

25 July 2003

Mr Sebastian Roberts
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Australian Competition and Consumer Commission
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Dear Mr Roberts,

**Transend Networks' Revenue Cap Application –
Hydro Tasmania's GHD Report Submission**

Please find enclosed our submission on GHD's recent report on Transend's Revenue Cap Application.

As you would expect, we will continue to actively engage in this process. I am contactable on 03 6230 5485.

Thank you for providing Hydro Tasmania with the opportunity to furnish this submission.

Yours sincerely,

[Electronic Version]

Greg Jones
Manager, Power Delivery

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Hydro Tasmania
the renewable energy business

**Transend Networks' Revenue Cap Application
GHD "Capital Expenditure and Asset Base
Operational Expenditure and Service Standards" Final Report
Hydro Tasmania Submission**

July 2003

This submission focuses on capex, opex and contestability.

- *Hydro Tasmania endorses the approach to opex forecasting adopted in the GHD Report.*
- *The submission further proposes an approach to rationalisation of the capex forecast. This is strongly informed by Transend's previous forecasting performance.*
- *We also seek further clarification on contestability.*

We consider that these approaches offer a reasonable balance of risk and cost for all Transmission Stakeholders.

1 Introduction

This document contains Hydro Tasmania's Submission on GHD's final report on "Capital Expenditure and Asset Base Operational Expenditure and Services Standards", prepared for the Australian Competition and Consumer Commission ("the Commission") as part of the determination of Transend Networks' Revenue Cap Application ("the Application").

As the Commission is aware, the success of Hydro Tasmania's business is reliant on the Tasmanian transmission system. Our submissions reflect our real interest in balancing the costs and risks associated with the provision of transmission services. It is not in Hydro Tasmania's strategic interests to simply strip out costs to the point that Transend cannot run their business. Equally, it is of real significance to Hydro Tasmania's and the Tasmanian energy sector's on going plans that Transend's new revenue control does not deliver a price shock.

1.1 This Submission adds to previous Hydro Tasmania Submissions

This Submission is complementary to Hydro Tasmania's previous submissions on the Application, which were:

- The main submission on the Application (Dated 30th April), which included various recommendations to reduce the impact of the Application on customers in general and Hydro Tasmania in particular;
- The supplementary submission on Service Standards (Dated 30th May), which argued for more challenging service standards to reflect the particular circumstances in Tasmania and sought Commission clarification on certain matters; and
- The letter on Capital Expenditure ("Capex") (Dated 14th May), which documented Hydro Tasmania's concerns with the need for and timing of a number of capex projects.

This submission does not repeat the points made in those submissions. Nonetheless, we would encourage the Commission to accept the recommendations in those submissions when it publishes its draft determination¹.

1.2 Transend's 10th July Supplementary Submission is not specifically commented on

This submission does not comment specifically on Transend's 10th July supplementary submission. The approach taken in this submission is to provide comment where new information has come into the public domain.

¹ With one exception. In our main submission, we questioned whether NEM Entry costs "should be borne by customers or the shareholder." We now understand that these costs have been passed through to transmission customers in other jurisdictions and, in fact, we had previously supported this approach in representations to the Electricity Oversight Committee. We would like to withdraw the comments made on this matter in our 30 April Submission. We would like to apologise for any confusion or inconvenience caused.

Unfortunately, Transend's 10th July supplementary submission does not appear to provide any new information – instead it either directs interested parties back to the Application or asserts that interested parties should rely on the experts appointed by the Commission. However, GHD themselves note:

*“The application did not include detailed breakdowns of cost elements or sufficient historical costs to enable the reader to gain an appreciation of trends, the impact or significance of each of element described. **Transend may provide further information to the public domain.** Transend provided GHD, largely on a confidential basis, detailed cost breakdowns and some historical information. [..]*

*It is difficult to assess the ‘right’ level of investment in a review process such as this: **it needs to be determined on the basis of detailed discussion, debate and rationalisation between Transend and its stakeholders**, using an appropriate level of understanding of risk, cost and service performance in each instance (eg program or major project)².”*

Unfortunately, this level of information is still not in the public domain. We note that Transend compares the level of detail that they have provided with that provided by other TNSPs. It is important to note that no other TNSP has applied for such a significant increase in its revenues. We maintain our position that Transend should provide more information in support of their Application.

1.3 The timing of revenue flows is crucial

Usually, the timing of revenue flows in regulatory determinations, while important, is not crucial. If a TNSP has been allowed overstated revenues, these can, depending on the particular circumstances, be clawed back at the next revenue determination. While there may have been some shift in transmission customers, by and large the customers who have overpaid will be reimbursed.

This will not be the case for Transend's next revenue period. As the Commission is aware, Hydro Tasmania has a number of vesting contracts with MI customers that, *inter alia*, ascribes the responsibility for changes in transmission charges to Hydro Tasmania. These contracts mostly expire by the end of the revenue cap period. If Transend were to underspend in the next period compared to their forecasts, then even if the Commission were to claw it back for the next period, Hydro Tasmania would be significantly out of pocket.

It is crucial that the timing of revenues is carefully considered, and that the ability to clawback is not relied upon.

1.4 This submission is primarily concerned with capex and opex

The remaining sections of this submission contain:

² GHD Final report “Capital Expenditure ad Asset Base Operational Expenditure and Service Standards” Pages I and II. Our emphasis.

- Section 2 – Comments on GHD's findings on opex.
- Section 3 – Comments on GHD's findings on capex, and thoughts on how the Commission can carry out the proposed rationalisation of the capex forecast.
- Section 4 – Detailed comments on areas where further clarification from the Commission would be beneficial.

2 GHD's findings on Opex

Hydro Tasmania has reviewed GHD's approach to the consideration of Transend's forecast opex. We note that GHD considers:

"This review suggests that Transend has carefully considered the technical processes and interactions that apply within the organisation, but has not adequately addressed the commercial aspects that are also critical to deriving expenditure forecasts within a regulated environment³."

GHD have therefore applied a trend analysis to Transend's opex to, in some part, take a more commercial view of these forecasts. On balance, Hydro Tasmania is more convinced by GHD's analysis, which looks at an efficient level of base service provision and provides additional revenues to support new services. Transend's analysis, on the other hand, seems to identify every task in a process that is more consistent with budget setting. GHD's trend analysis seems more suitable for understanding underlying costs over the 5 year Application period.

Hydro Tasmania has carried out some analysis of the benchmarking data. This analysis has been limited by the availability of data. Nonetheless, we conclude that the GHD analysis has delivered a level of opex broadly comparable to that allowed for the more efficient TNSPs – even allowing for the corrections that Benchmark Economics suggested in their report. This analysis is provided as Attachment 1 to this report.

We also note that Transend's strong renewal programme should help drive maintenance costs lower.

On this basis, we would endorse the approach recommended in the GHD report⁴. It seems to Hydro Tasmania that it adequately balances the costs and risks faced by Transend and its stakeholders.

³ GHD Final report "Capital Expenditure and Asset Base Operational Expenditure and Service Standards" Page 26.

⁴ GHD Final report "Capital Expenditure and Asset Base Operational Expenditure and Service Standards" Page 76 Table 7-8

3 GHD's findings on Capex

GHD have provided their opinion of a “*technically supported but unrationalised capex forecast*”⁵. Hydro Tasmania considers that GHD's revised forecast provides a reasonable basis for a rationalisation process.

Unfortunately, as we have noted above and in previous submissions, there is limited information in the public domain and so Hydro Tasmania is restricted in its ability to contribute to that debate. As one of many significant stakeholders, Hydro Tasmania have proposed to Transend that they provide this further information to stakeholders on a confidential basis. As far as we can see, this would address any concerns that Transend and the Commission would have about equipment and service suppliers pricing to the level of Transend's detailed forecasts. However, even if this information were provided, we note that:

“GHD considers that this level of data and knowledge is not fully adequate for determining renewals and maintenance requirements”⁶.

Absent this information, Hydro Tasmania has carried out a high level analysis of Transend's forecast capex. This analysis is based on our continued significant concerns about Transend's overall ability to accurately forecast and deliver required capex. Notwithstanding the discussion on this topic in the GHD report⁷, we consider that the same problems that dogged capex in the last revenue period still exist. These include:

- **Whether the major projects early in the programme will be required or occur in the forecast timescales:** We have set out example concerns about the timing of the Southern 220kV project in previous submissions. GHD has addressed whether the projects will take place in the Revenue period, not whether the expenditure will take place as forecast in the revenue model. However, even a short delay can have an impact on the appropriate level of revenue under the Commission's revenue model.
- **Whether there are credible alternatives to network projects:** including for example network support and demand side alternatives.
- **Whether the projects included in the later years will be approved in the timescales suggested:** Neither Transend nor GHD have addressed whether there is a pipeline of approvals being brought forward. Given the length of time required for the Southern 220kV Augmentation to achieve its (qualified) approval, we would expect to see some work commencing on approvals for projects later in the revenue forecast. We also have a particular concern with approvals

⁵ GHD Final report “Capital Expenditure and Asset Base Operational Expenditure and Service Standards” Page 56 Table 6-20

⁶ GHD Final report “Capital Expenditure and Asset Base Operational Expenditure and Service Standards” Page 28.

⁷ GHD Final report “Capital Expenditure and Asset Base Operational Expenditure and Service Standards” Pages 53 and 54.

for augmentation aspects of renewal capex⁸. The expenditure on OPGW seems to be not asset renewal, but actually new expenditure to deliver new capability, particularly given that there was no ground wire on these circuits previously. Transend has acknowledged that it has struggled with approvals in the past. Hydro Tasmania's expectation is that, broadly speaking, approvals are going to be harder and slower to acquire in the future rather than easier and faster.

- **Whether there will be sufficient outage availability to deliver the forecast programme:** Transend's forecast increase in capex comes against a background of a major increase in outage requirements leading up to NEM entry. GHD's suggestion that Bell Bay solves previous problems with water availability does not address the issue of funding – for example, on what basis would Bell Bay be run to provide additional storage at key stations to allow network support at a later stage? Hydro Tasmania will continue to support the efficient operation of the network as far as possible – nonetheless, outage availability is likely to be a critical issue going forwards. The challenge associated with managing water storage should not be underestimated. In our opinion, GHD's assessment appears optimistic.

GHD and Transend have sought to provide assurance that these issues are well understood and addressed in Transend's capex forecast. Unfortunately, on the basis of the limited evidence provided, Transend's forecasting seems to have worsened. In the first year of the OTTER determination, actual capex was 97% of the Transend Forecast. The GHD report notes that the actual capex in 02/03 will be 88% of the budget (ie the equivalent of the first year forecast). This appears to represent a significant decline in Transend's forecasting reliability.

Hydro have modelled various related impacts on the GHD's technically justified capex, leading to different reductions in capex allowance. This analysis is presented in Attachment 2. One scenario is based on Transend's historic forecasting performance – another extrapolates the 02/03 performance.

The Commission will broadly allow Transend sufficient forecast capex to meet its various obligations and meet the expectations of its stakeholders. To ensure that the analysis carried out in Attachment 2 does not represent an unreasonable risk to Transend and its stakeholders, we have assessed the impact of delay on Transend's overall capex programme. To do this, the analysis assumes:

- any capex deferred from the Application revenue period to the next period is spent in the first years of the next revenue period;

⁸ Hydro Tasmania considers that there should be an approval process for renewal expenditure that doesn't artificially inhibit worthwhile expenditure and also allows consideration of economic provision of enhanced capability. It would be unfortunate if TNSPs felt the need to either replace like for like in all circumstances or to declare expenditure which is clearly augmentation to be renewals, in both cases simply to avoid applying the regulatory test. This is consistent with Hydro Tasmania's earlier submission on the Commission's review of the regulatory test.

- that capex deferred to the next revenue period is spent at the same average rate as applies in the Application revenue period.

On this basis, our expectation is that Transend's programme would take 8 years instead of 5½ years. This would have a limited impact on the average age of Transend's assets, and would at this level, seem to provide an adequate balance of risk to Transend and its stakeholders.

For the avoidance of doubt, Hydro Tasmania is not arguing that these projects are not required, nor that they will never happen. Hydro Tasmania is simply highlighting that, for all sorts of reasons, we expect that there will be a delay to Transend's forecast expenditure.

On this basis, Hydro Tasmania recommends that the Commission adopts an approach to rationalisation of the capex forecast that is strongly informed by previous forecasting performance. On Hydro Tasmania's analysis, this would appear to provide a reasonable balance of risk and cost for all stakeholders.

4 Other matters that require clarification

This section deals with the other matters that Hydro Tasmania considers would benefit from further clarification. We are continuing to discuss these matters with Transend, and would hope to be able to put proposals before you that are to the satisfaction of both parties. Nevertheless, we list these matters here to ensure that the Commission is fully aware of the underlying issues.

It is our understanding that transmission services that the Commission does not reasonably expect to be available on a contestable basis, should be included in Transend's revenue cap. The Commission must assess whether services will be genuinely contestable to ensure competitive outcomes. Equally, Transend will wish to ensure that all non-contestable services have been included in the revenue cap, or they will suffer commercial loss.

4.1 Are metering assets contestable?

Transend note in their Application that:

"In the forthcoming regulatory period it is envisaged that certain services will be provided on a contestable basis. For example, the provision of non-retail metering at the generator/transmission interface is likely to become contestable⁹."

Transend consider that, broadly speaking, assets located on their substations are not contestable. Hydro Tasmania understand that Transend have nonetheless concluded that these services are contestable as these meters could be physically located at either Transend's site or Hydro Tasmania's site. Transend argues that, in principle, although the physical asset cannot be located at Transend's substation, Hydro Tasmania could seek the service from other providers at the generation site.

However, in practice most of Hydro Tasmania's sites are unsuitable for the installation of meters and the associated equipment, and could only be converted at considerable expense. This means that while there is a theoretical alternative, it is not a meaningful substitute for obtaining the service from Transend. Accordingly, we consider that these services should be priced on a regulated basis.

4.2 Should SPS costs be excluded from the revenue cap?

GHD have removed the costs associated with SPS from the revenue cap on the grounds that these costs are entirely attributable to Basslink Pty Ltd. However, it would appear to Hydro Tasmania that these costs are associated with prescribed services, as it is difficult to conceive that SPS would be provided on a contestable basis, due to its important network role. Therefore, we consider that SPS costs should be included in the revenue cap, or Transend would be unable to recover these costs.

⁹ The Application. Page 24.

4.3 To what extent are connection assets contestable?

Transend's Application asserts that:

“Non-contestable transmission services excludes the provision of connection services, apart from connection works that are required on Transend's existing assets or within Transend's property¹⁰.”

Hydro Tasmania is not clear that Transend's approach offers sufficient opportunity for the emergence of credible transmission contestability in Tasmania. Equally, there does not seem to be a sufficient safeguard on Transend's commercial behaviour, given the absence of meaningful contestability. We would be grateful for the opportunity to clarify this issue.

4.4 Progress on network support costs

The GHD report recommends that network support costs be addressed on a pass through basis. In its Electranet decision, the Commission indicated its preference to forecast these costs, and then deal with any overs and unders at the following reset. Hydro Tasmania and Transend have initiated discussions on the level of network support required in the Application period.

¹⁰ The Application. Appendix 1. Page 3.

Attachment 1 High level benchmarking analysis of Opex

The following figure provides an indicative comparison of GHD's proposed opex levels against industry benchmarks. For comparative purposes, Figure A1 is as far as possible consistent with Figure 23 of the Benchmark Economics Report contained at Appendix 2 of Transend's Revenue Application.

Figure A1 demonstrates that GHD's proposed opex level results in Transend performing in a broadly consistent manner with the industry with reasonable allowances for Transend's unique cost structure and operating environment.

Figure A1: Opex/Capacity (MW) and Load Factors

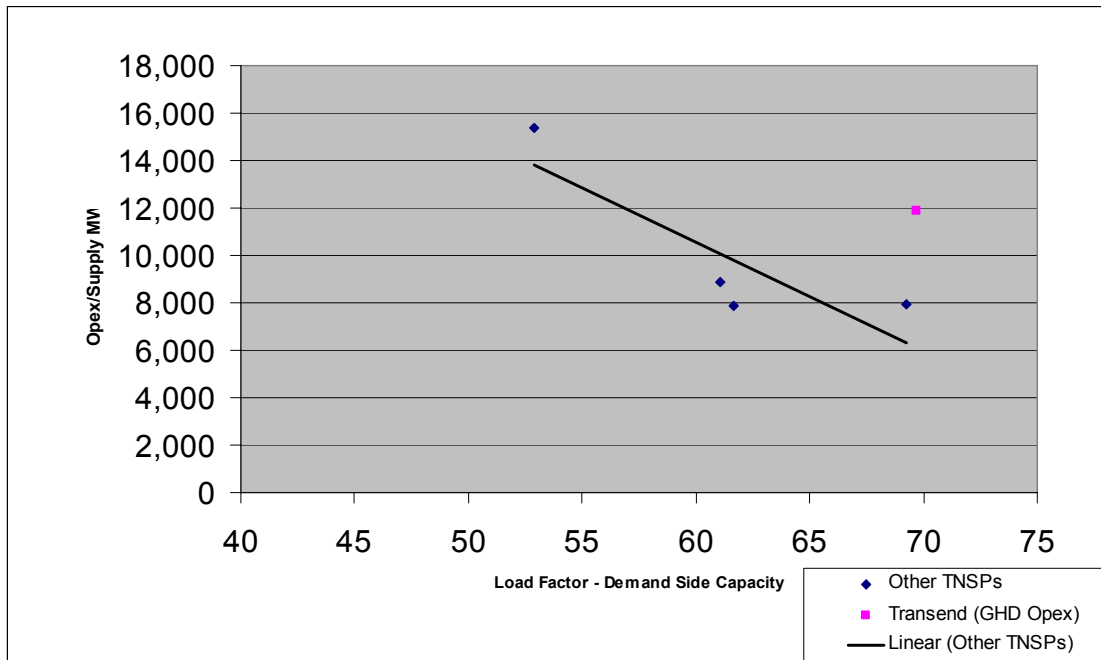


Figure A1 has been derived using information contained in Transend's Revenue Application, ESAA Electricity Supply 2001, and ElectraNet, SPI PowerNet, TransGrid and Powerlink's Revenue Cap Decisions.

Attachment 2 Analysis of Transend's forecasting capability

Year	98/99	99/00	00/01	01/02	02/03	Total
Regulatory Forecast (June 99 Dollars)	\$55.6	\$45.0	\$ 61.2	\$ 59.0	\$ 60.0	\$ 280.8
Regulatory Forecast Nominal	\$55.6	\$45.9	\$ 63.7	\$ 62.6	\$ 64.9	\$ 292.7
Recent Budget (P54 GHD Report)					\$ 48.99	
Actual (Nominal)	\$54.00	\$36.00	\$ 30.30	\$ 31.00	\$ 42.92	\$ 194.22
Analysis						
Otter Forecast cf Actuals	97%	78%	48%	50%	66%	
Budget cf actual					88%	
Correcting for change in first year performance	88%	71%	43%	45%	60%	

Year	04	04/05	05/06	06/07	07/08	08/09	Total	Difference
GHD Assessed Total Capex	\$27.10	\$86.10	\$ 55.80	\$ 92.10	\$ 43.50	\$ 36.30	\$ 340.90	
Hydro Tasmania Rationalisation (Average delay 3 years)	65%	65%	65%	65%	65%	65%		
	\$17.60	\$55.92	\$ 36.24	\$ 59.82	\$ 28.25	\$ 23.58	\$ 221.41	\$ 119.49
Average Delay (years)	3.0							
Hydro Tasmania Rationalisation (Corrected for change in first year)	88%	88%	71%	43%	45%	60%		
	\$23.74	\$75.43	\$ 39.48	\$ 39.54	\$ 19.43	\$ 21.64	\$ 219.26	\$ 121.64
Average Delay (years)	3.0							
Hydro Tasmania Rationalisation (OTTER forecast cf Actuals)	97%	97%	78%	47%	50%	66%		
	\$26.32	\$83.62	\$ 43.76	\$ 43.83	\$ 21.54	\$ 23.99	\$ 243.06	\$ 97.84
Average Delay (years)	2.0							
Hydro Tasmania Rationalisation (1 year delay)	85%	85%	85%	85%	85%	85%		
	\$22.97	\$72.97	\$ 47.29	\$ 78.06	\$ 36.87	\$ 30.76	\$ 288.92	\$ 51.98
Average Delay (years)	1.0							