



Tasmania

DEPARTMENT of
TREASURY and FINANCE

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Attention: Tanya Barden

Dear Ms Barden

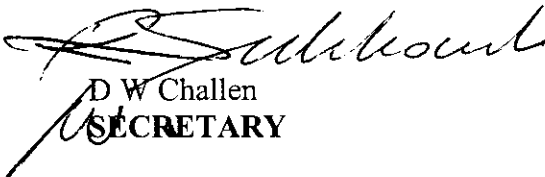
**ACCC DRAFT DETERMINATION
NETWORK PRICING AND MARKET NETWORK SERVICE PROVIDERS**

Attached is the submission from the Tasmanian Department of Treasury and Finance in regard to the ACCC Draft Determination on Network Pricing and Market Network Service Providers dated 12 December 2000.

This submission was dispatched by electronic email to the ACCC Electricity Group on 27 April.

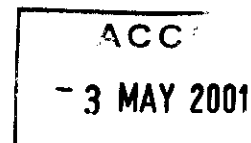
I believe that the submission is self explanatory. However, if you wish to discuss any aspects of the submission further could you please contact Richard Sulikowski, Director, Energy Markets Branch, telephone (03) 6233 2600 or email: richard.sulikowski@treasury.tas.gov.au.

Yours sincerely


D W Challen
SECRETARY

27 April 2001

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Tasmania

ACCC Draft Determination

**Network Pricing
and
Market Network Service Providers**

Submission

Department of Treasury and Finance

April 2001

1 Introduction

The Department of Treasury and Finance has a key role in providing advice to the Tasmanian Government on electricity sector reform, with a focus on Tasmania's entry to the National Electricity Market (NEM), subject to the successful completion of Basslink.

The Department is also responsible for administration of Tasmania's commitment to National Competition Policy. It also provides advice to the Government, as the owner of the existing State-owned electricity entities, in regard to issues that may impact on the financial performance of those entities.

The Department, therefore, has a key interest in:

- the establishment of network prices that are fair and reasonable for all parties and promote economic efficiency in the supply of electricity to customers in the short and longer term; and
- market arrangements that will allow the development of Basslink to proceed.

This submission:

- briefly outlines Tasmania's energy initiatives;
- emphasises the importance of regulatory certainty for major infrastructure projects, such as Basslink;
- comments on the ACCC draft determination in the context of its potential impact on Basslink; and
- proposes that any solution for network pricing needs to be consistent with the long term direction of the market.

2 Background

Tasmania's current electricity needs are approximately equivalent to the long-term supply capability of the State's hydro electric system. Tasmania needs to be able to access new sources of energy to attract new investment and jobs.

In this context, the Tasmanian Government is pursuing two critical energy initiatives through private sector developments; Basslink and the Tasmania Natural Gas Project. The Tasmanian Government has made an in-principle commitment to join the NEM, conditional on the successful completion of Basslink and the State securing appropriate transition arrangements.

These projects have a combined investment in the order of \$1 billion.

They are, therefore, significant private sector energy infrastructure projects which offer the prospect of transforming Tasmania's energy industry and the introduction of far greater competition and choice than has previously been available to the State's energy users.

Securing regulatory certainty is a key requirement for these highly capital-intensive private sector projects. However, construction and commissioning of both projects is scheduled to occur in a regulatory environment that is presently unclear.

Target dates for these projects are:

- Basslink - Commencement in 2001 with completion in late 2003; and
- Natural Gas Project - Commencement in 2001 with completion in mid 2002.

Basslink

Basslink is a nationally significant project, and this is reflected by the support the project has received in other States and by the Commonwealth Government.

By facilitating Tasmania's entry to the NEM, it builds on the significant electricity reform achieved in Australia over the past decade.

Basslink has been developed to date under the safe harbour rules for Market Network Service Providers (MNSPs) that already have an interim authorisation from the ACCC.

The potential benefits of the Basslink project for the Tasmanian economy are significant, and when realised, will go a long way towards reducing Tasmania's economic isolation.

The benefits flowing from Basslink are not confined to Tasmania. By introducing a major new supplier into the NEM, Basslink will augment the competitive dynamics of the NEM, as well as strengthening the physical aspects of the market.

The overall benefits can be summarised as follows:

For Tasmania:

- facilitates Tasmania joining the NEM;
- further diversifies and expands the market;
- secures the State's long term electricity supply, and reduces the costs and risks to the State due to its current exposure to hydrological risk,
- facilitates introduction of competition into the State's production and retailing of electricity; and
- provides the opportunity to develop new generation options in Tasmania such as wind generation.

For Victoria and other NEM States:

- introduces a new source of supply in the NEM;
- diversifies and expands the NEM with the inclusion of the Tasmanian region;
- increases security of supply for Victoria post-2003;
- provides additional capacity from a renewable energy source; and
- provides the potential for lower peak prices for customers in NEM jurisdictions.

Tasmania Natural Gas Project (TNGP)

The TNGP will introduce natural gas to the State via the construction of an undersea gas transmission pipeline between Victoria and Tasmania.

The project also involves the development of on-island large-scale gas-fired generation and the sale of natural gas to industrial, commercial and residential customers.

Private sector investment of around \$350 million, plus \$150 million for reticulation, is envisaged.

Gas and gas-fired electricity is planned to be available by mid 2002.

Certainty regarding future market and regulatory arrangements is also important for the TNGP.

3 Investment in Infrastructure Assets

The private sector has an important role to play in helping to meet Australia's future energy infrastructure needs. Establishment of the NEM was intended to provide the framework for private investment in energy generation and also in transmission.

While there has been some investment in new generation, uncertainty in regard to regulated transmission pricing arrangements has proved a major disincentive for private sector investment in this area and, indeed, limited investment more generally.

Ongoing regulatory uncertainty in regard to transmission investment also imposes uncertainty for generation investment. Hence, there is some risk that the market could fail to deliver the required level of system security because of this ongoing regulatory uncertainty.

Since commencement of the NEM, the only interconnectors that are being developed are private sector developments based on the MNSP concept.

Investments in major new interconnectors are typically capital intensive and of a long-term nature, creating significant capital risk. Hence, it is important that future regulatory burdens that may be imposed on the developers of such interconnectors do not change significantly from what might have been reasonably expected when the investment commitment was made.

The implementation of the recent ACCC draft determination could result in the imposition of burdens on the developer of Basslink that could not have reasonably been expected when the commitments to Basslink were entered into in 1999-2000. These concerns are outlined below.

4 Basslink Negotiation Framework

At the time that proposals were being prepared for Basslink, the project could have been developed as a regulated or non-regulated interconnector (MNSP). However, proponents judged that there was unacceptable regulatory risk associated with the regulated option.

The framework for network pricing, as outlined in the *National Electricity Code (NEC)* in force at that time, as well as in the Code Changes put to ACCC by NECA as an outcome of the Transmission and Distribution Pricing Review, envisaged:

- customers bear the sunk costs associated with existing transmission assets (unless they are optimised out of the asset base) – on the basis that this has the least distortionary impact on the market;
- generators (and MNSPs) may choose to fund augmentations needed for connection and for the level of access sought from TNSPs; and
- generators (and MNSPs) can negotiate compensation arrangements associated with the level of access service sought from TNSPs (ie firm access arrangements).

The arrangements for compensation outlined in the NEC require that TNSPs arrange for participants who do not have firm access to compensate participants who have firm access when the latter are constrained off. Alternatively, participants could pay a premium for firm access to TNSPs who could accept the responsibility for providing it and compensate participants who are constrained off. However, this could expose TNSPs to risks in the energy market, which are not presently within their capability to manage.

Therefore, considering the provisions that were in the NEC in force at that time, or in the Code Changes following the Transmission and Distribution Pricing Review, it was reasonable for proponents to infer the following:

- MNSPs would not be expected to contribute to any sunk cost recoveries for the existing network;
- MNSPs could negotiate with TNSPs to whom they were connecting in regard to the funding of any augmentations necessary to achieve the level of access sought;
- while compensation provisions related to firm access were possible in theory, TNSPs were unlikely to agree to such conditions in practice; and
- additional regions and reference nodes could be established in the NEM when congestion approached a defined level.

This was the basis on which the connection negotiations for Basslink were conducted.

5 ACCC draft determination

The ACCC draft determination contains a number of specific principles for transmission usage prices. On the surface, these principles seem economically sensible and rational.

However, transmission usage prices developed in accordance with these principles will overlap with pricing signals from the energy market. The need to avoid double counting in this context has been recognised by ACCC in its proposed principles, but the arrangements to achieve this in practice may not be practicable.

Furthermore, the adoption of a methodology, as described in the Appendix to the draft determination, which is based on an arbitrary transmission usage algorithm as a surrogate for signalling impending transmission congestion, runs the risk of:

- allocating sunk costs for the transmission system to participants, in particular MNSPs, who should not face such an allocation; and
- inappropriate allocations of costs between participants and variability from year to year with consequently inappropriate influence on market outcomes.

The ACCC draft determination has only outlined the principles that would be applied to transmission pricing under the new methodology. As NECA is required to develop the pricing regime over the next two years, it will not be possible to estimate the magnitude of the financial impacts of the new arrangements on Basslink (and similar developments) for some considerable time.

The draft determination also acknowledges that the form and structure of the network pricing being proposed by the ACCC are not a “final solution” - they are merely a step in what is considered to be the right direction. This suggests there will be material ongoing network pricing related risks and uncertainties even after two or more years of work to implement the ACCC’s current proposals.

6. The long term direction of the NEM

There have been a number of recent reviews, which have been carried out into aspects of the NEM and its operation. These have been carried out by various parties in accordance with their responsibilities and obligations including those in the relevant charters and/or the NEC itself.

Most of these reviews have taken the objectives for the NEM, as agreed by COAG and set down in the NEC, as important criteria. However, because of their restricted scope and the participants involved in them, they have not necessarily produced mutually consistent outcomes. In particular, there has been a major divergence of philosophy in regard to the competitive provision of services in the NEM versus the regulated provision of these services. Transmission access and usage has been one key area where this has been particularly significant as indicated above.

In essence, the development of the market could follow two paths in regard to transmission access as follows:-

1. Transmission access should be available to a certain standard(s) for all participants and all participants should be required to pay the relevant regulated charges for that access. In this event, transmission would be provided in a similar way to the road network, competition would be basically restricted to the energy market and the only significant issue is how transmission charges are determined and by who.
2. Transmission access arrangements should facilitate both competition in the provision of new transmission network services, and full integration of the markets for energy, transmission network services and ancillary services. In this event, it would be expected that the price signals relevant to transmission access would increasingly appear in the co-optimised market, thereby providing the appropriate economic incentives for efficient investment in local remote generation as well as in new transmission.

The establishment of regions in the NEM and the principles set down by ACCC in its draft determination suggest that the second path is the long term direction which has been envisaged to date. This direction is also more consistent with the expectations of private sector participants and the framework under which the connection negotiations for Basslink were conducted.

The establishment of competitive transmission access arrangements cannot be achieved without the simultaneous establishment of property rights.

For example, under the existing arrangements as set out in the NEC, constraints within the existing network could possibly lead to the funding of augmentations to the existing network by existing or new participants through access agreements. Due to the economies of scale associated with most transmission developments any congestion or price signals which were originally present would probably collapse as a result of the augmentation. Any participants that paid for the augmentation on the basis of the original constraints and price signals would then see the value of any access agreements significantly reduced with local competitors able to “free ride” on the new augmentation.

However, the framework established for MNSPs, which is already included in the NEC, allows the allocation and retention of property rights. As such, it also provides a mechanism for effectively applying usage charges.

A number of jurisdictions and the Commonwealth have been pressing for a high level review of the NEM arrangements. If such a review is to be undertaken, it needs to address the issue of transmission access as a fundamental issue associated with the long term direction of the NEM.

The principles set out by ACCC in its draft determination, in effect represent a mixture of the two long term directions outlined above. In these circumstances, any method developed to deliver pricing outcomes as a result runs the risk of adopting the disadvantages associated with each.

If the long term direction for the market is to be confirmed or may be subject to change in the near future, as appears likely, it would be preferable for any new pricing methodology to be consistent with the long term direction of the market.

6 Summary

In summary the draft determination:

- does little to address the current regulatory uncertainty regarding network pricing (the ACCC itself recognises that its proposals are not a long term solution);
- has the potential to substantially increase regulatory risk and uncertainty for the Basslink project and other like developments; and
- contains network pricing principles, which, if implemented, could have an adverse effect on the economics of the Basslink project, although an accurate assessment of the likely impact is not possible at this time.

These impacts could potentially cause significant disruption to Tasmania's energy reform initiatives, with long lasting adverse impacts for the Tasmanian and national economies.

If the proposed arrangements do represent a short term solution to network pricing, it is vital that they are consistent with the long term direction of the market. However, in view of the threatened high level review of the NEM arrangements, it must be questioned whether it would appropriate to choose any short term solution until this issue is resolved.

If there is to be a short term solution to network pricing, an approach based around the recent NECA RIEMNS Review and the Market Network Service Provider concept would be more consistent with the expectations of private sector participants.