



Electricity Transmission Network Owners

Regulatory Test Thresholds Thresholds for Application of clause 5.6.6 and 5.6.6A - Rule change proposal

A. Executive Summary

TRUenergy welcomes the opportunity to comment on the Rule proposal submitted by the Electricity Transmission Network Owners Forum (ETNOF) which seeks two Rule changes – the first relates to augmentation asset thresholds under the regulatory test and the second relates to information disclosure requirements for network replacements. This submission will focus on the Rule proposal that deals with an increase to augmentation asset thresholds under the regulatory test. In its current form, we believe this Rule proposal is inconsistent with the NEM Objective that requires the promotion of efficient investment. Accordingly, TRUenergy does not support the Rule proposal.

B. Subject Context

ETNOF submits a Rule proposal that seeks to increase the asset thresholds of new small transmission network assets from \$1Million to \$5Million and new large transmission network assets from \$10 Million to \$35 Million. It argues that in the past TNSPs expressed concerns that the thresholds for small and large transmission network assets were set without proper consideration of the actual cost of network developments and were set too low. Accordingly, ETNOF submits this Rule proposal arguing augmentation asset thresholds under the regulatory test need to be increased to more realistic levels.

This paper raises some arguments that rebut the rationale presented for the Rule proposal. In our view, increases of 500% and 350% are not justifiable whilst the overhead of completing the test remains very small in comparison to the augmentation itself.

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C. Key arguments against the Rule proposal

1. Inconsistency with the NEM Objective-promoting efficiency

The current Rule proposal is potentially inconsistent with the NEM objective which implies that only efficient investments should be promoted in electricity services.¹ The regulatory test currently determines whether there is a need for an investment and establishes the most efficient investment option to meet that need. A large increase in the thresholds will result in the test being bypassed on a range of investments whose efficiency would currently be assessed under the test. The cost overhead in running a fully transparent test is very small compared to the capital being proposed to be invested in these augmentations and therefore the current thresholds do not seem overly burdensome.

2. The requirement for TNSPs to apply the regulatory test to investments under the current asset thresholds assists AER determinations into whether a TNSP's capital expenditure proposal at regulatory reviews is efficient

The regulatory test assists the AER prudency assessment process at rate reviews. Thus, reducing the use of the regulatory test will hinder economic regulation. Whilst some industry experts have expressed the view that the regulatory test has no direct impact on the AER's forecast of capital expenditure during a regulatory determination,² the improvements under chapter 6A of the Rules provide additional clarity on the link of the regulatory test to the AER assessment of capital expenditure forecasts.

Chapter 6A provides that the AER must accept a TNSP's forecasts if it is satisfied that the forecast reasonably reflects efficient costs. Clause 6A.6.6 (B) (3) (7) of the Rules denote the AER must consider the reasonable estimates of the benchmark capital expenditure that would be incurred by an efficient TNSP over the regulatory control period. Given the regulatory test's role in assisting the AER to determine whether forecast capital expenditure is reasonable and efficient, the commission should not permit a dramatic increase in the thresholds.

3. The increase in augmentation asset thresholds applied under the regulatory test result in a lower level of transparency and information available to market participants on the impact of transmission investments

Generator investments can be significantly impacted by the wealth transfers that result from decisions to progress (or not progress) transmission augmentations. These transfers can be large in comparison to the cost of the augmentation itself. Whilst the investment may be efficient, it is inherently controversial and so it is very important that the planning and assessment process is done transparently in a manner that provides confidence to participants affected by it. If such augmentations occur opaquely, then market based investors will lose confidence in the process of transmission development and the risk burden upon participants and therefore the market will increase. The proposed increases will substantially reduce the information available to market participants from which to assess the impact of transmission investments.

¹ NEM Objective – " To promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.

² Planning and Governance Arrangements for the National Transmission Grid – Draft Report Firecone Ventures Pty. Ltd. October 2006 p. 21

"In addition, the regulatory test has no direct impact on the AER's forecast of required capital expenditure during its revenue determination. It is possible that the AER's view of required capital expenditure during its revenue determination. It is possible that the AER's view of projected capital expenditure requirements would be influenced by the effectiveness by which the TNSP has conducted its capex appraisals. It would however be misleading to consider- or advocate- that the AER is approving a capex program when it makes a revenue determination."

As an example we refer the Commission to TransGrid's Final Report published on February 27, 2007 - "Addressing Emerging Constraints on QNI" which involved the installation of a 132KV transformer in Armidale, NSW. Note that this project was not justified under the regulatory test. Whilst it had a cost of only \$13M dollars, it significantly impacted the capacity to flow power between Queensland and NSW and therefore had a much larger impact upon the expected prices for those regions. It should also be noted that very few network projects in the Tasmanian region would approach the \$35m threshold, but are still very significant to participants operating in that state.

We note the ETNOF claim that participants have expressed negligible interest in regulatory tests for augmentations below \$35m. We presume this interest is measured by formal submission. This overlooks the main benefit of the consultation process, that of the provision of information regarding the augmentation decision process. The dearth of formal submission should be interpreted as a statement of confidence by the industry in these regulatory tests, not as a lack of interest.

4. The lower levels of transparency and information available to the market as a result of any increase to the augmentations asset thresholds applied under the regulatory test are contrary to the recommendations of a recently released NERA report on the role of demand side participation in the NEM.

Any increase to the augmentations asset thresholds under the regulatory test is contrary to the recommendations by NERA in a recent report on demand side participation which recommends there is a need to improve the availability of information available to demand side proponents. NERA consider the impediments to demand side participation within the regulatory planning and investment framework in a report entitled "Review of the role of demand side participation in the National Electricity Market" released on the 4th February, 2008. In doing so, they conclude there is a need to improve the information available to demand side proponents to facilitate the identification of demand side opportunities as a substitute to network investment.³ If this Rule proposal is successful it will discourage demand side participation. Accordingly, it is not supported.

³ NERA Economic Consulting " Review of the role of demand side participation in the National Electricity Market" p.38
" In this chapter we have considered the impediments to demand side participation within the regulatory planning and investment framework. In doing so we have made a number of recommendations including:

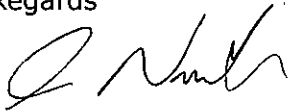
- Improvements to the information available to demand side proponents, to facilitate the identification of demand side opportunities as a substitute to network investment

D. Conclusion

TRUenergy believes the current augmentation asset thresholds applied under the regulatory test result in a wider range of investment options being considered under this test (an efficiency test) compared with the outcome were the current Rule proposal successful. It would also result in less transparency and confidence for market based investors. Further, the costs of performing a regulatory test are very small in comparison with the thresholds being considered.

TRUenergy submits the current thresholds are more consistent with the NEM Objective.

Regards



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Manager Regulation (Access)