Matters of regulatory principle

TransGrid - ACCC Forum

18 June 2004

Principles

- Consistency in applying regulatory principles is very important in providing a stable environment for investment

- Some aspects of application of principles in this draft determination raise concerns:

  - WACC vs MCE policy
  - Service standards and opex
  - Asset base growth and opex

WACC

- As NEM policy setting body, MCE is seeking better interconnection between States
- Hence the decision to have a new Regulatory test which recognises the benefits of increased competition between generators

WACC

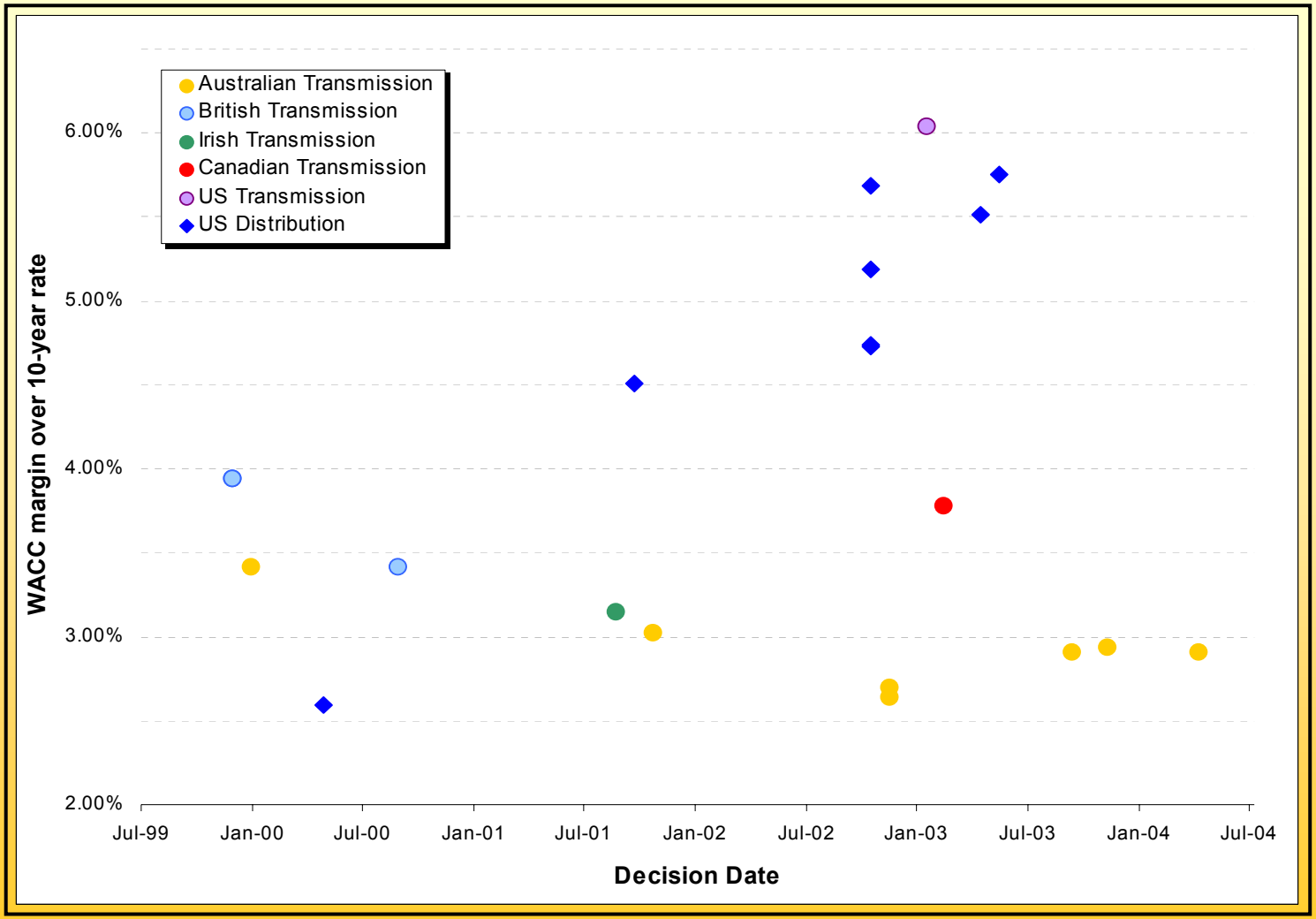
- BUT…….interconnectors are a discretionary investment for TNSPs
- Will only happen if the WACC makes this investment more attractive than alternative investments eg shopping centres
- The WACC margin (the gap between WACC and the risk free rate) does not deliver this

ACCC transmission decisions

WACC vs overseas

- Consumer groups “cherry pick” by showing selected overseas data eg headline WACC or risk premiums but without relating back to the different risk free rates in those countries
- A comparison of “WACC margin” (the gap between WACC and the risk free rate) is most revealing

International comparison of WACC margins



Service standards and opex

- MCE, reacting to market participants, wants service standards / incentives which encourage TNSPs to minimise adverse market impacts eg of network outages
- TNSPs can do this by a variety of higher cost techniques:
  - more “live” work
  - outages at non-peak time (overtime)
- For regulatory consistency, the ACCC must, in introducing these market-related standards, allow the consequential higher opex needed to deliver the desired outcomes

Opex and asset base growth

- Suggestions that opex doesn't increase as more lines, substations, transformers etc are put into service are palpably nonsensical
- Misplaced notion that IT investment is about opex reduction - it's actually mostly about increased "service level" e.g:
  - outage management system to minimise customer and market impacts of outages;
  - environmental management systems to meet today's higher modern environmental standards; and
  - safety management system to comply with new Electrical Safety Act

Opex and asset base growth

- Misplaced notion that new technologies have lower opex costs in early years - experience is quite the opposite; new technologies have major teething problems and high rates of “infant mortality”

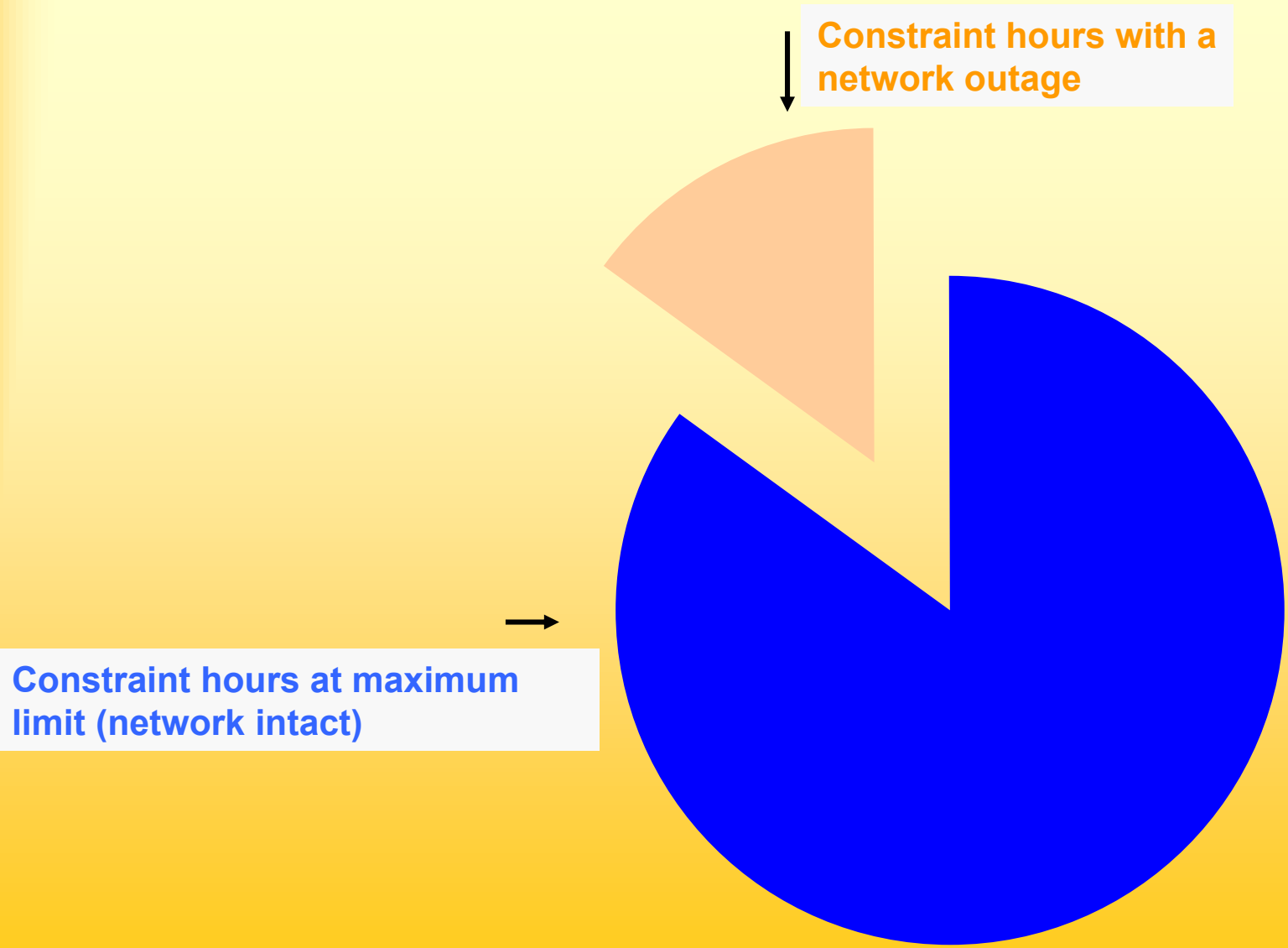
- Opex costs do increase as networks grow larger, and in particular, maintenance costs are directly proportional to the network assets (unless there is a material and sustained reduction in average age of the assets)

Observations on combined user groups submission

- Lots of focus on incentives for reducing impacts of network outages on the market - citing impacts on pool prices and resultant volatility premiums to consumers

- BUT… the major cause of constraints is NOT network outages … it is predominantly flows reaching the maximum transfer capability

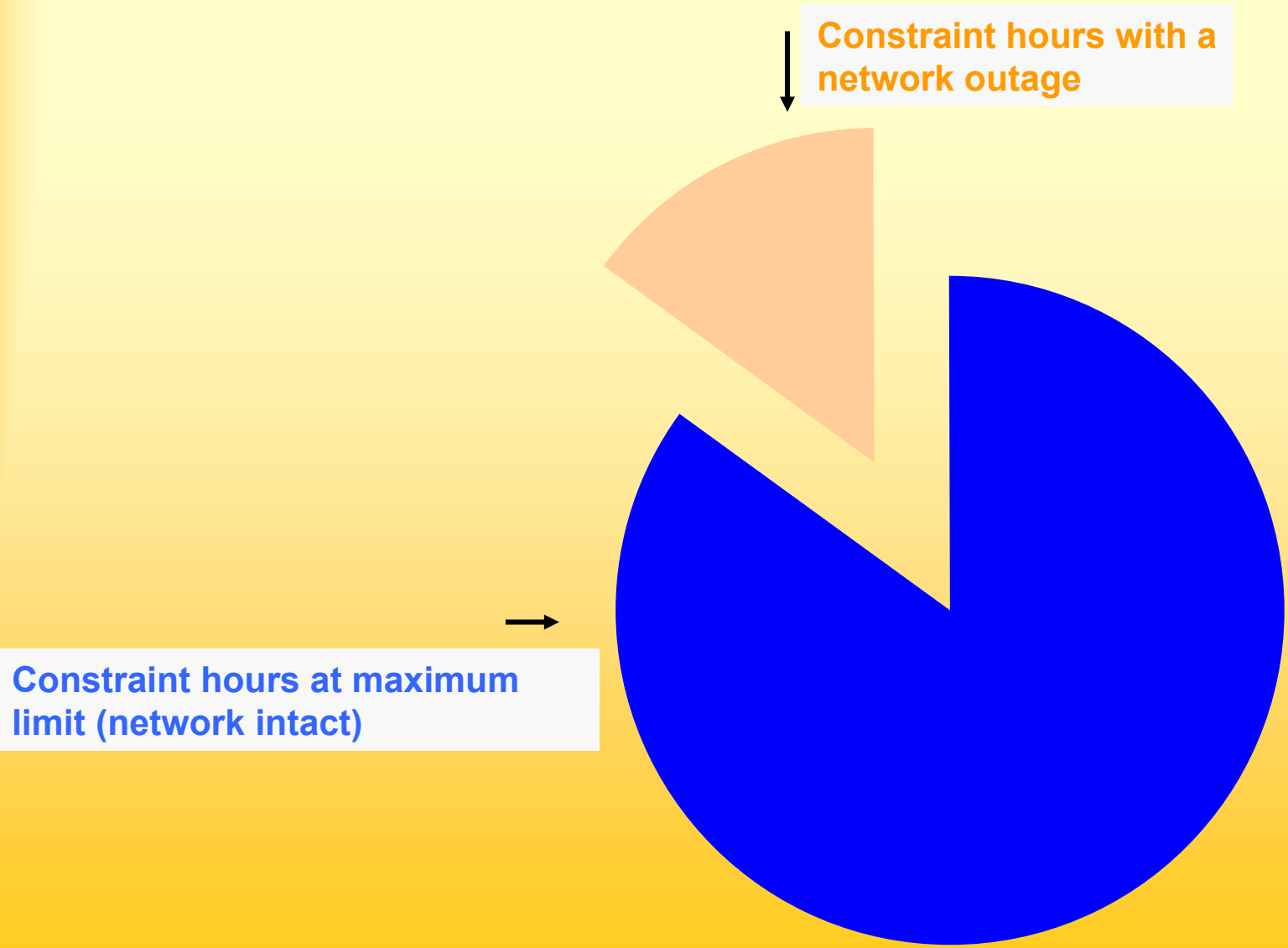
QNI constraints hours in 2004 thus far



Observations on combined user groups submission

- Addressing the major cause of constraints requires investment in interconnectors, which are discretionary investments for TNSPs
- Discretionary investments require a WACC which is attractive vs other alternatives
- YET… some user groups lobbying for a much lower WACC
- Thus, effectively seeking even more constrained interconnectors, and even larger price volatility premiums for consumers

QNI constraints hours in 2004 thus far



Observations on combined user groups submission

The position appears to ignore the data and the internal inconsistency of the position is apparent

Questions?