2003 ACCC REVIEW

OF

THE TRANSEND REVENUE CAP

An assessment of the Transend responses to

the ACCC Draft Decision

by

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1. Introduction

Transend continues to maintain that it is entitled to a massive increase in its regulated revenue, despite the fact that its major customers are operating in a highly competitive environment, which will not permit the pass through of the increased Transend costs to their customers. This places pressure on these businesses to remain viable and so continue to contribute to Transend's revenue. Should this contribution cease, in the short term Transend will be permitted to maintain its regulated revenue stream by levying increases on its other customers.

In its responses to the ACCC Draft Decision, Transend fails to accept that (contrary to normal business practice) it has any responsibility to minimise its costs in order to maintain the continuing viability of its customers, relying on the explicit terms of the code which permit it to maximise its revenue with little consideration as to how its customers will be impacted. It is implicitly critical of the extent to which OTTER undertook its responsibilities to ensure Transend was driven to manage its assets at minimum cost to Transend customers.

Notwithstanding this background, Transend maintains that the ACCC has unreasonably reduced the income sought by Transend, and attempts to point out that the ACCC has made significant errors in reducing the Transend target income. At the public forum and throughout all of its submissions, is an underlying threat that if Transend is not awarded the full amount it seeks, then Transend alleges that there will be an increased chance of system failure, and points to the recent highly publicised events in the US, UK, Scandinavia and Italy as being examples of system failure caused by under-investment and insufficient opex.

However, Transend fails to explain why these failures may have application to the Transend system. This is because there is very little comparison between these failures and Transend!

1. The failure in the NE of the United States was initially caused by a plant failure in Ohio, resulting in a lack of local voltage support. Due to poor communications the impact of this voltage support cascaded through the connected system, although it was stopped at a number of system interfaces, such as with PJM.
2. The failure in the UK was caused by a single plant (transformer) failure which was quickly overcome, but received widespread news coverage due to the recent US failure.

3. The failure in Scandinavia related to malfunction of protection equipment, and is best compared to a distribution network issue, rather than a transmission matter.
4. The failure in Italy was directly caused by a lack of competent communication between generators in France, transmission through Switzerland and usage of power in Italy.

As Transend has full coverage of system control in Tasmania, and NEMMCo will have full carriage of system control for Tasmania and the other states when Tasmania joins the NEM, this lack of competent communication is not an issue in the country. Thus, these highly publicised supposed “network failure events” have little relationship to the operation of the Transend network.

This approach of engendering a fear of system failure must be seen by the ACCC for what it is – totally unrelated to Transend and providing no basis for awarding an increase in revenue.

2. Transend letter dated 20 October 2003

Transend refers to the meeting held with the ACCC prior to the public forum. In this letter it specifically expresses concern at the simplicity of the ACCC approach to setting the allowable opex, the confusion within the ACCC as to what should be included on capex, disenchantment with the concept of "clawback" of underspent capex, and rejection of the alternative capex approach suggested.

OPERATING EXPENDITURE

The GHD report

Transend reiterates the complaints it made in response to the GHD report, alleging that the GHD narrative is at odds with the recommendation – which Transend points out "…amount to no more than 2 pages of trend analysis." Transend then states that the ACCC should not rely on the GHD conclusions.

What Transend fails to recognise is that, by its decision not to provide detailed information disclosure on its past and current activities, GHD had to provide this information both to the ACCC and to Interested Parties. The narrative provided in the GHD report is purely to provide more information about what Transend was seeking and on what basis, so that an informed response could be made to the opex claims by Transend. What made interpretation of the Transend claims for opex even more confusing was the benchmarking study provided by Transend which referred only to Transend current costs, and not to the costs being sought under the application.

Further, Transend effectively required GHD to carryout a detailed explanation of what Transend was seeking. In response to a call from MEG for Transend to provide more information regarding its application, Transend commented:-

> "The ACCC has appointed consultants to scrutinise Transend's expenditure plans in much more detail than could be achieved through a process of industry consultation. … Instead, the ACCC's role is to reach a soundly based judgement on the company's revenue requirements, …"[1]

As Transend elected to have GHD carryout the detailed explanation of its application, for Transend to now assume that the inclusion of the narrative (explanation) of the Transend claims substantiates the claim, must be ignored.

[1] Transend response to issues raised in submissions from interested parties July 2003. (Page 20).

Interested Parties have only assumed that the GHD narrative was to explain the basis of the claims and the inter-linkage of the claims with the actual recorded costs Transend has previously incurred.

That this assumption has been made is demonstrated by the MEG response to the ACCC draft decision indicating that the opex allowance is still too high, based on the information provided by Transend (claims and recorded costs), GHD in its report and in the additional ACCC analysis and benchmarking.

The 2% efficiency dividend

Transend does not accept that an efficiency dividend is appropriate. The NEC clause 6.2.4 quite clearly states that the economic regulation using the form of CPI - X is to be used. Therefore, the ACCC approach is clearly consistent with the Code in applying the ‘X factor’ in its incentive regulatory approach.

What is missing from the draft decision is the origin of the quantum of 2%. Deeper review indicates that the 2% equates to the 2% forecast for inflation over the next five years and used within the WACC calculation development. As industry in a competitive environment operates on nominal forecasts, to discount the “real” costs by the expected effect of inflation is not an unreasonable approach.

Setting a “reasonable” opex budget

Transend has proposed an opex allowance based on a “bottom up” approach. This inevitably results in a “would like to have” budget. What is missing is the discipline on the opex approach which reduces the “like to have” to a “need to have” in order to provide the service. The GHD/ACCC approach provides this (commercial) discipline.

Transend refers to the GHD approach as being “rudimentary”. If this is so, then most of industry in a competitive environment is using a “rudimentary” approach to opex setting.

In competitive industry budgeting, invariably the starting point for setting the coming years’ allowances is the past actuals recorded which are then usually discounted for items which were “abnormal”. Further, in order to increase competitiveness an “arbitrary discount” is also often applied. The new budget is adjusted for additional costs which are expected to be incurred and then a requirement placed on management to find ways of reducing these budget increases through savings in other areas.

As highlighted graphically in the MEG submissions, if industry just maintained its costs in “real” terms it would quickly become uncompetitive. What Transend seeks is a massive increase in its allowances which would not be tolerated in a competitive environment – the ACCC is required to impose pressure on Transend which will replicate a competitive outcome. The approach recommended by GHD provides this pressure.

The Transend claims are simply driven by a ‘cost-plus’ culture which cannot be sustained in any competitive business environment.

Transend refers to the simplicity of the ACCC benchmarking. All of the benchmarking provided by Transend shows that its current allowances (set by OTTER) are appropriate for the organisation. In fact the benchmarking provided by the ACCC shows that the proposed allowances are far too high.

Transend advises that the ACCC and GHD received over 100 additional documents to demonstrate the need for more money. Unfortunately most of these were marked “confidential” and so have not faced the rigor of assessment by Interested Parties. Without input from the Interested Parties, many of whom operate in a competitive environment, it is made unnecessarily difficult for the regulator – a factor Transend is well aware of.

CAPITAL EXPENDITURE

Capex for generation

The ACCC is required to ensure that all consumers do not have to pay for costs attributable to specific connections. The NEC quite specifically provides for parties wishing to connect to the network, to pay for these costs directly. The network owner and the party wishing to connect are expected to reach agreement as to the costs associated with such a connection, regardless as to whether the connection is for a new generator or a new customer.

The capex allowance built into the revenue cap provides for the capex needs of the network, and is therefore predominantly funded by consumers. If there is legitimate capex which is needed and will cause Transend to over-run its capex allowance, then the additional capex will be appropriately included in the RAB at the next reset.

The MEG submission addresses this point in more detail.

<u>The 10% reduction of capex</u>

Transend conveniently overlooks the statements[2] made by GHD that the capex of $341m should be considered a maximum allowance:-

> "…as there had not been an appropriate practice of cost-risk trade-off or budget rationalisation process."

Further, the GHD report added that the reliability impacts of any project should be quantified. Based on this GHD advised that the allowance should be rationalised taking into account non-technical factors such as deferrals of projects and lower cost/service level solutions.

Transend delves into the arithmetic of whether the ACCC believes it has provided a 10% or 21% reduction to the GHD recommendation, and that the ACCC has made errors. There is little doubt that the ACCC has decided that an amount of $307m of capex is appropriate to be permitted into the revenue cap calculation.

In the MEG submission it is pointed out that there is little justification provided for even this allowance, and that for this amount Transend delivers no more than consumers get under the current opex and capex allowances.

CLAWBACK

Transend considers clawback is not in keeping with an "incentive based regulatory regime". Equally, consumers do not consider the ability of Transend to have the use of their money and not use it, is in the interests of consumers.

The NEC is written with a basic assumption that there is no incentive for regulated businesses to invest unwisely. This assumption is flawed, because if the WACC granted is too high, there is an active incentive to invest. Unfortunately there is no countervailing control available to the regulator to ensure that the business develops its capex needs appropriately. If there is no control on over-stating the capex needs and the ability of the business to be able to manage the capex program, then the business has the right to retain the unearned benefits of accruing the return permitted on the unused capex allowance during the regulatory period.

This concern is especially of interest where the business has a record of underspending its permitted capex allowance, where the requested capex is a massive increase on past capex and where the capex demand is not offset by an

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[2] GHD report. (Page 56).

appropriate reduction in opex. The Transend application fails on each of these counts.

Transend implies that by including for a clawback, there is little incentive on the business to use its best efforts to reduce the capex for each project and share the benefits with consumers. So far no such benefits have been given to consumers and so on balance, from a consumers' viewpoint, the benefit of actually recovering the value of unspent capex far outweighs any potential benefit of the business identifying that in fact the underspend was a result of its effectiveness, providing a sharing of this good work.

ALTERNATIVE CAPEX APPROACH

It is noted that Transend rejects the alternative approach to capex.

It would be appropriate for consumers to be included in any discussions about this alternative before it be accepted by the regulated businesses.

3. Transend letter dated 24 October 2003

Transend opens its response with a dissertation on all of the reasons why its revenue cap application should not be considered as an ambit claim. It cites a low asset base, a low opex, new cost recovery needs, NEM entry, potential new generation, competition from gas and an elderly network as justifying a major increase in its revenue needs. It then advises that in considering all these complex matters, the ACCC should disregard that fact that almost every other transmission network faces similar problems.

It goes on to advise that using simplistic comparisons with other networks do not recognise the unique differences Transend has compared to all other transmission networks. Of course each network considers itself as having unique differences which justifies each one having the right to increased revenue.

Transend goes on to say that the regulator has provided no justification for reducing its claimed revenue. Transend should note that in the competitive market, customers equally give no reasons for changing their supplier, and that the ACCC has the responsibility to replicate competitive pressures on Transend.

<u>CAPITAL EXPENDITURE</u>

<u>Regulatory test</u>

Transend asks that the already approved capex be exempted from the "arbitrary" 10% cut to capex.

The reasons given for the capex cut were widespread, and mentioned in section 2 above where it is noted that:-

> "… the GHD report added that the reliability impacts of any project been quantified. Based on this GHD advised that the allowance should be rationalised taking into account non-technical factors such as deferrals of projects and lower cost/service level solutions."

Transend has yet to spend the capex it claims has past the regulatory test, yet the reasons for recommending a cut to all capex are more widespread than just that the capex has not passed the test. GHD notes that <u>no project</u> has the reliability impacts quantified, casting doubt on the validity of the tests carried out on the committed projects.

Arbitrary cut

Transend considers that the ACCC has arbitrarily cut 21% of its capex rather than the stated 10%, and this is not consistent with the GHD report. The GHD report recommends that a total of $341m of capex be permitted (GHD report table 6-20). The ACCC has reduced this amount by 10% to $307m. There appears no inconsistency in the draft decision.

The assertion of inconsistency is primarily based on the exclusion of the generator related projects where the ACCC has apparently confused the “who pays” part of the NEC with the “what revenue applies” part of the Code. There is no confusion and the matter is addressed more fully in the MEG submission to the draft decision.

As mentioned in section 2 above, Transend has the ability to recover connection costs (whether for generation or consumer) separately under the code, so there is no need for the capex funded by consumers to be increased by this subterfuge.

Transend advises that if the ACCC continues to only allow for $307m of capex in the revenue cap, then it will have to require new generators to supply funding directly in order to maintain delivery of other capital works. This approach appears similar to the approach taken for specific customer augmentations where the requirement for capital contributions is common.

Clawback

Reference is made to the comments on this issue in section 2 above.

Transend refers to the ESCoV decision as to the incentive for the Victorian distribution businesses to share in the benefits of their good work in reducing opex and capex. This decision was the first undertaken by the regulator with regard to electricity distribution. Included in that decision was a close review of opex and capex as the initial start point, and it was intended to test the efficacy of the approach at the end of the first regulatory period. The second review is about to commence. One of the key issues for consumers will be how well this supposed incentive program works in practice.

However, in the case of Transend, Transend has introduced a major cash “comfort zone” between its past regulatory allowances and the future allowances, throwing severe doubt as to whether any under-run will be the result of the effort of Transend officers, or because the initial allowance was inflated. Because of this doubt consumers would prefer to have the clawback mechanism proposed

by the ACCC, at the possible expense of losing some indeterminate potential sharing of a benefit at some point in the future.

Capital under-recovery

The ACCC has provided for the over-spend (actual) capex for 2003 in the roll over of the RAB. Transend has consistently underspent its capital allowance for the bulk of the current regulatory period, and also has returned to its shareholder a consistent dividend.

On this basis there would be little reason for the ACCC to change its decision not to admit this amount into the new revenue cap.

Alternative capex approach

This matter is addressed in section 2 above.

OPERATING EXPENDITURE

Transend notes that the revised opex is neither sustainable in terms of long term operation, nor sustainable in terms of ensuring a commercial return to shareholders.

These statements are not supported by fact. Transend has maintained its operational performance for four years, and has been granted a major capex boost in order to assist in maintaining its performance. After comparing actual performance with the currently approved opex to a “would like to have” allowance for opex with no enhancement of performance, Transend has not demonstrated a need for additional opex.

Further, Transend alleges that the ACCC proposed opex will not allow it a commercial return to shareholders. Firstly, opex is not intended to provide a commercial return – this return is granted by the WACC. Under the building block approach, opex is purely assessed as the amount required to the cover the costs Transend incurs in providing the regulated service and to maintain the regulated assets in good working order. It is not the intention that there be opex remaining to provide a return to shareholders.

Secondly, Transend has not demonstrated that the opex requested or proposed by the ACCC is “commercial”. MEG has consistently pointed out that in a commercial (competitive) environment such a large opex increase would not be tolerated in the absence of an equivalent or greater output. In commercial terms Transend is not entitled to an opex increase.

Transend continues to maintain that the ACCC decision to use the GHD recommendations is flawed and inconsistent. This allegation is flawed and as mentioned earlier, should be ignored.

Example – Connection and Development

Transend offers an example of the supposed flaws in the GHD approach. In developing the example Transend takes a particular issue, finds fault and then converts the specific to the general.

What Transend fails to recognise, is that the allocation of costs to any cost centre, is totally within the control of Transend, both in the past and into the future. The GHD start point does not nominate any allowance against any specific cost centre, and only provides for additional items which it considers were not adequately covered in the base. This approach is typical of that used by competitive industry.

Transend's approach assumes that the GHD narrative is support for its claims, where in fact it is an explanation of what Transend was seeking. By its very recommendation for a lesser amount of opex, GHD does not accept that the Transend justifications are feasible and provide sufficient basis for the large increases claimed.

The ACCC has determined that overall, the opex sought by Transend is too high, and it's benchmarking using the GHD basis still indicates that the opex proposed by the ACCC is too high. The ACCC is required to allocate an appropriate amount for opex and it is the responsibility of Transend to allocate this amount into the various cost centres which it deems appropriate for it to manage the regulated assets.

Way forward

The issue of whether the GHD narrative is at odds with its opex recommendation has been addressed elsewhere in this submission and other MEG submissions. There is no doubt that consumers remain convinced that the ACCC proposed allowance for opex is still too high, and do not consider that the GHD approach to opex setting is inappropriate.

Efficiency dividend

This issue is fully addressed in section 2 above. A sharing of efficiency savings is only appropriate where the actual opex costs have been reduced to the absolute minimum needed to operate the network. There is considerable doubt whether

the proposed increases being granted by the ACCC are the minimum needed by Transend. The very granting of an excessive increase in opex provides Transend with the future opportunity to "game" the next review, as there is every driver for Transend to use the opex proposed, regardless whether such is really needed. Benchmarking is the only tool available to regulators to prevent the gamin g of opex allowances.

In the circumstances of a large increase in opex being recommended, the proposed efficiency dividend is considered appropriate. The quantum of 2% is seen, if anything, as being too small.

Benchmarking

As noted above, benchmarking is the only tool available to regulators to assess the legitimacy of the opex allowances. What has been seen over the past years is for each business to argue a need for increased opex, due to the specific circumstances facing each of them. Subsequent reviews use these benchmarks to set new opex allowances, which consistently put the opex granted in the upper range compared to the previous decisions. This approach provides the regulated businesses with an upward spiral for increasing opex at each review. By consistently using only the same five businesses as the basis for comparison and allowing the practice of awarding opex in the higher range (preferring to "err on the side of caution") does little to apply competitive pressure to the regulated business.

Transend avers that the benchmarking by the ACCC is both dubious and shows that GHD recommendation puts Transend opex only once into the highest position. This is a distortion of the facts. If the RAB for Transend was not artificially inflated, Transend opex/RAB would move into the highest position. In two of the other measures, GHD opex allows Transend into a clear second spot, close behind the top spot ElectraNet.

On an overall benchmarking "score", adjusting for the RAB, Transend opex as proposed by the ACCC moves it into the highest opex allowance of all of the five Australian transmission businesses. This is despite the clear benefits Transend has over its mainland comparators, which easily counter the detriments stated by Transend.

WACC

Transend considers the ACCC has erred by reducing the WACC from that sought by Transend to a lesser figure.

It points out that the Productivity Commission considers that regulators should err on the side of caution, to ensure that there is greater potential for over-investment rather than under-investment in regulated assets. This principle is not contested, but it must also be said that the Productivity Commission does not expect that this view should become the basis for regulated businesses to be permitted the ability to have returns which are greater than those achieved by enterprises operating in a competitive environment. Nor should the interests of downstream investments be ignored or penalised by the paying of monopoly rents. Poor regulation leads to over-investments in regulated assets and the creation of a nation of rent seekers.

Transend adds that the Productivity Commission recognises that there is some uncertainty in the regulatory process. Transend appears to limit the areas of uncertainty to market risk premium, equity beta, the bond rate duration, and the benchmark credit rating.

Each of these "uncertain" issues has been addressed in this and earlier MEG submissions. However there is no doubt that the levels sought by Transend for each of these variables will result in a WACC which is totally inconsistent with the benchmark results achieved by industry operating in a competitive environment.

The regulated businesses have espoused the CAPM approach to setting WACC. As the elements in these formulae are developed from the results achieved by businesses actually operating in the competitive world to argue that regulated businesses should be permitted returns based on CAPM elements which are higher than the average is clearly counter-intuitive and should not be supported. Transend provides its views as to why elements of the CAPM formulae should be increased. However, in the final analysis, the calculated WACC should bear some resemblance to what competitive returns are. The WACC resulting from the Transend developed CAPM elements bears little relationship to the returns earned by its customers.

The reference to the work by Mr H Ergas would appear to be self-serving in the extreme. Not only did Mr Ergas provide input into the original application by Transend, but his very close association as an adviser to regulated businesses means that Mr Ergas' observations must be recognised as such.

Reference to the "lights going out"

Transend makes reference to the risk the ACCC faces if it determines a WACC for Transend which is too low to encourage investment and points to a blackout in the US and Canada earlier this year. Before the ACCC accepts this assertion at face value, it is necessary to examine the facts behind this and other well publicised network failures.

As mentioned earlier in this submission, the causes of the failures have little to do with low returns being awarded to transmission businesses, but more to do with how the networks are operated. Australia is fortunate that it has one operator for the entire NEM, which eliminates most of the problems which caused the blackouts, or resulted in the geographic extent of the failure.

Equity beta

The MEG response to the draft decision, points out that an equity beta of unity, equating the risk of Transend with the average of all Australian enterprises, is too high.

Market risk premium

There has been extensive work undertaken to identify current MRP levels. This shows that an MRP of 6% is too high in the current economic climate and there is a growing body of independent work supporting this view. The MEG response to the draft decision provides supporting evidence regarding this issue.

Risk free rate

The MEG submissions support the ACCC in its view that the five year bond rate is the appropriate basis for the CAPM formulae as the five year rate provides for the appropriate level of future risk over the regulatory period.

Transend observes that the Productivity Commission counsels regulators to be pragmatic in eliminating returns that are potentially in excess of "normal" levels. What is not expected is that transmission businesses with their very low risks should be awarded returns above what is achieved in the competitive environment.

Cost of debt

This matter is more fully addressed in the following section. Suffice to comment that the level of debt premium should reflect that applying to all regulated businesses regardless of ownership. As governments do not guarantee the performance of their corporatized entities[3], in effect the businesses with government shareholders are treated no differently to businesses with private shareholders, and they are certainly treated no differently under the Corporations

[3] One of the prime reasons for corporatizing government owned enterprises was the specific goal of segregating the debt of the corporations from that of governments, and severing any liabilities the governments previously had relating to the new corporations.

Law. Therefore to exclude the corporations owned by governments is to artificially skew the ratings with no sound basis for doing so.

Sampling period

Transend wishes to change the sampling period away from the date of the Final Decision, but fails to advise what period should be used. The date of the Final Decision is a date known, and reflects the latest information available to set a “forward looking” risk free rate.

As the WACC is to be constructed to be a forward looking return, it should use the latest data available. Transend proposes that a 40 day average be used with a start date to be determined. The reasons for this request are for greater certainty and Transend advises that its proposal will have no detriment to consumers and Transend. This raises the question why extend the averaging period, and what date becomes the start (or end) date, creating more uncertainty.

Intriguingly Transend wants to use an MRP rate which is based on historical returns, and would appear to be asking for the risk free rate to be related to an historical basis, moving away from the aim of setting a forward looking WACC.

WACC conclusion

Transend debates the values set for the variables in the CAPM formulae. What is absent is any assessment as to whether the “parts” proposed will lead to a “whole” which is out of relativity with returns being earned in a competitive environment. After all the ACCC is to replicate competitive pressures and results that are achieved resulting from competition.

ASSET VALUATION

Transend protests that the Minister’s valuation with regard to easements is correct. The ACCC has required that easements be valued on the actual proven costs incurred in the easement acquisition. Transend considers that the costs it would have incurred if the easements were to be acquired now (ie the DORC value) should apply.

The Transend approach is contested but the issue, at this stage, is academic as the Minister’s valuation is to apply as required by the TEC.

4. PowerLink submission

WACC

PowerLink refers to as a “disturbing trend” of the ACCC to reduce the value of the WACC margin over the risk free rate. They are of the view that the level suggested by the ACCC for Transend is now too low to encourage investment in discretionary activities. They consider that at this stage “academic dissertations” are a sideshow to the main game of assessing he return an investor will accept before deciding to invest in another class of investment.

What PowerLink fails to add into its observation are:-

- The WACC is still well above the “risk free” level and so offers an attraction to improve a return by investing in an asset which effectively guarantees a return through the implicit need of using an essential service coupled with a revenue cap. Compared to other investment classes which provide similar returns, the security of the transmission revenue provides a very safe location for investment.
- In its submission to the ACCC, the elements of the WACC and CAPM approach were debated extensively. It seems that when PowerLink made its application in 2001, it did not have these same concerns as it professes now. Notwithstanding their reluctance to rely on the CAPM elements, the concept they espouse of benchmarking the WACC outcome is supported.

PowerLink notes that debt raising costs are best included in the debt premium. Providing the quantum allowed for debt raisings reflects the actual cost involved, it would appear immaterial as to which way the revenue is constructed.

There is doubt raised as to whether the ACCC should include in the assessment of the debt margin, the influence of the government owned enterprises. This leads to two observations:-

1. The majority (in asset terms) of the electricity transmission and distribution businesses are owned by governments. To exclude them from any benchmark comparison leads to a skewing of the reality of the NEM composition.
2. Notwithstanding this, each of the government owned businesses are fully established as corporate entities with the shares being owned by the government, in the person of nominated ministers. As the businesses are corporations within the meaning of the Corporations

> Act, the assessments made about them by lenders and ratings agencies are made on the basis as to the legal ability to obtain future redress. For PowerLink to observe that they may be rated differently to privately owned businesses because their shareholders are governments rather than on the specifics of the business, is a very broad assumption. Such an assumption only has weight if the shareholding governments are providing guarantees to lenders and prospective lenders. As there is an expressed desire of governments to limit their exposure to the debts incurred by the corporatized businesses, it is quite apparent that government owned businesses are unlikely to be rated higher than their private counterparts, purely because of the ownership structure.

Debt margin should be assessed by the ACCC based on the business type, and not on who the shareholder may be.

REGULATORY UNCERTAINTY

It is accepted that cuts by regulators to proposed revenue creates uncertainty. Equally for a regulated business to include in its application for ambit claims for revenue which are clearly seen as excessive and unsubstantiable, also adds to regulatory uncertainty.

As it is within the purview of the regulated business to provide accurate historic data about its activities, to provide misleading information or not provide information which would assist the regulator determine a fair allowance for an activity, leaves the regulator with little option but to make what PowerLink refers to as arbitrary cuts" to the proposed revenue claim by the business. The regulator has the responsibility to allow the regulated business only that revenue required to properly manage the business *as if it was operating in a competitive environment.* Management in competitive industry is consistently met with decisions of its Board or CEO, to reduce costs based on arbitrary cuts (eg requirements for an X% reduction in staff levels is an often seen report in industry).

In the absence of adequate information or ambit claims, the regulator has no alternative but to institute such an approach.

GRID SUPPORT

PowerLink reinforces the point made in the MEG submission to the draft decision regarding this issue. Grid support is predominantly an alternative to capex.

> "Whilst grid support is also used to facilitate maintenance work, the most significant use of grid support arises when it is the lowest cost solution to a network limitation under the regulatory test."[4]

Thus grid support should not be seen as an operating cost, but as an alternative to capex. To include both an allowance for grid support and capex is clearly double counting.

PowerLink avers that grid support should be a pass through allowance, this is not correct as an allowance for the capex which the grid support replaces has already been included in the revenue cap. An adjustment should be made at the next regulatory reset to reduce the roll forward of the capex so replace by the grid support, and the new opex increased for the cost of grid support.

Grid support should not be a pass through, as to do so constitutes a double allowance for the same work.

[4] PowerLink submission to ACCC draft decision on Transend application, October 2003. (Page 6).