

Ref: 379/168/3
Letter No: MT 343

28 March 2003

Mr Sebastian Roberts,
A/g General Manager
Regulatory Affairs - Electricity
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2606

Dear Sebastian

REVIEW OF THE REGULATORY TEST

Thank you for the opportunity to comment on your discussion paper "Review of the regulatory test". As stated in our previous submission CS Energy along with many other commentators believe that transmission investment is not keeping pace with the requirements of the National Electricity market. We see the major cause of this situation is that the current regulatory test hurdle is too high and when this is coupled with optimisation risk of the asset base, required transmission projects do not proceed in a timely manner

A major shortcoming of the regulatory test is that it is based on market benefits in terms of costs, alone and fails to recognise the competition benefits that result from additional transmission capacity.

The commission proposes a number of options for review of the test and solicits comments on whether some or all these areas should be adopted. These options include:

1. Maintain the current test with minor modifications to ensure consistency with the NDR Code changes;
2. Define and clarify elements in the test across the NEM; and
3. Consider possible methods for assessing competition benefits.

CS Energy Ltd believe that the Commission should adopt all options. The current regulatory test should be maintained and competition benefits be introduced in a fashion that adds to the benefits to enable projects to proceed that would otherwise not proceed. These competition benefits should be added to both market and reliability based transmission projects. With is addition it will be necessary to change the asset optimisation process and reduce the WACC in the revenue test to gain maximum customer benefit. This may require an early review of the revenue cap to account for additional projects and the reduced WACC.

Minor modifications in line with NDR Code Changes

CS Energy agree with the modifications proposed and that that the basic regulatory test should remain in its current form. However we do not agree that the market requires time to adapt to these changes before considering further

amendments. These changes are small and considerable experience has been gained with the test in its current form. Extending the test to recognise competition benefits without a wholesale redesign will allow urgently required transmission investment to proceed without delay.

Definitional Amendments

Generally we agree with the proposed clarification and definition of terms in the regulatory test. One area where we have an alternate view is in valuing unserved energy. We believe that VoLL as it applies to the National Electricity Market is a price cap to control trading risks and not the value of unserved energy. The Commission should allow values higher or lower than VoLL to be used for unserved energy if they can be verified through robust analysis of the particular circumstance.

Competition Test.

Competition benefits should be included in the regulatory test as experience has shown that these benefits can be much greater than the market cost benefits. We acknowledge that bid based simulations are problematic because the assumptions for bids are subjective. Other indicators use historical pool prices and bidding behaviour qualitative measures or calculation of indexes. As suggested in our previous submission reserve capacity in a local area also provides a reasonable indication of the level of competition.

Insufficient information has been provided on the alternative methods suggested in the paper to determine if one method is superior than another and we believe additional analysis is required to highlight the strengths and weaknesses of each method.

It is noted that including competition benefits may lead to early investment, as the pool average price is much higher than the transmission cost. This may necessitate a method of capping the number of investments needed. This is a desirable outcome as erring on the side of over investment is better for customers than under investment.

Of the method presented the Hirschmann-Herfindahl index appears the most credible and robust. We also note that jurisdictions represent a suitable proxy for the interests of end use customers.

We provide the following suggestions for consideration valuing competition benefits:

- Market benefits to be returned over a shorter time frame of say 3 to 5 years;
- A process should be used to determine a quantity that can be added to other benefits under the current test;
- There is not need to be limited to one methodology provided a quantifiable benefit can be derived from each one;
- The method for determining the quantity of the benefit should be included in the regulatory test so it cannot be disputed. The method can include empirical or qualitative measures; and

- The methodology should be applicable to both intra-regional and inter-regional investment projects.

Other issues

We note that the Commission intends to address the issue of optimisation in its final reports and reiterate our view that the risk of optimisation acts as a deterrent to required transmission investment. Removal of optimisation risk also provides justification for reducing the WACC to risk free rates in revenue cap determinations resulting in returns that are significantly less than generator required internal rates of return.

As the regulatory test is modified to more correctly include competition benefits it is clear that customers are the primary beneficiaries of transmission investment through reduced energy prices. As such there is no economic benefit in levying shared transmission network charges on generators.

Conclusion

The regulatory test as it stands is preventing required transmission investment from proceeding. The major flaw in the regulatory test is that it fails to recognise competition benefits, which can be far greater than market cost benefits. Adding of competition benefits to the current regulatory test is preferred rather than a complete overhaul of the regulatory test because a complete overhaul would take significant time to complete and runs the risk of further delays in transmission investment.

Nothing in this submission is considered confidential.

Yours sincerely

A. G. Bellas
CHIEF EXECUTIVE

Enquiries Ron Roduner
:
 Telephone (07) 3222 9361
 Facsimile (07) 3222 9343