



Australian Competition and Consumer Commission

Transend Revenue Cap Review

SUPPLEMENTARY NOTE ON ALTERNATIVE OPEX TREND REVIEW

1.1 Scope of Supplementary Note

Transend Networks Pty Ltd, in its response to the Commission's Draft Decision, has specifically requested the Commission to examine whether there is a gap between GHD's narrative and the alternative trend review in its report "Transend Regulatory Review" dated June 2003.

This supplementary note to the Commission provides clarification of the reasons for, and the basis of, the alternative trend.

1.2 Rationale for Alternative Trend Review

The need and reasons for the trend review are provided in Section 7 of the GHD report. The detailed analysis of each Opex cost category is provided, followed by the trend analysis and a summary of findings.

In summary, the trend review was found to be necessary because:

- ▶ There was a significant disconnect between the Application Opex forecast and the historical cost base of Transend in the annual financial statements. Minimal historical cost information was contained in the Application and when further detail was provided it revealed a relatively large Opex increase from the current (2002/03) actual costs.
- ▶ Whilst a number of significant cost items were considered to be justified, others showed costs trending upwards without adequate justification for the extent of cost increases proposed (for example, Connections and Development costs).
- ▶ Transend stated that a range of cost efficiencies were built into the forecast Opex, but could not adequately support them with quantification.
- ▶ Some cost items were considered recoverable from Basslink.
- ▶ A detailed "cost plus" approach was used by Transend, without a comprehensive risk, cost-benefit or impact analysis.

On the basis of these key findings, GHD considered that an alternative approach was appropriate which provided the connection between historical actual cost and forecast costs, allowing for scope changes and a reasonable level of performance efficiency improvement over the RP. This alternative is another way of assessing the forecast Opex, in order to overcome some of the deficiencies in Transend's Application, for the Commission's consideration.

1.3 Trend Review and Explanatory Notes

The GHD Report "Transend Regulatory Review" dated June 2003 has been used as the basis for Opex recommendations in the Commission's Draft Decision on the Revenue Cap



Some clarification has been requested on the specific breakup of GHD's Opex Trend Analysis in Section 7.14, Table 7-7 and Table 7-8 of the report.

An inconsistency was found in the assessment detailed in the report, between the narrative and Table 7-8. The System Controller cost would be incurred by Transend from 2005/06 as stated in the notes following. Table 7-8 showed this as being incurred from 2004/05.

The amended Table 7-8 has been reordered and is reproduced as Table 2 below, and annotated. Detailed notes follow the Table. The summary Table 7-7 in the report is amended and appears herein as Table 1.

Table 1 GHD Opex Trend Review (2002/03 \$ millions)

	03/04	04/05	05/06	06/07	07/08	08/09	Total
	6 months						
Transend Application	16.0	33.4	36.5	36.9	35.0	35.2	193.0
Suggested Adjustments	-2.9	-5.8	- 5.6	-7.2	- 7.8	-8.1	-37.4
GHD Review	13.1	27.6	30.9	29.7	27.2	27.1	155.6

The forecast is based on the published 2001/02 financial results to establish a base Opex. This year is considered most appropriate as it demonstrates current cost levels, and where one-off or significant cost items can be separated. The trend has allowed for the acknowledged increase in scope for additional tasks relating especially to NEM entry and participation, and increased maintenance activity and telecommunications costs. It should be noted that, in general, the full costs estimated by Transend for these activities has been included in this trend build-up. Some efficiencies may reduce future costs in these areas to allow for other, at this stage, unidentified tasks.



Table 2 GHD Trend Analysis (Detail) (2002/03 \$m)

TRANSEND	Note	Published	Published	Published	Adj Factor	F/cast	F/cast	F/cast	F/cast	F/cast	F/cast	F/cast	F/cast
		2000/01	2001/02	2001/02		2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	
Base Operating Cost	1	18.20	20.79	20.79		21.41	21.41	20.99	20.57	20.15	19.75	19.36	
Efficiency Improvement	2		3%				-0.43	-0.42	-0.41	-0.40	-0.40	-0.39	
Easement Management Program	3		-2%			1.75	1.57	1.78	1.79	1.76	1.78	1.77	
Overheads Recovered	4			-2.22		-2.45	-2.45	-2.45	-1.20	-1.20	-1.20	-1.20	
Sys Cont. Cost		8.24			8.50								
Sys Cont. Recharge		8.33			9.15								
System Controller Cost	5			-0.65		-0.65	0.00	0.00	2.22	2.22	2.22	2.22	
CAPEX to OPEX	6						0.13	0.40	0.05	0.03			
Connection & Development	7						0.02	0.09	0.09	0.09	0.09	0.09	
Telecommunications	8						0.25	0.50	0.50	0.50	0.50	0.50	
Substation Maintenance	9						0.32	1.05	0.99	0.96	0.68	0.98	
NEM Preparation	10					1.14	2.23	2.36	1.93				
NEM Participation	10						0.07	0.05	2.05	2.39	2.39	2.39	
Tas. Whls Elect Mkt.	11			0.67		0.50	0.50						
Tas. Elect Mkt.	11			0.58		0.50	0.50						
Insurance	12												
Lease Payments	13			0.30		0.95	0.95	0.95	0.95	0.95	0.95	0.95	
				0.35		0.40	0.40	0.40	0.40	0.40	0.40	0.40	
OPEX forecast incl, NEM				18.77		23.55	25.46	25.70	29.92	27.84	27.16	27.07	
Projected OPEX for Rev. Cap				18.77		23.55	25.46	25.70	29.92	27.84	27.16	27.07	
Dismantling	14			9.17		0.00	0.00	1.90	1.00	1.90	1.90	1.90	
OPEX Recommended				27.94		23.55	25.46	27.60	30.92	29.74	27.16	27.07	



The following notes are to be read in conjunction with **Table 2 GHD Trend Analysis (Detail) (2002/03 \$m)**.

Note:

- 1 For 2000/01 and 2001/02 this line represents the base operating cost in nominal dollars excluding one-off or separable cost items of significance. A 3% CPI increase has been applied to the 2001/02 costs to arrive at the 2002/03 base operating cost in 2002/03 real dollars. The base operating costs in subsequent years include the efficiency gains in previous years, i.e. the efficiency gains are compounding.
- 2 A modest improvement in performance efficiency of 2% p.a. commencing in **2003/04** is applied to the base operating cost only and shown as a separate line item deduction. It should be noted that no efficiency improvement has been applied to other items included in Table 1-2.
- 3 Increased easement management activities amounting to around \$1.75m p.a (total \$9.67m) above historic levels, as proposed by Transend, have been allowed in full. It should be noted that this relates directly to a herbicide-based vegetation control plan which has a five-year period coinciding with the RP. Transend expects this program to result in long term reductions in hand clearing of easements. This program is consequently an efficiency program and future costs in this category should reduce significantly. This aspect should be considered in the next revenue review period.
- 4 A significant proportion of the Corporate costs were directly attributable to maintaining a System Controller function. The costs of the function are currently shared with Hydro Tasmania and Aurora Energy, along with a proportion of Transend's Corporate costs. With the impending entry of Transend into the NEM, and the transfer of the System Controller function to NEMMCO, Transend will only be required to maintain a back up System Control function. The sharing of Corporate cost will no longer be possible and all Corporate costs must be borne internally. These additional costs are reflected in the Table.
- 5 Direct costs associated with running the back up System Control function have been reviewed. Transend estimates that the net cost associated with the provision of this function is \$2.22m pa from 2005/06 onwards (total \$11.10m), and this has been included in full.
- 6 GHD has provided for Capex to Opex allowance of total \$0.60m due to changes to Transend's Capitalisation Policy. Transend's request for this category has been reduced by \$6.20m in total for amounts considered as most appropriately allocated to Capex.
- 7 Significant additional scope increases to Connections and Development activity have been included under Note 10 as part of NEM preparation and participation costs. An additional allowance of around \$0.09M pa. (total \$0.48m) is considered appropriate by GHD to provide for increased Connections and Development activity.



- 8 Additional telecommunications costs of \$0.50m p.a. are considered appropriate due to acknowledged low market rates during previous periods (total \$2.75m) for services supplied by Hydro Tasmania.
- 9 Increased substation maintenance activity amounting to an approximate \$1 million p.a. (total \$4.98m) is considered appropriate and is included in full.
- 10 NEM preparation and participation costs have been allowed in full excluding costs forecast for entry and participation into Basslink amounting to \$4.39m. Such costs are considered recoverable from Basslink Pty. Ltd. NEM costs have been allowed in full even though some reductions are considered possible through combined tasking and replacement of current similar tasks, e.g. for regulatory reporting and corporate management. Note that these costs will apply across all of the cost categories of Transend's Opex as detailed in Table 7-5 of the report.
- 11 TWEM and Tasmanian Electricity Market costs were considered as short term activities and deducted from base operating costs in 2001/02. The estimated additional costs of these activities was added back in for each year to 2003/04, when these activities will cease and projects associated with NEM preparation and participation ramp up.
- 12 Insurance premiums were deducted from base operating costs in 2001/02 and added back in for each year to the amount of \$0.95m p.a.
- 13 Lease payments, were deducted from base operating costs in 2001/02 and added back in for each year. The full amount was reviewed and considered reasonable.
- 14 Dismantling costs of total \$4.8m were considered as reasonable and appropriate to include as Opex, for expenditure associated with asset relocation.

Grid support costs are not included.