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

ACCC Discussion Paper- Review of the Regulatory Test

Thank you for the opportunity to comment on your Discussion Paper on the Review of the Regulatory Test[1].

The members of the National Electricity Distributors Forum (NEDF) are generally supportive of a streamlined, workable and uniform investment approval process for infrastructure investment.

In the present discussion paper, the ACCC has sought comments on three options for amending the regulatory test:

1. maintaining the current test with minor modifications to ensure consistency between the regulatory test and the code following the Network and Distributed Resources (NDR) Code changes;
2. define and clarify elements of the regulatory test to ensure a consistent application of the test across the NEM; and
3. outline possible methods for assessing competition benefits.

The Commission has also noted the possibility of combining the options identified above.

Option 1

The NEDF accepts that Option 1 is appropriate and desirable, to resolve any inconsistencies between the Code and the regulatory test (the Test).

In my letter of 24 June 2002, I detailed the principal concern of the members of the NEDF, that Codified investment approval arrangements should not duplicate the various Jurisdictional requirements. At the time of the NDR Code change, NECA acknowledged the need to consult with the Jurisdictions to resolve

1 This letter constitutes a submission from the National Electricity Distributors Forum (the NEDF). The Forum comprises the following member organisations: Energex; Ergon Energy Corp. Ltd; Country Energy; Australian Inland Energy; EnergyAustralia; Integral Energy; ActewAGL; AGL Electricity; CitiPower; Powercor; United Energy; ETSA Utilities; Aurora Energy; and Western Power Corporation.

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issues of uniformity and duplication of regulatory requirements, with a view to achieving greater uniformity in investment approval using the Code as a vehicle[2]. The Regulatory test is a good example of such overlap with jurisdictional arrangements where, in Victoria, the regulatory regime is such that this test is an unnecessary burden and conflicts with the fundamental incentive regime because the distribution businesses already have strong incentives to make efficient investment decisions through the capital efficiency carryover mechanism. The NEDF is unaware of either NECA or the ACCC engaging in dialogue with the Jurisdictions and distribution businesses on this important matter. I would also reiterate my offer that the members of the NEDF would be pleased to advise the ACCC of the various approval processes and their potential overlap with the Code.

There is an inconsistency between Clause 5.6.6A of the Code and the ACCC's proposed change to the Test in Section 3.1.3 – other amendments, small network assets. Code clause 5.6.6A is applicable to TNSPs. The ACCC's reference to NSPs implies that the Test would also apply to DNSPs.

In relation to the classification of small and large assets, the NEDF is of the view that both limits are so low as to present an unwarranted burden upon NSPs and unduly delay the provision of necessary augmentations. This is a particular issue for DNSPs, where short lead times are the norm in meeting rapidly changing customer requirements. The construction or modification of a new zone substation in a metropolitan area would routinely exceed the $10 million limit, meaning that an urban DNSP may have a few large projects per annum under the existing definition. The NEDF therefore suggests that both limits for asset classification could be doubled.

The NEDF supports the ACCC's clarification that the direct replacement of assets should not be considered an augmentation for the purpose of the Test. However, it must be recognised that a straightforward replacement of aged assets with their modern equivalent may increase the capability of the network. For example, modern switchgear would generally have both higher fault level rupturing capacity and higher current rating than the equipment near the end of its life that it might replace. In this circumstance, it would be inappropriate for the Test to apply only to the increased capability such an augmentation could deliver. Therefore, the NEDF recommends that the primary intent of an augmentation should be the determinant of whether the Test should be applied.

Option 2

In my earlier letter, I outlined the preference of NEDF members for a greater degree of definition in the Test. The NEDF agrees with the clarification of various matters proposed by the ACCC as Option 2. We would however seek further clarification of which costs and benefits should be taken in to account in investment analysis.

On the matter of whether a commercial discount rate or the discount rate appropriate for regulated investments should be used in NPV analysis, the NEDF considers that the appropriate discount rate is the rate applied to regulated

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2 A network and distributed resources package – Report, NECA Code Change Panel, December 2000.

investment because a discount rate appropriate for private investment will not provide the appropriate outcome for regulated network investments in all circumstances. The reasons for this belief were set out in my earlier letter and are restated here:

"The existing networks have been progressively developed, by choosing from augmentation and design options at each stage. Each choice has been made using a discount rate appropriate for relatively low risk investments. The networks are largely optimal and within regions, have relatively low costs of losses and generally small levels of out of merit generation, which continue to benefit customers.

To move towards a cost of capital reflecting higher risk would result in an inappropriately short-term focus for investments. The inevitable result would be a move to the minimum sized, least capital cost solution, which would be accompanied by much higher:

- *cost of losses;*
- *risk of non supply, where this is factored into account;*
- *out of merit generation; and*
- *opex.*

Furthermore, the pricing associated with regulated network investments reflects their economic life and would not be aligned with the investment process.

Such an approach would be of particular concern if applied to regulated network investments designed to meet specified regulatory reliability standards."

The NEDF urges the ACCC to reconsider its position on this matter.

Option 3

The DNSPs do not expect that a competition benefits test is likely to apply to the developments taking place within their networks. No comment is tendered on the alternative proposals.

The NEDF's principal concern is that the Codified investment approval process will overlap and in many instances contradict existing Jurisdictional arrangements for prudent investment criteria by DNSPs. The members of the NEDF will be pleased to engage in a process to resolve these issues.

I trust this submission will be of assistance to the Commission in its review of the Test.

Yours sincerely

Patrick McMullan

Patrick McMullan
Secretary, National Electricity Distributors Forum