
TasNetworks Transmission Revenue Proposal 1 July 2014 – 30 June 2019**Submission by Bell Bay Aluminium****To The Australian Energy Regulator****A. INTRODUCTION**

Rio Tinto Aluminium (Bell Bay) Limited (BBA) owns and operates an aluminium smelter at Bell Bay in Northern Tasmania. We are a major stakeholder both in Tasmania and the Tasmanian electricity market, with take or pay power contracts to 2025 for 322 Megawatts. As Tasmania's largest electricity consumer, the Bell Bay Smelter consumes more than 25% of the State's electricity demand.

BBA is pleased to make this submission on TasNetworks Revenue Proposal (RP) for its 2014/15 to 2018/19 transmission revenue cap under the *National Electricity Rules (NER)*.

BBA acknowledges that in TasNetworks revenue proposal, a lowering of the proposed Capex by 52% and Opex by 12% over the period is a positive step. This reduction however, is not seen in a reduction to BBA's current charges.

The key issue for BBA and other consumers is the approximately 200% increase in transmission charges over the last five years which remains in stark contrast with capacity to pay. In considering the Revenue Proposal set forward by TasNetworks, the AER should take into account the extent to which it achieves the national electricity objective (including promoting efficient investment in electricity services for the long term interests of electricity consumers in relation to price, quality, reliability and safety). In this sense, the AER in reviewing this Regulatory Proposal should question 'What is this costing the electricity consumer?' Asking that question for the next RP will reveal the 200% plus increase will fall back to 196% before steadily escalating again. This does not reflect an outcome in the best interests of the consumer or the national electricity objective.

As a producer of a commodity product, traded on a highly competitive, global market, BBA is a price taker and therefore has no capacity to pass these transmission costs which are higher than any other Australian States transmission costs, on to its customers. These costs are absorbed by the

business and can only be offset by further reducing our workforce and capital expenditure.

In contrast to TasNetworks, BBA does not enjoy the benefit of being able to recover all allowable revenue from its customers as allowed under the rules.

The current Revenue proposal does not adequately address the cost escalation for Tasmanian electricity consumers.

The Tasmanian economy can ill afford a further round of unjustified increases, particularly given the last five (5) years of substantial expenditure which has occurred through a period of falling demand and declining reliability.

As an aluminium smelter, operating continuously 24 hours a day/ seven days a week, a secure and reliable electricity supply is important to BBA. However this requirement needs to be delivered in an efficient and cost effective manner. Excessive transmission charges, resulting from poor planning and excessive expenditure, are a serious threat to BBA's ability to remain competitive in the global market. TasNetworks is responsible for operating and managing the transmission system in a manner that is both prudent *and* efficient.

In light of this, BBA urges the AER to rigorously assess TasNetworks proposal, ensuring lowest cost Transmission services result in Tasmania.

B. SPECIFIC ISSUES ARISING OUT OF REVENUE RESET PROPOSAL

1. BBA acknowledges the work TasNetworks has completed to reduce its Capex by 52% and Opex by 12%. However, based on the following reasons we question whether this reduction is enough:
 - a. This reduction has not translated into lowering the transmission charges from its current base. Why not?
 - b. Is the level of Capex of \$275.9M the minimum required? As the majority of the proposed Capex program is replacement work, can some of this be deferred to the next revenue period?
 - c. A reduction in Opex of 12% is a good start, but is the scale of improvement out of step with the six-fold increase in FTEs justified to support the capital expansion. BBA considers that 50% reduction in capital expenditure should see an associated significant reduction in Opex expenditure to support the reduced program. However, the only

savings have largely come from “back-office” changes attributed to the merger of Aurora and Transend.

- d. The AER is urged to review what base the savings have originated from. Have these savings originated from Plan or Actual amounts? It is considered that the baseline year of 2007/2008 for Opex would not have been the most efficient year as demonstrated from the last two years of the most recent regulatory period.

2. (Ref P.7 – from Tasmanian Transmission Revenue Proposal)

It is acknowledged that TasNetworks proposed Cost of Capital (WACC) at 7.58% is a lesser amount than allowed by the AER, and that TasNetworks has followed the AER’s Rate of Return Guideline. However, BBA considers that:

- a. The AER should review the proposed values as shown in Table 10.1 of the RP to further reduce these. Of worthy mention is the Market Risk Premium (MRP) which is currently set at 6.5%; could this be around 6%? Could the equity beta, currently at 0.7, be lower?
- b. The “AER Better Regulation: Rate of return Guideline”, indicates that 6% is more appropriate for MRP and the equity beta has a range of 0.4 to 0.7

3. (Ref P.11)

BBA notes TasNetworks comment that reducing expenditure levels any further would result in “excessive risk” to service levels.

- a. The AER is encouraged to explore TasNetworks definition of “excessive risk” and provide details of what risk analysis tools have been used to arrive at this conclusion.
- b. Private businesses are accepting more risk to remain viable in business. BBA queries whether TasNetworks is taking a similar approach? If not, it should be encouraged to do so by the AER.

4. (Ref P.24)

Within the Table 2.3, it is noted that as part of the Transmission system, there are 49 substations, 7 switching stations and 11,176 hectares of easements

- a. The RP should show the recorded value of this land and the easements and the cost to maintain these easements;
- b. BBA is further concerned that some distribution and generation assets may be included in this asset base, maximizing revenue at the expense of consumers. The AER should review this concern or at least compel Tas Networks to make their Regulated Asset Base content more visible to consumers;

- c. It's further noted in section 5.10.3 that TasNetworks propose an escalation factor of between 4.7 and 5.1% for land based on structural adjustment occurring in mainland rural water allocations and the trend towards increased foreign investment. We query whether comparing prices paid by foreign investors for Tasmanian agricultural holdings is an appropriate comparison point for the significantly smaller parcels of land used for electricity infrastructure.

5. (Ref P.27)

Inter-regional Transmission Charges

- a. There is no indication in the RP as to what dollar value Tasmania will be better off. Is there an indication of the costing and sensitivities around this?
- b. RP states it is calculated on whether Tasmania is a net importer or exporter, TasNetworks has previously advised it is calculated on the peak transfer, e.g. export is always greater than import, so Tasmanian customers will benefit. TasNetworks needs to clarify whether these charges are based on net or peak?

6. (Ref P.53)

TasNetworks is the only business in the NEM to keep maintenance costs from increasing as the RAB has grown

- a. As the RAB has grown due to Augmentation and Replacement, then why have the maintenance costs not decreased, as the new assets have less maintenance requirements? In this regard, prudent replacement of aging assets should result in lower ongoing maintenance costs and an improvement in reliability. The opposite is reflected in the historical performance, and unless challenged, this trend shall continue in the current RP. The AER should challenge TasNetworks on the assertion that the assets being replaced require less maintenance frequency and less cost to maintain, ultimately driving costs down.

7. (Ref P.57)

Capex – Costing of planned CapEx Projects

- a. BBA considers the costing of capital projects undertaken by TasNetworks should be scrutinized to ensure such projects are delivered in a cost effective manner. In this regard, are competitive bids received to arrive at lowest cost of capital solutions, or are these projects kept “in-house”? Why is this not explained in the RP?
- b. What criteria is used to decide if projects are delivered turn-key approach versus internally delivered?

- c. The AER should request answers to a. and b. above and put some rigor into the review of the Capex.

8. (Ref P.58)

Mature estimating principles

- a. Per the above, the AER should review if this includes competitive bids from external suppliers? In addition, how do such estimates compare to similar projects for other TNSPs?
- b. What is the accuracy of the estimating for RP requirements? For example +/- 30%.

9. (Ref P. 59)

Forecasting and Planning

- a. Does the AER see a conflict of interest in TasNetworks doing the forecasting and planning activity?
- b. Should or could this function not be done by an independent body? For example AEMO.

10. (Ref P.61)

Table 5.1 Maximum Demand predicting to rise over winter of 100MW over next 5 years. This is inconsistent with the latest AEMO forecasts issued in June 2014.

- a. TasNetworks should explain where this demand will come from? What supports this prediction?

11. (Ref P.62)

AEMO Maximum Demand forecasting

- a. AEMO has provided forecast information taking into account national efficiency improvement trends. TasNetworks has not considered these and as such their respective Maximum Demands are different.
- b. What is the position of the AER on this as it is not clear to the consumer if their interests are being looked after? TasNetworks should be compelled to use the AEMO forecast which is much more representative of future demand growth in Tasmania.

12. (Ref P.64)

Table 2 Escalation – Aluminium

- a. Aluminium is escalated at the following: 14 (-0.2%), 15(4.2%), 16(5.8%), 17(5.0%), 18(4.2%), 19(3.6%).
- b. Where is this information sourced from and how much does this impact project pricing?

13. (Ref. p 73) –

BBA notes that Table 5.7 sets out the forecast capital renewal projects and programs greater than \$5 million. Given the value of these projects, BBA considers that the AER should:

- a. Challenge the degree to which such projects are required to be undertaken in the next five years;
- b. Challenge whether the estimated total project costs represent the 'best value'. Are these projects being undertaken internally or through external service providers?

C. CONCLUSION

Bell Bay Aluminium cannot stress enough the need for the AER to challenge and make changes to the TasNetworks Revenue Proposal for the benefit of all consumers in Tasmania.

The outcome of this RP could ultimately play a significant role in determining whether Bell Bay Aluminium remains viable or not, and no doubt other businesses in Tasmania are also facing the same challenges.

In this regard, a strong determination by the AER may assist avert a failure within the Tasmanian economy. Conversely if transmission prices continue to escalate, it will again highlight the ineffectiveness of the regulated electricity market of representing the long term interests of electricity consumers.

The AER should challenge where acceptable level of risk can be lowered and where costs can be deferred to the next Revenue period.

TasNetworks needs to operate as a business providing the minimal services required at the lowest cost possible.

Bell Bay Aluminium appreciates the opportunity to provide feedback on TasNetworks Submission and is contactable at any time to provide further clarification or advice on any matter that could assist in the reduction of transmission prices in Tasmania