



New South Wales
TREASURY

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Dear Mr Asher

Proposed Code Changes to Implement the NECA Transmission and Distribution Pricing Review

In September 1999 the ACCC released an Issues Paper in which it sought comments from interested parties on the proposed Code changes to implement the NECA Transmission and Distribution Pricing review.

NSW Treasury has set out its comments on particular aspects of the proposed Code changes in the attached submission.

Should you have any questions, or wish to discuss these comments, please contact Adriaan van Jaarsveldt on (02) 9228 4203.

Yours sincerely

Don Anderson
Director, Market Implementation Group

ACCC Consultation on Proposed Code Changes to Implement the NECA Transmission and Distribution Pricing Review - NSW Treasury Comments

Introduction

The ACCC released in mid-September an Issues Paper in which it seeks responses from interested parties to a number of questions.

A number of the issues raised by the ACCC are outside the immediate experience of the NSW Treasury. As the nature and context of the issues raised requires direct experience of particular Code processes and/or provisions, Treasury is unable to provide additional insight but expects that affected Code participants will provide the range of views sought by the ACCC.

Accordingly, the following comments are directed to matters about which the NSW Treasury has either formed or previously expressed a view.

General

NSW Treasury welcomes the release of the draft Code changes setting out the proposed implementation of the NECA Transmission and Distribution Pricing Review. We note that the principles underlying this draft have been the subject of much internal industry debate leading to NECA's final report on the subject. We expect that when fully developed and implemented those principles will, in a number of areas, lead to improvement in the market design.

Whilst the desire to now complete a process which has exceeded its original timetable is understandable, this should not be at the expense of careful evaluation of what we consider to be a set of material, far-reaching and complex code changes.

In reviewing the draft Code changes we have noted that the opportunity for the public as a whole to consider and evaluate the draft Code changes has been limited. Despite the significance of the changes proposed these have not been discussed in draft form with market participants and key stakeholders before submission to the ACCC as is required under Chapter 8 of the Code. In particular, we note that the provisions of clause 8.3.5(d) concerning public consultation would appear not to have been followed.

It is our view that the consultation process followed by NECA is not consistent with the exemption provisions of clause 6.1.6. That Clause only exempted application of the Code change consultation process to the *principles developed under clause 6.10.1(c)*. These Code changes would appear to be beyond the scope of that exemption.

NECA has included comment on the principles of, and objectives for, network pricing in the Code. Indeed, it has developed a substantial framework for evolution of the market and seeks to now replace the existing Part A.

The broader issue which arises with respect to NECA's proposed changes to Part A is whether NECA may have exceeded its terms of reference in expanding the scope of its review beyond a review of parts C and E of the Code. Although this would appear to be the case, the chief concern which arises is with the adequacy of the consultation process which has accompanied these changes and less so the form and content of the changes proposed.

Our chief concern is that NECA's proposed key principle 6.1.1(b)(1) is to:

... promote competition in network services wherever practicable;

It is suggested that the wording of clause 6.2.2(h) is a better expression of the principle intended in the market design namely:

... promote competition in network services where economically feasible;

Many circumstances may arise where it may be *practicable* to promote competition in network services but not necessarily *economically feasible* to do so. Such situations are anticipated within the ambit of the *Trade Practices Act* and give rise to the powers granted to the ACCC under that legislation to authorise anti-competitive conduct in particular circumstances. We do not believe it appropriate through the Code to cast provisions in a manner which seeks to fetter the statutory powers of the ACCC.

A similar drafting occurs in 6.1.5(b). Here the intent would appear to be to provide certainty in the approval process for the benefit of *Transmission Network Service Provider's* and ultimately, customers. While this is laudable, we query whether the process described is reasonable or whether it seeks to fetter the statutory discretion of the ACCC. Further, the intent appears to be to define a process within which the ACCC grant's approval to a methodology or framework in the capacity of Jurisdictional Regulator. This provision, by applying to all Jurisdictions, conflicts with clause 6.2.1(a) which provides the timetable for the assumption of the jurisdictional Regulator role by the ACCC within each jurisdiction.

Finally, we query whether this provision is poorly placed. It clearly relates to clauses 6.5.8 and 6.5.9 and should logically be placed with those clauses.

Responses to ACCC Issues Paper

4.1 Transmission Network Pricing

4.1.1 Existing Arrangements

Issues for the Commission

- *Are the proposed Code changes sufficient to encourage networks to negotiate and provide generator access services?*

- *Is there sufficient clarity to distinguish between the unregulated generator access services and the regulated generator negotiated use of system service (and any associated assets and revenues)?*

These issues are matters best evaluated by reference to market participants.

4.1.2 Who should pay TUoS charges

Issues for the Commission

- *Do interested parties believe that recovering the costs of the existing network from network customers minimises the distortions from recovering sunk costs?*
- *Would the recovery of a proportion of the sunk costs from generators be less distortionary than the framework proposed in the NECA review?*
- *Could the framework for recovering sunk network costs from customers also be applied to generators? That is, allocate a proportion of existing network costs to generators and allow individual, price sensitive generators, to negotiate discounts.*

NSW Treasury supports the development of a framework for the application of a *generator TuoS* charge in respect of the relevant portion of new investment cost. We have previously expressed the view that the recovery of sunk costs from existing network customers is appropriate and confirm that view is still current. NECA has concluded that the recovery of sunk costs from customers is no more or less distortionary than the alternatives. As no measurable benefit appears likely to accrue from an arbitrary change in this arrangement we support NECA's conclusion that no change is warranted.

The critical element of the framework for *generator TuoS* is contained Schedule 6.8. We are of the view that Schedule 6.8 is an unsatisfactory basis for apportionment of new investment costs to generators.

Modelling performed to assess the relative benefit of a regulated network investment option against competing options is considered reasonably reliable but it cannot identify in all circumstances the individual beneficiaries of an investment decision. The central issue is that the outcome of the modelling used in the analysis of a regulated investment decision is linked to a range of representative scenarios developed for a different purpose. The modelling outcome is critically dependent on the assumptions made and the range of scenarios studied and could be quite volatile in circumstances where a multiplicity of possible beneficiaries exist. Studies of a suitably large number of scenarios may produce a statistical distribution of the range of benefits and the likely beneficiaries but in many circumstances it is unlikely to be sufficiently robust to meet with market participant acceptance or approval.

It is therefore unlikely that an individual market participant faced with additional charges arising from an arbitrary allocation of costs arising from a regulated investment could, or would, willingly accept the assessment. This will inevitably lead to scope for substantial disputation and attendant, undesirable transaction costs. Institutionalising the application of charges to parties deemed to be beneficiaries does not in our opinion provide a sufficiently robust and defensible basis for doing so.

Moreover, the methodology as framed does not appear to recognise the dynamic nature of the market. No provision is made for the recalculation of charges as the mix of generation plant

varies in the market nor if the balance between the supply and the demand side of the markets alters over time.

There is also no guidance as to how the estimate of benefits is to be derived and applied. A *Network Service Provider* could as easily conclude in applying S6.8, clause 1 that generators received all of the benefit of reduced congestion as did customers. Thus the Code changes do not provide a sufficient basis for determining who are the beneficiaries of the investment.

NSW Treasury supports the planned distinction between small and large capital investments and adopting streamlined processes for smaller and/or uncontroversial investments. Further consideration might be given though to the appropriate threshold by reference to actual project experience of the network businesses and considering the substantial transaction costs that accrue when applying the consultation processes developed in respect of major investments.

4.1.3 How should TuoS charges be levied

Issues for the Commission

- *Do interested parties believe that NECA's proposals introduce more "market like" disciplines into network's investment planning processes?*
- *Are NECA's proposals likely to be consistent with the future directions of network pricing in the NEM (such as nodal pricing and transmission congestion contracts which are the subject of a new review by NECA)?*
- *Are NECA's proposals sufficient to get market participants to reveal the extent of the benefits they will receive from a new network investment?*
- *Alternatively, are the proposed new network investment arrangements likely to illicit behaviour where market participants will act in a strategic manner by denying they receive benefits from a new investment in the anticipation that the investment will go ahead and be paid for by other network users?*
- *Will regulatory responsibilities be fragmented if the code's dispute resolution procedures are used to arbitrate disputes between networks and connected users? If so, do interested parties believe the ACCC's regulatory powers should be extended to allow it to arbitrate such disputes?*
- *Do interested parties believe that a move to long run marginal cost (or utilisation adjusted) pricing represents a significant improvement in transmission pricing?*
- *Do interested parties believe that the proposed pricing arrangements will ensure that network customers face charges that accurately reflect the needs for new investment at each connection point?*
- *By using both short run (reflecting losses and constraints) and long run pricing methodologies, will there be over signalling of new investment at constrained parts of the network?*
- *Do the proposed Code changes provide sufficient guidance to require the networks to adopt efficient prices from within the cost ranges?*

NSW Treasury supports the adoption of the proposal to determine cost allocation within a range determined by three methods as proposed by NECA. We consider the proposals represent progress towards a more sustainable approach to network pricing within the known limits of the CNRP methodology which otherwise applies to the NEM.

The ACCC has sought views on whether the approach taken by NECA is consistent with other possible methodologies such as full-nodal pricing. In our view it is not. But it must be recognised that no analysis has yet been performed to demonstrate a positive benefit to consumers from a move to a more intellectually pure regime such as full nodal pricing or perhaps an intermediate regime. Assuming at some point in the future such a benefit were proven, it is likely that significant transitional issues will arise in respect to the orderly introduction of such a change. We consider it unlikely that the current proposals will materially impact on the severity of the transitional issues which would arise in those circumstances.

While we support the broad thrust of the NECA proposal we recommend that the ACCC give consideration to an enhancement that would enable the relevant regulator to apply a consistent policy to all eligible parties based on a price determined within the permissible boundaries established by the NECA methodology. It would then be feasible for NSP's to avoid unnecessary cost and effort in determining three prices on all occasions when the policy determined by the relevant regulator might only require one methodology be employed.

As this suggestion is permissive in nature and creates only a discretion for the regulator to apply or not apply as deemed appropriate, we consider it represents an enhancement which will ultimately benefit customers by reducing costs.

As NSW Treasury has no experience in the application of the pricing methodology to customer connection agreements, we do not comment on the practical issues which might arise. Instead we would refer the ACCC to the comments of the network businesses who are best positioned to respond on that aspect.

4.1.4 Summary of proposed changes to TUoS charges

Issues for the Commission

- *Do interested parties believe that the proposed Code changes reflect the findings of the NECA review?*

This issue is best evaluated by reference to market participants.

We believe the Code changes broadly reflect the findings. However the proposed changes to S6.7.4 *Financial transfers between Network Service Providers* do not appear to have been the subject of consultation and extend beyond the scope of what might be termed "consequential amendments". We understand that the *Transmission Network Service Providers* have expressed concern as to whether these changes are workable in practice. At the very least we would expect the changes proposed in this clause to be further investigated before a final decision is made.

4.2 Distribution network pricing

Issues for the Commission

- *To what extent is a uniform approach to the development of principles for distribution network pricing desirable and should jurisdictional regulators develop, as a matter of some urgency, national guidelines for distribution network pricing?*
- *Does the flexibility available to jurisdictional regulators in determining how distribution network service providers pass on TUOS charges to final customers weaken the applicability of the principles emerging from the NECA review?*
- *Other than NECA's proposals for a sizeable peak demand charge, what issues should be included in any review of distribution network pricing principles?*

NSW considers a uniform approach to the development of national principles for distribution network pricing desirable and agrees that Jurisdictional regulators should undertake this task as a matter of some priority.

Whilst the flexibility of Jurisdictional regulators may impinge on the strict application of the principles emerging from the NECA review, we are firstly of the view that insufficient emphasis has been placed on the question of economic feasibility. Beyond this, it is our experience that the flexibility available to regulators serves an important and useful purpose in ameliorating undesirable impacts on customers such as price shocks which, by virtue of the highly prescriptive nature of the Code, are otherwise inevitable. We do not support any move to lessen the capacity of regulators to exercise reasonable discretion in the execution of their functions.

We consider the development of terms of reference for a review might best be carried out by broader public consultation coordinated by the relevant regulators in each Jurisdiction.

4.3 Price negotiation framework and unbundling transmission and distribution charges

Issues for the Commission

- *Are the proposed Code principles and regulatory arrangements sufficient to guide the negotiation processes, in particular where one party (ie the network) is a monopolist and likely to have an information advantage over customers?*
- *Is it reasonable to allow some users to negotiate discounts but to require other users, presumably with less negotiating power, to bear the cost of the discounts?*
- *Is it reasonable for negotiations on higher service standards to be subject to a network's negotiation framework yet negotiations on price discounts are not?*
- *What sort of information should be publicly released on the outcome of the negotiations, in particular if the outcome is that some customers pay a greater share of someone else's network charges?*

- *Is this negotiating framework sufficient to ensure that networks are limited in their ability to cross-subsidise some customers at the expense of others?*
- *Should networks have the ability to negotiate lower service standards than those specified in the Code, in particular in lightly utilised parts of the network where providing N-1 may not provide a net public benefit but where investments proceed on the basis that they are “cost effective”?*
- *Do the proposed Code changes meet customer expectations on the type and level of disaggregated information on network costs and prices?*
- *Are the time frames reasonable in which requested information must be provided?*
- *Is it reasonable that the proposed Code changes have been inserted into a part of the Code which has been derogated by all of the participating jurisdictions and, therefore, will not come into effect in the immediate future?*

NSW supports the framework developed by NECA for the offering of discounts in appropriate circumstances and in accordance with procedures endorsed by the relevant regulator.

As the methods of determining the range of prices are defined, we consider it more likely that a policy will rapidly evolve driven by equitable treatment considerations to adopt a particular price within the permissible range. This is at the core of our suggested enhancement in section 4.1.3 above. Accordingly, the scope for negotiation would in our view be minimal and the issue of a negotiation framework would not arise. Given the involvement of the regulator, we would anticipate the policy being a public document and the same supervision should ensure the framework is not abused.

Treasury supports the notion of flexibility in the determination and application of service standards. However, we have not had the opportunity to evaluate the further implications of negotiating for lower service standards.

The penultimate two issues are largely matters for market participants to comment upon.

NSW Treasury believes the Code changes are appropriately placed in the correct segment of the Code. The transitional nature of the derogations is well understood both within the industry and the market place. Scope exists in the current regulatory framework for Jurisdictional regulators to deal with the issue of unbundling and NSW does not support ad-hoc changes to the integrity of the current regulatory framework.

4.4 Service Standards

Issues for the Commission

- *Do the proposed Code changes fully implement the findings of the NECA transmission and distribution pricing review?*
- *Do the Code changes impose sufficient obligations on the networks to establish clear and measurable service standards in advance of the determination of their revenue cap?*

- *Has an appropriate balance been achieved between the responsibilities of the networks and independent parties (eg technical panels or regulators) in establishing network service standards?*
- *Are the responsibilities and powers of regulators clearly defined?*

These issues are best evaluated by reference to market participants.

4.5 Embedded Generation

Issues for the Commission

- *In the absence of generators contributing to the costs of the existing (sunk) networks, does the proposed arrangements establish a competitively neutral environment for embedded generation?*
- *Is it reasonable that the existing requirement has been deleted from Chapter 5 of the Code and replaced by proposed Code changes that are to be inserted into a part of the Code which has been derogated by all of the participating jurisdictions and, therefore, will not come into effect in the immediate future?*

We believe the framework for embedded generation errs on the generous side. It is observed that an embedded generator does not have to undertake a transparent public assessment process to qualify to receive a substantial quantum of regulated revenue whereas an equivalent network investment must do so and is further subject to the regulatory risk of optimisation. If an embedded generator benefits from a network investment by way of increased access to load the generator will, within a distribution network receive the appropriate TUoS component. If the embedded generator exports energy via the transmission network it is appropriate that it be subject to identical treatment to any other generator.

NSW Treasury believes the Code changes are appropriately placed in the correct segment of the Code. The transitional nature of the derogations is well understood both within the industry and the market place. Scope exists in the current regulatory framework for Jurisdictional regulators to deal with the issue of unbundling and NSW does not support ad-hoc changes to the integrity of the current regulatory framework.