



*Hon. Patrick Conlon MP
Minister for Government Enterprises
Minister for Energy
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FAX TRANSMISSION COVER SHEET

Date: 28 March 2003

To: Mr Sebastian Roberts, Australian Competition and Consumer Commission

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Subject: Review of the Regulatory Test

Sender: Daniel Minchin

*YOU SHOULD HAVE RECEIVED 7 PAGE(S), INCLUDING THIS COVER SHEET
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Please find attached a submission from the South Australian Minister for Energy on the ACCC's Discussion Paper for its review of the Regulatory Test.

The original will follow by post.

Regards,

A handwritten signature in cursive script that reads 'Daniel Minchin'.

Daniel Minchin
Ministerial Liaison Officer to
MINISTER FOR ENERGY

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TF03D01701

Mr Sebastian Roberts
A/g General Manager
Regulatory Affairs - Electricity
Australian Competition & Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Roberts

Thank you for the opportunity to comment on the ACCC's Discussion Paper for its review of the Regulatory Test.

As I stated in my submission to the Issues Paper (copy attached), the South Australian Government is keen to promote new electricity supply from all sources including interconnection. Strong interconnection is essential for a competitive market and acts to reduce the potential for the exercise of market power. The South Australian Government has been a strong supporter of the SNI interconnector. I have acted successfully to become a party to resultant appeals of NEMMCO's SNI determination in an effort to ensure the interconnector's construction.

A regulatory test that can be applied on a consistent basis in a timely, robust and transparent manner is of key interest. To this end South Australia would advocate that a test that is as simple as possible be pursued.

The ACCC's Discussion Paper seeks comment on three options for going forward on this matter. In regard to the Commission's specific recommendations, Option 1 is supported, ie maintaining the current test, with minor modification to ensure consistency between the regulatory test and the recent Network and Distributed Resources Code changes. Recognising the importance of providing regulatory certainty for investors in the electricity supply industry, it is agreed that there are advantages in maintaining the regulatory test in its current form. The familiarity with the test's operation and the considerable experience being developed through the series of appeals to the NEMMCO SNI determination are positive reasons for maintaining the current test with minor modifications. Perhaps the ACCC would be willing to commit to a future review of the regulatory test with particular regard to what may be learnt from the SNI appeal proceedings.

As I stated in my earlier submission on this issue, a key concern for the NEM Ministers Forum (NEMMF) will be to resolve the role and future direction of the transmission network. Accordingly, the appropriateness of the regulatory test will need to continue to be assessed against the transmission model ultimately adopted.

In supporting Option 1 it **would** appear self-evident that support, at least in principle, should follow for Option 2 noting the above point regarding providing regulatory certainty where possible.

In defining and clarifying elements of the regulatory test to ensure a consistent application across the NEM, care may need to be exercised in assessing whether a project is 'committed' and hence included in the base case. A restrictive Statement of Opportunities (SOO) definition of 'committed' that excluded projects that had passed the regulatory test may lead to inconclusive results in subsequent applications of the regulatory test. Following on from the suggestions made by NSW Treasury and TransGrid, there may be merit in considering projects 'committed' once they have passed the regulatory test if this approach **was** also supported by a non-refundable bond arrangement.

Whilst **generally** supportive of the proposed definition of 'alternative project', there is a risk with the suggested approach that for a proposal to be classed as a substitute, the outcomes delivered should be similar, in that 'similar' may be interpreted too broadly in some circumstances. A clear understanding of the project purpose in each assessment: is important to make more robust: both the clarification of alternative projects and the benefits that might be included.

In relation to Option 3, assessing competition benefits, I support the economic benefits of lower prices being recognised in the test. However, there would need to be a concise and robust test developed to avoid the potential for introducing further delays in the assessment process, for example, due to appeals. For these reasons, there would appear to be merit in having any such competition test applied as a separate test and not included in the regulatory test. There would also appear to be merit in the ACCC considering commissioning research into what might constitute an objective and quantifiable competition test.

Should you have any enquiries on this submission, please do not hesitate to contact Mr Vince Duffy, Acting Director-Electricity, Microeconomic Reform and Infrastructure Branch, Department of Treasury and Finance on telephone number (08) **8204 1724**.

Yours sincerely



HON PATRICK CONLON MP
MINISTER FOR ENERGY

27 March 2003



Hon. Patrick Conlon BA LLB (Hons) MP

Minister for Government Enterprises

Minister for Energy

Minister for Police

Minister for Emergency Services

TF02D02828

Mr Michael Rawstron
General Manager
Regulatory **Affairs** - Electricity
Australian Competition & Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Rawstron

Thank you for the opportunity to comment on the ACCC's Issues Paper for its Review of the Regulatory Test.

The South Australian Government is keen to promote new electricity supply *from* all forms including interconnection. Consequently, a regulatory test that is able to be applied in a timely and transparent manner is of key interest. To this end South Australia would advocate as simple a test as possible be **pursued**.

The regulatory structure, which incorporates the regulatory test, must **assist** in the difficult task of minimising any 'gold plating' or over-investment in the network while at the same time not delaying or stymieing any required investment.

An important aid to investment in the NEM is access to reliable and detailed information on investment opportunities. You would be aware that South Australia seeks to achieve this at a regional level through the establishment of the independent South Australian Electricity Supply Industry Planning Council (**ESIPC**).

The appropriate structure of the Regulatory Test cannot be determined in isolation to the regulatory framework it operates within. A key issue for the NEM Ministers Forum (NEMMF) will be to resolve the role and future direction for the transmission network. Accordingly, the appropriateness of the regulatory test: will need to continue to be assessed against the transmission model ultimately adopted.

The attached paper prepared by officers of my Department provides more detail on issues South Australia would wish to raise at this stage of **the** ACCC deliberations.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P Conlon'.

HON PATRICK CONLON MP
MINISTER FOR ENERGY

3 July 2002

ACCC Review of the Regulatory Test Issues Paper

General comments on Regulatory Test

Test should be as simple as possible

A key issue for any regulatory test and its overarching framework is that it should promote timely efficient investment in interconnection, in the context of ensuring adequate new supply occurs as required. Whilst South Australia has benefited in recent times from new generation plant and interconnection, it is important that the incentives exist within the NEM to promote continuing investment that achieves adequate reserve levels.

Clearly it is important that the Regulatory Test is able to be applied in a timely and transparent manner. Some criticism has been directed at the current Regulatory Test in terms of delays in decisions being made on regulatory status. Particular criticism has been levelled at the time it took to produce a determination for SNI. However, the SNOVIC decision would seem to suggest that a relatively quick determination is achievable under some circumstances.

Intelligent Energy Systems (IES) in its report for the "EM Ministers Forum (NEMMF) on interconnection" identifies what it regards as a number of issues with the Regulatory Test. In commenting on the complexity associated with implementing the current test, IES states "...that the majority of benefits arise through deferred capital expenditure, which is largely determined through satisfying the deterministic NEMMCO reserve criterion" (p77). IES suggests that the test could be undertaken in a much simplified form, which would be supported providing there was no adverse impact on the integrity of the process. No doubt a trade-off exists, but the focus should be on including items of a material nature.

The Commission questions whether the Regulatory Test should cover additional benefits such as the competitive effect of a new interconnector. Treasury are concerned that such an approach would risk adding subjectivity and complexity to the Test, resulting in further potential dispute and delays. The onus should be on any proponents for the inclusion of such additional benefits to demonstrate it would be workable and that any such additional benefits would be material to the outcome.

The level of potential competitive benefits would be dependent on the bidding behaviour assumptions employed and the structure of the Electricity Supply Industry (ESI) in the relevant region. Further, for the benefits of regulated interconnectors to be achieved the issue of lack of financial firmness over interconnectors needs to be addressed. Any adverse price impact faced by the exporting region would also have to have regard to other factors such as resultant reliability benefits and potential for ancillary services cost savings.

¹ Intelligent Energy Systems (IES), April 2002, Assessment of the Adequacy and Development of Future Interconnection-A report to NEM Ministers' Forum: <http://www.energymarketreview.org/> (see DNRE submission).

What is the role of the Regulatory Test?

It is important to consider what role the Regulatory Test currently performs. The appropriate structure of the Regulatory Test cannot be determined in isolation to the regulatory framework it operates within.

The current framework is 'ex post' in that optimisation of the asset can occur after the event, with the Regulatory Test providing initial comfort **that** a robust process **has** been engaged (a necessary but not sufficient condition for a continuing regulated return). A key benefit of the current Test is to deal with information asymmetry so that other potentially beneficial proposals are not 'crowded out' without some independent consideration.

A key objective of the regulatory **structure** is to minimise any 'gold plating' or over-investment in the network.

Under the current framework **the** proponent accepts the risk that **an** investment may not be optimal at some future time. The **previous** IRPC process did not test a proposal as to whether it was optimal at the time, *only* that there was a net benefit. If the proponent is to bear the optimisation risk then it would seem appropriate for the proponent to define the project it is prepared to invest in. For the incentive structure to be effective, however, the proponent must perceive a real risk that the ACCC **would** optimise **an** inappropriate investment.

An 'ex ante' regulatory test would **make** the optimisation decision **up** front, in the sense that if approved the proponent would not face **any** risk of the **asset** subsequently being revalued. However, this would effectively give the ACCC a central planner role, which **at** the moment it **is** not seen as equipped to perform nor is it **seen** as a long-term role for the ACCC in any case.

Importance of independent sources of information

Information asymmetry is a key issue for the NEM. The **Issues** Paper notes that under recent Code changes a TNSP **Annual** Planning Report *is* required to contain detailed information concerning all proposed augmentations to the network.

The Electricity Supply Industry Planning Council (ESIPC) has 'been established in South Australia as **an** independent body and source for such information. Whilst planning bodies continue in some cases to be combined with network operations there remains some **question** over the independence of information **supplied**.

Additional comments on remaining specific issues

Maximising net benefits

There are a number of issues associated with **any** suggestion that the Regulatory Test might only refer to a nominated hurdle, such **as** a hurdle rate of **return**. Given the assets **are** to *e m* regulated returns **then** some form of optimisation process should be engaged, at least for **significant** proposals. The **current** Regulatory Test employs a contestable discount rate, so any lower rate would **nsk** 'squeezing out' potential market responses.

The size of project rather **than** whether the proponent is a Transmission Network Service Provider (TNSP) or Distribution Network Service Provider (DNSP) is **the** key factor in coverage of **the** Regulatory Test. **This** approach could also be applied to reliability driven augmentations, in that those reliability investments **involving** large expenditures should face greater scrutiny to ensure that the Regulatory Test is not being circumvented.

Network and distributed resources code change package

Issues with the application of the current Regulatory Test may *be* raised **as** an outcome of **the** current consideration by the National Electricity Tribunal (NET) of the NEMMCO SNI determination. It is **noted** that the Issues Paper states **that** the **ACCC** will monitor the outcome of the Tribunal **proceedings**.