# The Transend application for a revenue cap

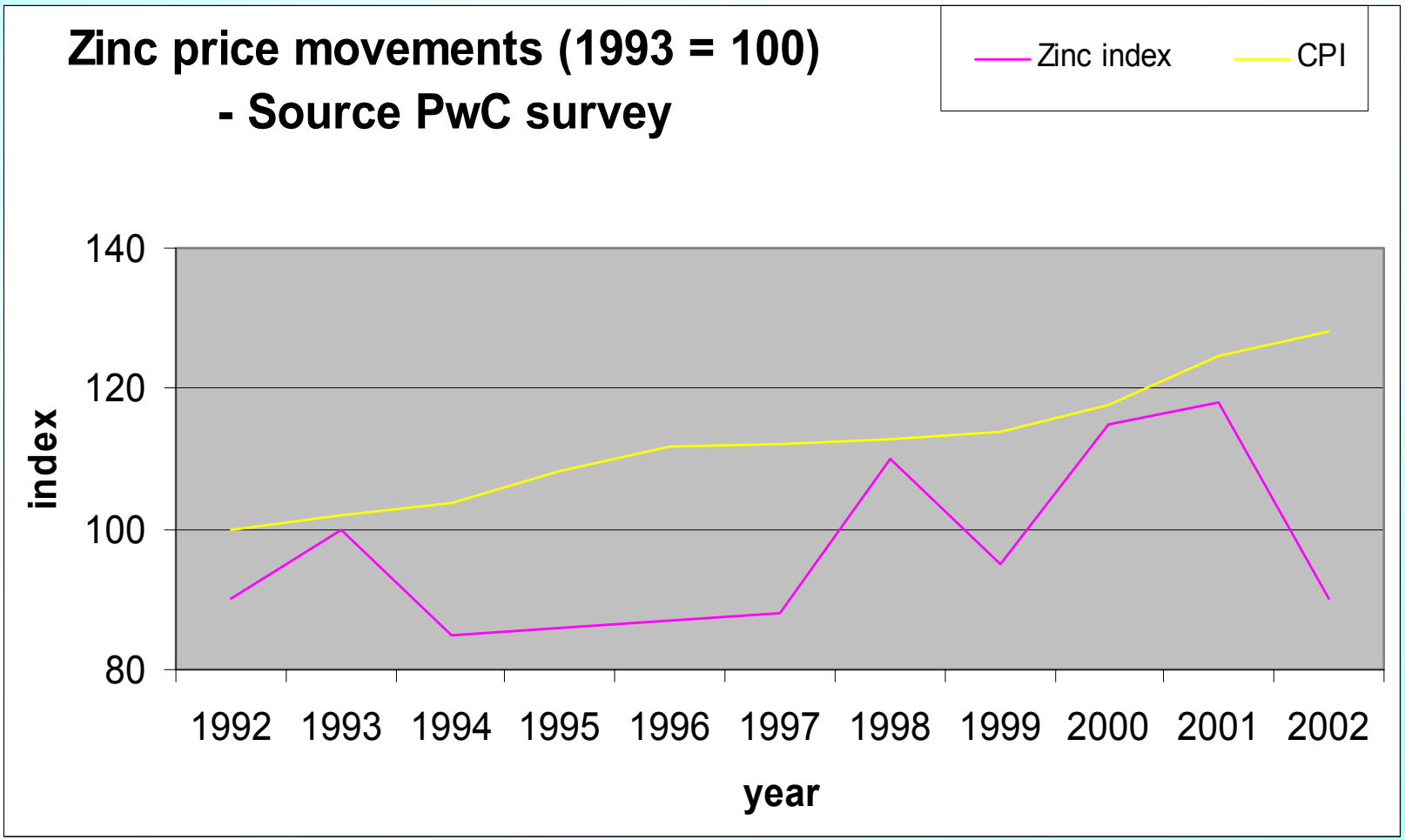
**ACCC Post Draft Decision Forum**

**17 October 2003**

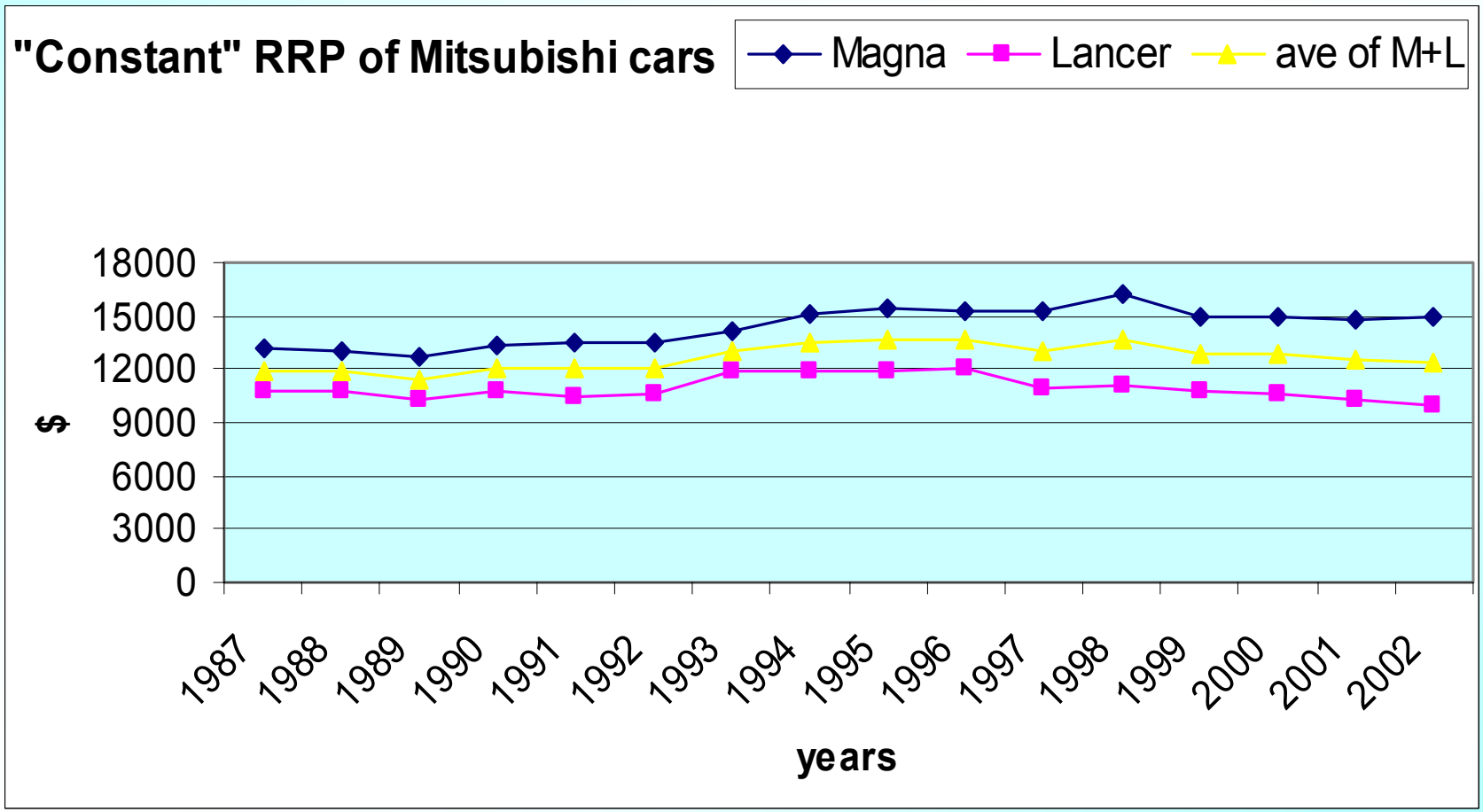
**Presented by**

**Major Employers Group, Tasmania**

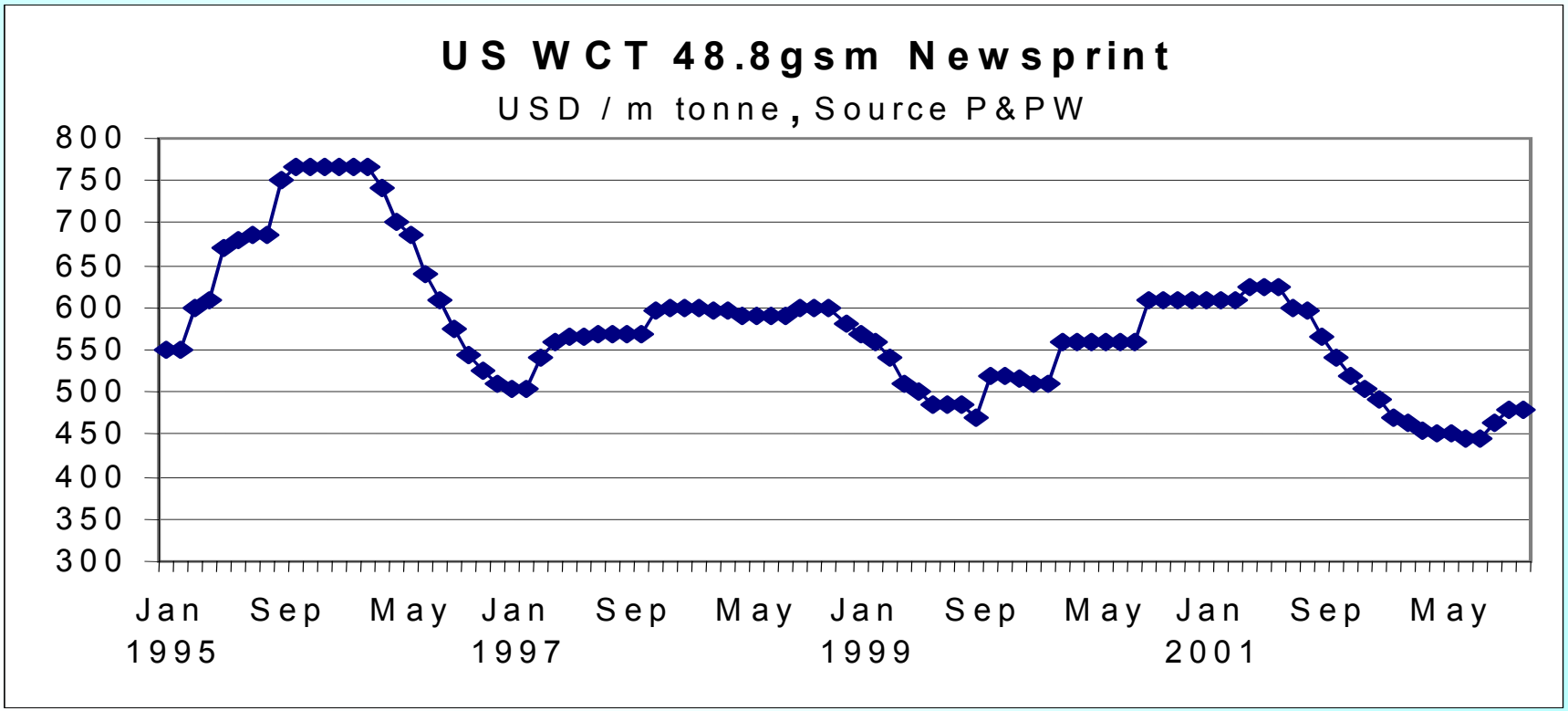
# The Context of the proposed increase for Transend(1) – Price changes for zinc



# The Context (2) – Price changes for manufacturing (eg. Cars)



# The Context (3)
# – Price changes for newsprint




**Australian Mkt' Price is set by reference to the US WCT price**

**Data source: Norske Skog**

# What does competition cause?

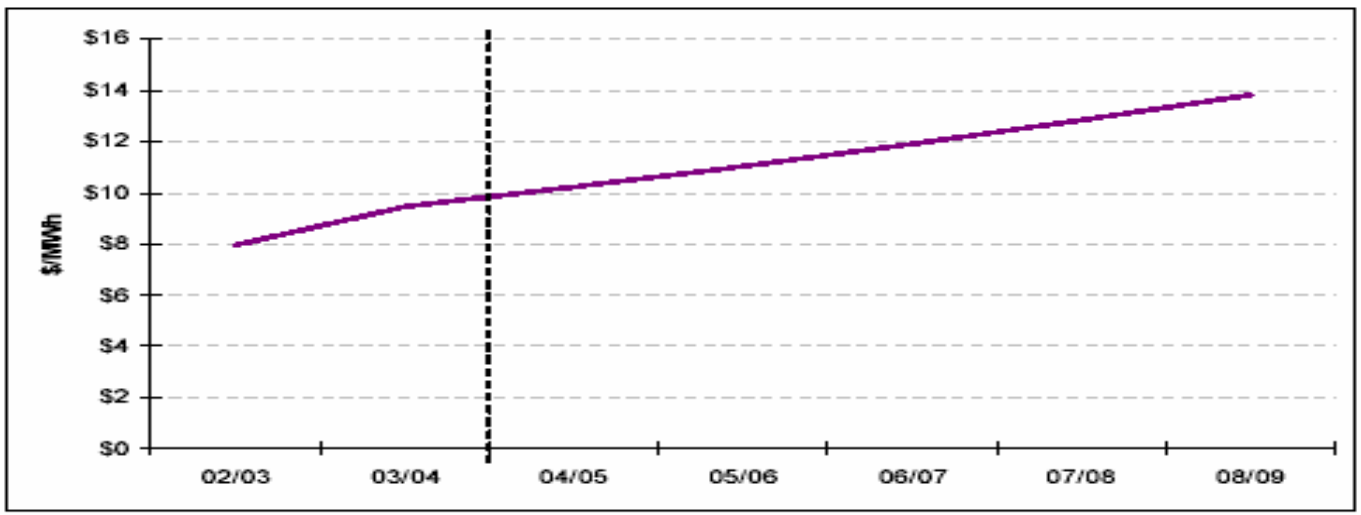
**Over the past 8-10 years**

- **The prices of manufactured products has fallen or improved in quality for the same "real" price**
- **The selling price of zinc has fallen in real terms by nearly 30% (ie averaging a fall of ~3% per year)**
- **The selling price of newsprint has fallen in "real" terms by nearly 3% per year**
- **Gaining a little the period the average "real" selling price of aluminium has risen by a modest 1.3% pa**
- **These selling price falls are inclusive of concurrent major capex injections**

# How does the Transend decision compare? – Not well!

**In comparison to these large falls and some very modest rises, the proposed decision for Transend increases Transend rates ($/MWh) by an average "real" change of 10% per annum – and by 15% pa in nominal terms, increasing the electricity transmission price to be the highest in Australia, to exceed the next highest price (ElectraNet) by 30%.**

Figure 1.5 Illustrative price path 2003-04 to 2008-09 ($m, nominal)



# How does the Transend decision compare? – Not well!

**On a comparative basis the Transend decision fails in the most basic test.**

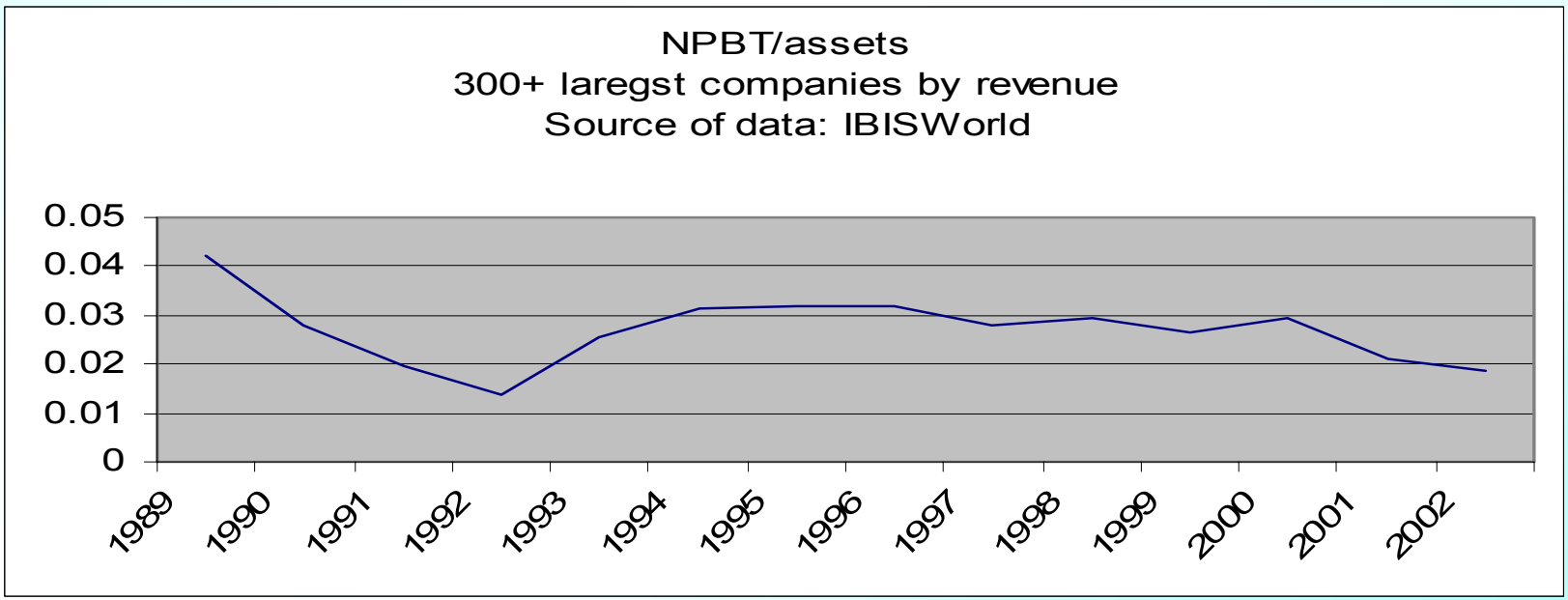
**The regulator is expected to replicate competitive outcomes on monopolies, but the numbers show the decision does not even come near to imposing any competitive pressures at all.**

# Why is Transend being given such a non-competitive revenue?

- Despite evidence to the contrary from a range of sources (including the ACCC), the Government has increased the asset base by over $70M causing consumers to pay a premium of nearly $1/MWh.
- The WACC awarded is high compared to the “real” world
- Opex shows a continuing increase, despite the injection of massive capex
- Users are providing a return on a major capex program which shows no discernable benefit other than the explanation that “our assets are old”

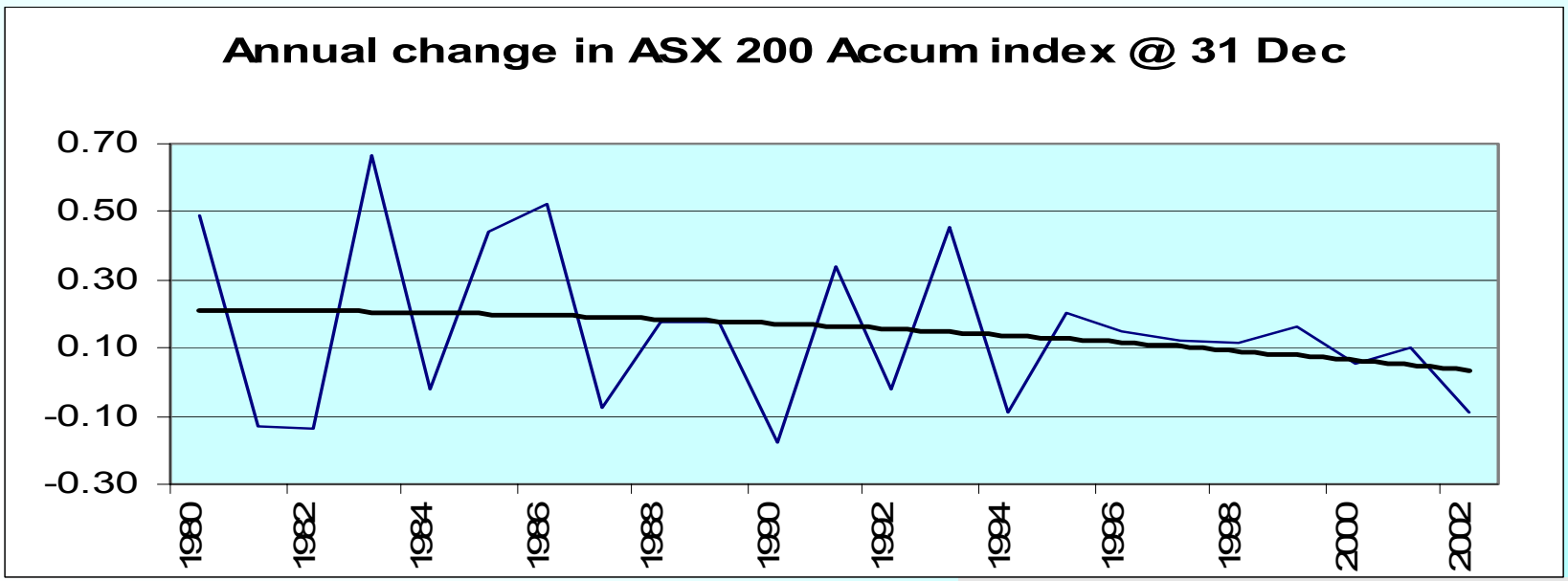
# Return on assets

- Benchmarking of returns is missing. This is essential to test the calculated answer
- The ACCC has awarded 8.3% after tax WACC
- Compare this to the competitive world



# Return on equity

- Benchmarking of the equity return is missing.
- The ACCC has awarded 11.41% after tax WACC
- Compare this to the pretax returns for investing in the competitive world



# The Causes of this disparity

- Applying a WACC calculated from input based on historic investment values, to asset values calculated on replacement cost
- The use of a post tax market risk premium of 6% where current pretax MRP is closer to 3%
- Using an equity beta replicating the average of all industry, rather than one replicating revenue stable and market stable returns
- The ACCC in its current review of SoRP acknowledges the equity beta is too high

# What are the drivers for capex?

- Capex must result in reducing opex
  (opex increase)
- Capex must show a benefit
  (only maintains performance)
- Capex is used to accommodate growth
  (there is little growth – less than 1% pa)
- Capex paid for by consumers must benefit consumers (some is for new generation and export)
- The corporation must be able to spend the capex requested (has not spent approved capex)
- The corporation must show an ability to manage its capex (usual capex is half of planned capex)

# The Capex allowed is too high

**Unfortunately Transend application fails on all counts – and the ACCC still permits it to spend in five years over 50% of its RAB as capex!**

**To be fair**

- **The ACCC says it will "claw back" the revenue element from unspent capex – Good**
- **The ACCC will impose a strict regulatory test requirement on capex for new assets – Good**
- **The ACCC implies refurbishment capex should be controlled by OTTER - Good**

**But who will ensure the Transend cost allocation will replicate the usage of the assets?**

# The Opex allowed is too high

**The GHD approach to setting opex is supported over the Transend approach, but**

- **The start point gives $2m+ pa over the average actual opex of for the past period (regulatory games? or are OTTER and Annual Reports wrong)**
- **Why add another $1.8m pa for clearing when the responsibility should be included in the opex base**
- **Why add so much for NEM entry – Powerlink got $2.4m pa for a network with 5 times the RAB and 3 times the demand growth, Transend gets an average increase of $3.5m pa for doing what it should be doing anyway**

# In the words of M. Thenardier from Les Miserables

"When it comes to fixing prices
There are lots of tricks we knows
How it all increases
All in bits and pieces
***** its amazing how it grows!"

**What the ACCC is proposing is to allow Transend to increase its prices by over 10% each year compounding, plus inflation for the next five years - and what do consumers get for all this?**

**Very little!**