory test. The processes set out in the *Draft Regulatory Principles* may be simpler than the regulatory test processes but the Commission considers that no material advantage will accrue to NSPs converting from market to prescribed status through bypass of the regulatory test.

Accordingly, the Commission indicated that, in considering applications for conversion and setting the relevant revenues, the Commission would follow an approach that is consistent with the intent of the regulatory test. This was in order to ensure that achieving regulated status via the conversion process was not used as a means of bypassing the objectives of the test laid down for achieving regulated status via the process set out in chapter 5.

The Commission invites comments from interested parties on MTC's proposed approach to adopt the regulatory test as the basis for assessing the conversion application.

Application of the regulatory test to Murraylink

It would appear that as Murraylink has been operating as an MNSP since October 2002, section 5.6.6 may not be applicable. Nevertheless, some of the principles set out in section 5.6.6 may provide some guidance on how to consider the prudence of Murraylink. In particular, the regulatory test would appear to be the most suitable instrument in the NEM for determining whether Murraylink is a prudent investment, and whether it is eligible to receive a regulated revenue. However, interested parties may wish to comment on whether considerations other than those currently contained in the regulatory test would be appropriate in assessing MTC's application.

Furthermore, the Commission believes that MTC's application, consultation process, and application of the regulatory test (albeit a modified test) for measuring Murraylink's market benefits, is consistent with the requirements of clause 5.6.6.

The primary difference between MTC's modified regulatory test, and the 1999 regulatory test promulgated by the Commission concerns the selection of alternative projects. MTC has selected alternative projects that it submits provide an equivalent technical service to Murraylink.

In previous applications of the market benefits limb of the regulatory test the alternative projects considered provided *similar* but not *equivalent* levels of service. However, the Commission notes that MTC's selection of alternative projects is consistent with an Optimised Depreciated Replacement Cost (ODRC) valuation process.

To assist in assessing MTC's application, the Commission has engaged consultants to review aspects of MTC's application. The following reports are available on the Commission's website at www.accc.gov.au:

PB Associates Pty Ltd:

- *Transfer Capability Review of Murraylink Application to the ACCC*; and
- *Review of Murraylink Transmission Partnership Service Standards*.

Saha Energy International Ltd:

- *Review of Murraylink Transmission Company Pty Ltd's Application of the Regulatory Test*.

Having regard to the matters outlined above, and the report by SEIL, interested parties are invited to comment on MTC's application of the regulatory test, particularly MTC's approach regarding the selection of alternative projects. Parties may also wish to comment on the link between PB's power transfer review and the calculation of Murraylink's market benefits.

4. Relationship between the regulatory test and the opening asset value

When a TNSP applies the regulatory test to a new large network asset, it will determine the asset's regulatory cost (based on an engineering assessment). If the proposed augmentation satisfies the regulatory test (i.e. it maximises net market benefits compared to relevant alternatives), the regulatory cost is typically included in the TNSP's asset base.

MTC's proposed approach for determining the regulatory cost of Murraylink can be expressed as Murraylink's gross market benefits (as determined by the regulatory test), less the NPV of Murraylink's expected future operating and maintenance costs (Opex). MTC proposes that the regulatory cost will also constitute Murraylink's regulatory asset value (i.e. regulatory cost = regulatory asset value).

At this stage, the Commission is considering the merits of MTC's methodology for determining an opening asset base value. The Commission also notes that MTC has been operating as an MNSP since October 2002. Interested parties may wish to comment on whether the Commission should take this into account if setting a revenue cap.

Interested parties may comment on MTC's use of the 'regulatory cost' of Murraylink to determine an opening asset valuation.

5. Issues for consideration

Having taken the above issues into account, and in conjunction with the Commission's consultants' reports, interested parties are invited to comment on issues including, but not limited to:

- MTC's application of the regulatory test;
- MTC's approach regarding the selection of alternative projects;
- the appropriateness of using the value of Murraylink's market benefits as MTP's opening asset value;
- whether MTC's selection of alternative projects constitutes a material advantage over the process specified by clause 5.6.6;
- whether there are material differences between the 5.6.6 process for assessing new large network assets, and the approach used by MTC;
- the Commission's interpretation of the code clause 2.5.2(c), and any other code provisions that are relevant to new interconnectors in the NEM;
- the circumstances under which an MNSP should be able to apply for conversion; and
- whether the Commission should have regard to the fact that MTC has operated as an MNSP since October 2002, if it sets a revenue cap for MTC.

6. Conclusion

The Commission now invites comments on interested parties on MTC's application (including appendices), the consultants' reports, and the matters outlined in the issues paper. The closing date for submissions is Friday 28 February 2003. Submissions can be sent electronically to electricity.group@acc.gov.au. Alternatively, written submissions or submissions on disk, in Word 7.0 compatible format, can be sent to:

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