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Mr S Roberts
Acting General Manager, Regulatory Affairs – Electricity
Australian Competition and Consumer Commission
GPO Box 520J
Melbourne VIC 3001

Dear Mr Roberts

MURRAYLINK APPLICATION FOR CONVERSION TO A PRESCRIBED SERVICE

You have called for comment on Murraylink's application for conversion from unregulated to prescribed service status. The Essential Services Commission of South Australia (ESCOSA) is pleased to provide the following comments, in line with its longstanding contribution to the national debate on regulated and unregulated interconnectors, the market benefit test, and the impact on South Australian consumers.

ESCOSA has always been keen to ensure that, before South Australian consumers are forced to pay for transmission services through higher TUOS charges, a realistic assessment is made of the magnitude and distribution of benefits (such that those who benefit should pay). One of the problems with the net market benefit test is it has no regard to this issue, and can result in consumers paying for benefits which are received by other parties. We will have the opportunity to comment on the regulatory test when submissions are made to the ACCC paper recently released.

When new regulated network assets are proposed, the current regulatory test requires that the proposal will maximize the NPV of the net market benefit based on projected energy market impacts, costs of alternatives and the costs associated with the proposal. If approval is given, it is generally expected that the owner will receive regulated revenues based on the cost of providing and operating the new regulated assets.

In the application for conversion of Murraylink from operation as a market network service to a regulated prescribed service, Murraylink Transmission Company (MTC) are basically proposing that in approving the conversion application, the regulatory asset value should be set at the lesser of the NPV of gross energy market benefits provided by Murraylink, the cost of the cheapest equivalent alternative, or the cost of Murraylink.

Based on the MTC analysis, the regulatory asset value would be equal to the gross energy market benefits (less present value of O&M), and would effectively give a zero impact on all other market participants.

ESCOSA has many concerns about the accuracy of specific elements in the analysis in the MTC application. Matters of concern include:

- The contribution of Murraylink to transmission network capacities,
- Selection and costing of alternatives to Murraylink,
- Major uncertainties with the assessment of energy market benefits,
- Benefits associated with supply to the Riverland, and
- The impacts of the assumption that SNI will not proceed.

Some of these concerns were discussed in the report prepared for the ACCC by SAHA Energy International or are addressed in a submission by ESIPC: they will not be further explored in detail here. Nevertheless, each of these matters is of fundamental importance to the application. The main point of this submission, however, is to emphasise ESCOSA's view that MTC's proposed approach for applying the regulatory test as the basis for assessing the conversion application is not valid.

The remainder of this submission is concerned with underlying principles for applying the regulatory test to the Murraylink application and the separate questions relating to determining the magnitude and sources of the allowable regulated revenue.

<u>Applying the Regulatory Test to Murraylink Conversion:</u>

The Murraylink conversion application does not involve the provision of a new transmission line. SAHA Energy International recognized this when indicating that sunk capital expenditures are not incremental market costs for the purpose of applying the regulatory test. SAHA suggested that only future operating and maintenance costs and the estimated energy market benefits are relevant.

The existence of Murraylink and its operation as a market network service also have major implications for the incremental benefits **attributable to conversion**. (It could even be argued that, although they are not yet sunk, future operating and maintenance costs are not fully attributable to conversion either).

The regulatory test is intended to be based solely on variations in underlying real costs and benefits from a total market perspective. Changes in commercial arrangements and financial transfers between market participants as a result of different operational details are only relevant to the extent that they impact on net market benefits.

This suggests the application of the regulatory test to this application should only consider the real cost and benefit impacts due to the **conversion** of Murraylink from unregulated to regulated operation. Estimates based on comparisons with and without Murraylink do not appear to be relevant. A large proportion, if not all, of the assessable energy market impacts in total market terms would probably be obtained with the present market network service arrangements. These matters are discussed in the Transgrid/NERA and ESIPC submissions.

The main impacts of conversion probably relate to operating practices, different allocations of commercial risks and the distribution of related costs and benefits. This suggests the regulatory test should focus on the assessment of impacts on underlying costs and benefits due to different operating practices. The resulting impacts on costs and benefits, and the net market benefit, may be relatively small compared with the overall impact of Murraylink.

Regulatory Asset Value and Sources of Regulated Revenue:

There is no necessary direct link between any values of relevance for the regulatory test and an appropriate regulatory asset value. In particular, SAHA Energy International notes that Code provisions do not define how the regulatory asset value should be determined in the case of a Murraylink conversion.

In these circumstances, it seems reasonable to seek an approach where the regulatory asset value and the sources of the corresponding regulated revenues, are consistent with the financial impacts of conversion.

As the provider of a market network service, MTC is expected to meet Murraylink investment and operating costs from income related to operation as a market network service in the energy market. This income includes both NEMMCO payments related to actual flows on Murraylink and any contractual payments from arrangements with other market participants. If conversion is approved, MTC will forego these income sources and other parties will gain new benefits related to the changed impacts of Murraylink as a regulated service.

It seems reasonable to expect the magnitude and sources of regulated revenues for Murraylink to be based on projected financial impacts due to the new arrangements.

It would not be reasonable to impose new regulated revenue contributions on participants who will not receive projected corresponding benefits of at least the same magnitude.

ESCOSA is particularly concerned about the lack of adequate Code provisions requiring that new regulated revenue is sourced from the projected beneficiaries of new regulated investment in general. In the Murraylink application, MTC has simply suggested that the revenue be obtained by the relevant existing TNSPs based on the physical location of Murraylink assets.

Interconnectors do not actually produce any electricity, and benefits (excluding possible impacts on supply interruptions) are related to reductions in the cost of generation by generators. Savings may be in both investment and operating costs. It would not be reasonable to recover new regulated revenues on the assumption that all these savings would flow through to customers. It is not difficult to identify circumstances where customers might receive very little of the benefits.

Appropriate modeling studies may have relevance for assessing underlying costs and benefits **for the regulatory test** (even there, we have major concerns with the credibility of market models projecting supply and demand out many years ahead and determining impacts on spot prices – such work is unreliable and different models produce widely different results, as ESCOSA found in its modeling of the SNI project). However, it does not appear to be a reasonable or reliable basis for determining either the appropriate **regulatory revenue value** or the corresponding revenue sources without a consideration of projected commercial market outcomes.

ESCOSA is firmly of the view that the approach proposed by MTC is not appropriate for determining the asset value or allowable revenue for Murraylink. We have some ideas on how this might be done, but will await the Commission's consideration of the fundamental concerns before proposing alternative valuation methods (but they must clearly be linked to the value of the alternative link adjusted for different beneficial impacts).

In concluding, ESCOSA reiterates its concern at the use of modeling outputs to determine market benefits and then asset values. This represents an unjustified faith in modeling and a total disregard for the actual recipient of benefits. Agreeing to the MTC approach as the basis for determining whether or not to approve an application for conversion from unregulated to prescribed services would be a dangerous precedent, and open the market rules to significant abuse. The interests of consumers who will be required to pay for this conversion must be paramount in the Commission's evaluation of the application.

Yours sincerely

Lewis W Owens

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CHAIRMAN