

**National Electricity Amendment
(Transmission Last Resort Planning)
Rule 2005**

Submission to AEMC

-from-

**TRUenergy
NRG Flinders
International Power
Loy Yang Marketing Management Co
AGL**

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1. Introduction

This submission represents the views of the following companies, “The Group”:

- TRUenergy;
- International Power;
- Loy Yang Marketing Management Co; and
- NRG Flinders
- AGL

The Group owns the majority of Victorian and South Australian generation capacity and will be approaching this review with prime consideration of the interplay between the regulated transmission network and the competitive national electricity market.

2. The Case for Change

2.1. *Empirical Evidence*

The MCE concern which has prompted it to propose the Last Resort Planning Power (LRPP) is that “current arrangements may not deliver timely and adequate levels of transmission investment”

We agree that this statement could have been true at times in the past. However, a number of recent improvements have been made (and others are in prospect from current reviews) to the arrangements for transmission planning and investment: including:

- a new version of the Regulatory Test,
- the ANTS process,
- ACCC changes to regulatory principles for transmission: especially removal of optimisation risk; and
- the current AEMC review of TNSP revenue regulation.

These changes have specifically designed to address and correct historical problems in transmission development. They are substantial enough to make historical investment performance largely irrelevant to the case for further changes, such as the LRPP. In short, these changes should be given a chance to work before further change is proposed.

Furthermore, regarding the current state of investment efficiency, there are no identified and potentially economic transmission investment projects – that we are aware of – that are languishing as a result of TNSP inaction.

Thus, we do not believe there is any compelling empirical evidence that shortcomings in transmission efficiency are such that further powers of regulatory direction are necessary or appropriate.

2.2. *Theoretical Considerations*

On the other hand, we agree that the problems that the MCE describes could, in principle, arise in the future. Broadly speaking, there are three possible impediments to the development of an identified transmission investment project:

- the regulatory framework for transmission is such that a rational investor has insufficient commercial incentive to invest;
- the company or companies that, in practice, are able and entitled to invest do not respond rationally to the regulatory incentives, either because of a lack of commercial discipline or because they have other, conflicting, non-commercial objectives; or
- the project is likely to be uneconomic

The first impediment is best addressed by changes to TSNP regulation, which is the subject of a current AEMC review¹. We have previously submitted some suggestions to this review which we think are also relevant here². These are presented in section 3.3 of this submission.

The second impediment must be addressed by placing a greater commercial discipline on some existing TNSPs. Whilst this might be achievable through expanded regulatory direction, we think that it is better done through measures to enhance the contestability of transmission development. Again, we have previously made some relevant suggestions to the AEMC TNSP Review³ and these are presented in this submission in section 3.4.

The third impediment is a deliberate and necessary aspect of the regulatory framework and so need not and should not be mitigated.

¹ Gordon Jardine, Chairman of the Transmission Network Owners Forum, has been quoted as saying that such changes could boost transmission investment by 40% over the next 5 years: Australian Financial Review, 20th February 2006

² AEMC Review of the Electricity Transmission Revenue and Pricing Rules, Response to the Revenue Requirements Issues Paper: November 2005. Note that, although AGL was not in the group that made this submission, it supports those elements of the submission that are referred to in this document

³ *ibid*

3. Options for Change

3.1. *Concerns with the LRPP Proposal*

We do not support the LRPP approach, for reasons which we set out below. However, in case this measure is to be included in the Rules, we make some suggestions, in section 3.2 below, for refining it, with the aim of increasing its effectiveness whilst restricting its scope. First, we set out our concerns with the LRPP proposal.

Our first concern is that it doesn't actually solve the MCE's perceived problem. At best, it will make a TNSP submit a project to the Regulatory Test ("the Test"). This will only lead to actual investment if, firstly, the project passes the Test and, secondly, the TNSP (or, possibly, another party) then decides to make the investment. Neither is guaranteed, particularly if one or more of the fundamental impediments that we identified above remains.

We have seen in the past, particularly with SNI, that much of the work in developing an investment project – especially one whose economics may be marginal – is in the detailed "optimisation" of the project design. In the case of SNI, when the economic outlook looked poor (as a result of the commissioning of the Murraylink competitor), Transgrid – with support from VPX – optimised the project in a way which substantially enhanced its inter-regional capacity with little or no increase in cost.

Who is going to undertake this optimisation for the "unloved" project that the MCE envisages may be the subject of the LRPP? Not the AEMC, as it simply does not have the necessary information or expertise. And probably not the directed TNSP, who (for whatever reason) has no interest in developing the project and so is unlikely to make any effort to nurse the project through the Test⁴. In other words, an unloved project will not become loved simply because of regulatory direction: if anything, the reverse.

Our second fundamental concern is that it expands the regulatory powers of the AEMC, in a way not envisaged in the development of the new NEM governance arrangements, and thus increases regulatory risk, at two levels:

- specifically, it increases uncertainty associated with transmission investment, as affected parties will have to second-guess not just the likely response of a TNSP to an identified investment project but also the likely response of the AEMC if the TNSP's response is inaction⁵;
- philosophically, it challenges and upsets the established governance principles of AEMC as "rule-maker" and AER as "enforcer" by creating a precedent⁶ for the AEMC awarding itself new "executive"

⁴ Taking into account that, if the project did pass the Test, there may then be some "moral" pressure on the TNSP to invest.

⁵ And then the response of the TNSP to any AEMC direction and so on.

⁶ if the Rule changes are approved

regulatory powers on the basis that these promote the NEM Objective.

In summary, we do not support the LRPP proposal as:

- it is not clear that there is an existing regulatory failure;
- it neither addresses nor solves any potential regulatory failure; and
- it expands the scope for regulatory intervention and therefore exacerbates regulatory risk.

3.2. Refining the LRPP Proposal

If an LRPP is to be introduced, the proposals need to be refined to be more restricted and focused. This should be done in the following ways:

- firstly, the AEMC should explicitly be restricted to using the LRPP only in relation to investment projects which have been identified through the ANTS process and which have a high likelihood of being economic⁷;
- secondly, the AEMC should be required to develop and publish guidelines describing when and how it proposes to use the LRPP – and of course adhere to these;
- thirdly, these guidelines should specifically allow and encourage a voluntary response to the identified investment need⁸, from either regulated or non-regulated investors; and
- finally, the Rules should make clear which party or parties may be directed using the LRPP. One would expect that this would be only the TNSP or TNSPs with transmission franchises in the location of the investment project

3.3. Improved Incentives for Efficient Transmission Investment

We have previously suggested the following changes to TNSP revenue regulation to the AEMC:

- a TNSP should be entitled to recover⁹ either the efficient cost of an augmentation, or its measured market benefit, whichever is lower. The market benefit will be established when the project is subjected to the Test. Once this value has been established, it should not be revisited¹⁰, even if the anticipated market benefits subsequently fail to arise.

⁷ based on the high-level economic analysis undertaken in the ANTS process

⁸ an example of this approach is in the requirement on NEMMCO to encourage a market response to a projected reserve shortfall before using its powers to contract for reserve

⁹ on an NPV-basis based on its regulated WACC

¹⁰ Except in the normal process of establishing a depreciated replacement cost. In short, there should be no subsequent optimization.

- an additional reward should be obtainable for efficient projects (and a further penalty should be imposed for inefficient projects). These rewards and penalties may arise from other aspects of the regulatory framework. If they do not – or are insufficient – an additional reward/penalty mechanism may be needed.
- a TNSP should be allowed to choose at what point the efficient cost and market benefit for an augmentation are determined: either prior to project commitment and development; or after project completion, at the next regulatory reset.

We believe that such measures would clarify and strengthen the incentives for a rational TNSP to undertake economic transmission investment.

3.4. *Enhanced Contestability of Transmission Development*

We have previously suggested to the AEMC¹¹ that any suitably qualified 3rd party should be entitled to:

- request that a TNSP submit an identified project to the Test, so long as the TNSP's direct costs are covered;
- itself submit an identified project to the Test where the relevant TNSP has declined to do so; and
- develop an efficient project¹² which a TNSP has declined to develop, and receive regulated revenue¹³ for that project on the same terms as those for a TNSP.

We believe that such enhanced contestability will encourage a TNSP to develop economic projects and, where it declines to do so, will allow a third party to develop the project itself. Importantly, this is achieved without increasing the scope of regulatory intervention or the level of regulatory risk

¹¹ AEMC Review of the Electricity Transmission Revenue and Pricing Rules, Response to the Revenue Requirements Issues Paper: November 2005

¹² ie a project which has passed the Test

¹³ Most likely, the local TNSP would continue to levy TUoS on users, but would be required to forward a part of this revenue to the 3rd party developer (much like a coordinating TNSP).

4. Equal Treatment of National Flow Paths

The National Electricity Rules have defined the term *national transmission flow paths* with the intent of capturing major paths of bulk energy. NEMMCO have effectively identified these in their ANTS processes. Whereas many relate to flows between the currently defined regions, several do not. This is not surprising because the choice of regional boundaries and regional reference nodes is essentially arbitrary.

The proposed rule however does not capture some key flow paths, due to its inclusion of the words “between *regional reference nodes*” in its definition of the constraints associated with national flow paths that are to be subject to the power of direction. It would appear that such a limitation is unnecessary and at odds with the claimed policy of “the realisation of a national grid” and criticism of previous planning being “state based and piecemeal in nature”.

It would appear that if the Last Resort Planning concept is to go ahead, that consistent with the objective of achieving a national approach to transmission and focussing upon the most key national flow path congestion, the last four words of this definition should be deleted.

5. Conclusions

We do not support the LRPP proposal. We can see no evidence of a *current* regulatory failure (the historical examples referred to by the MCE occurred under a substantially different regulatory framework) which would justify the proposed increase in the AEMC's regulatory power.

Even if there were a regulatory failure, we cannot see how the LRPP would correct it. If a TNSP is unwilling to invest in an identified project, simply forcing it to submit that project to the Regulatory Test is unlikely to change its position.

Instead, the AEMC should be considering *why* a TNSP might be unwilling to promote a potentially economic investment. If it is due to insufficient financial incentives, then this should be corrected through changes to TNSP revenue regulation. On the other hand, if it reflects poor TSNP commercial discipline, we think this is best addressed by allowing greater contestability in transmission development. Both of these potential solutions lie within the scope of the AEMC's current Chapter 6 review and this review should be completed – and its recommendations implemented and given time to work – before the alternative approach of regulatory direction is considered.

If an LRPP *is* to be introduced, it should be designed so that uncertainty around its scope and operation is minimised. It should be confined to projects identified through the ANTS process and conducted by the AEMC in a manner which allows investment alternatives – regulated and unregulated – to be put forward.