

NSW Electricity Transmission Revenue Reset

Norske Skog Albury Mill's Response

to the

AER's TransGrid Draft Determination

and to

TransGrid's Revised Application

Norske Skog Paper Mills (Australia) Limited

Hume Highway via Albury	Phone: + 61 2 6058 3111
Private Bag, Lavington	Fax: + 61 2 6058 3080
NSW 2641	ABN: 84 009 477 132
Australia	

Norske Skog

Norske Skog Paper Mills (Australia) Ltd is Australia's only manufacturer of newsprint. Norske Skog is owned by Norske Skogindustrier ASA, a Norwegian based company, which is among the largest newsprint producers in the world. The company specialises in the production of newsprint and magazine grades of paper.

Norske Skog Paper Mills (Australia) Ltd is as a registered Australian Company and has two paper mills operating in Australia, one at Boyer near Hobart in Tasmania and the Albury Mill in New South Wales.

The Albury Paper Mill has one paper machine with a capacity of approximately 275,000 tonnes per annum manufacturing newsprint grade paper. The mill employs 185 people and approximately 700 people indirectly. The Albury Mill spends approximately \$100 million per annum within the local community and a further \$150 million per annum in NSW.

The newsprint industry is capital intensive with the most recent upgrade at the Albury Mill costing \$135 million in 2006 and the conversion project to lightweight coated production at the Boyer Mill \$85 million in 2014.

The Albury Mill has been in continuous operation since 1980.

The Albury Mill's newsprint production relies on the use of both plantation radiata pine pulp logs and recycled paper. The significant proportion of fibre produced at the Albury Mill is from plantation radiata pine pulp logs using a thermo mechanical pulping process. This type of pulp production uses significant amounts of electricity to mechanically separate the wood fibres. This is the major difference from a chemical pulping processes.

The Albury Mill supplies the majority of its output into the Australian Newsprint market, supplying 40% of the Australian newsprint market under medium term contracts. Combined with mills located at Boyer, Tasmania and at Kawerau in New Zealand, Norske Skog provides 80% of the Australian newsprint market. The Albury and Boyer Mills export surplus newsprint capacity into Asia as required.

Even though we are a large newsprint market player, the newsprint industry is an internationally competitive, price-taking market. Our competition in Australia is from newsprint imported predominantly from Asia and Norske Skog has no ability to pass through to customers' higher electricity transmission costs. In addition Norske Skog operates in shrinking markets due to the global and local downturn in newsprint demand. All of Norske Skog's operations in Australia are in regional areas with any potential impacts having direct effects on local employment.

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Executive Summary

Norske Skog appreciates the opportunity to present its views to the Australian Energy Regulator (AER) in regards to AER's Draft Decision on TransGrid's transmission determination and TransGrid's revised revenue proposal. Norske Skog's Albury Mill (NSA) is directly connected to TransGrid's high voltage electricity transmission network.

NSA thanks the AER for the clarity and detail behind the components that have led to its draft decision.

NSA congratulates the AER's draft decision which has removed the excesses created by the changes to the National Electricity Rules in 2006 and 2007. The draft decision has restored the Maximum Allowed Revenue (MAR) path to reflect the efficient levels applying prior to the 2009-14 regulatory period.

However, NSA was anticipating that the regulated MAR from 2015-16 would be significantly lower than that proposed in the AER draft decision. That it isn't, indicates that the AER has moved towards the top end of the range allowed under the Better Regulation guidelines and together with a generous MAR transition decision for 2014/15, the AER in its final decision needs to progress TransGrid towards a more efficient and cost effective MAR quicker than what the AER is proposing.

What TransGrid is seeking to implement in its revised revenue proposal does not meet the National Electricity Objectives by promoting efficient investment in and efficient operation and use of electricity services for the 'long term interests of (NSW) consumers.

It is extremely disappointing that TransGrid has failed this test across a number of categories:

- NSA recommends that the AER ensure TransGrid's opex is at the most efficient level possible, commensurate with its spend in 2012/13 and that a conservative approach isn't taken by the AER due to both the AER and TransGrid agreeing that 2012/13 is the efficient base year,
- that until TransGrid provides network demand price signals, no further investment occurs in demand management as there is no demonstrated return from this investment for NSW customers,
- that despite conducting a customer engagement process, this process seems to have the purpose of satisfying the AER and not NSW customers. NSA questions the ongoing benefits to NSW customers of such a program and recommends that no funding be allocated to this activity, again on the basis that there has been no return on the investment for NSW customers.

While NSA supports the move by TransGrid to universal demand based pricing for the postage stamped elements, TransGrid in its pricing methodology update indicates it would require significantly more than 10 peak days to gain an effective outcome for locational TUOS and will instead apply a 365 day basis. A 10 peak weekday pricing methodology for customers that are capable of load shedding can make a significant pricing difference in the order of 15% per annum and provide valuable impacts to the dynamics of network investment, sizing and utilisation.

Due to the evident anomalies that currently exist with TransGrid pricing as applied to NSA, NSA is not confident that its future pricing will be reflective of the AER final decision on the change to the MAR.

The NCIPAP scheme requires a fundamental overhaul as it isn't meeting the National Electricity Objectives.

NSA is disappointed that no change will occur to the excess demand charge, as this charge has no resemblance to the actual costs incurred by TransGrid nor is it reflective of the impact on the network.

AER's Draft Decision on Maximum Allowable Revenue

The AER's 2014 draft decision has removed the excesses created by the changes to the National Electricity Rules in 2006 and 2007. This has the effect as demonstrated in Figure 1 below of restoring the Maximum Allowable Revenue (MAR) to that as shown by the trajectory of revenue decisions pre the 2009-14 MAR review.

It was anticipated that under the *Better Regulation Program* guidelines following wide consultation and with significant consumer input, that NSW consumers would see benefits despite the network over investment between 2009-14. It is disappointing that the benefits have not been fully realised and NSA concludes that while the AER's draft decision is moving NSW TNSP's in the right direction, it hasn't avoided NSW consumers continuing to suffer from this high cost but unnecessary investment.

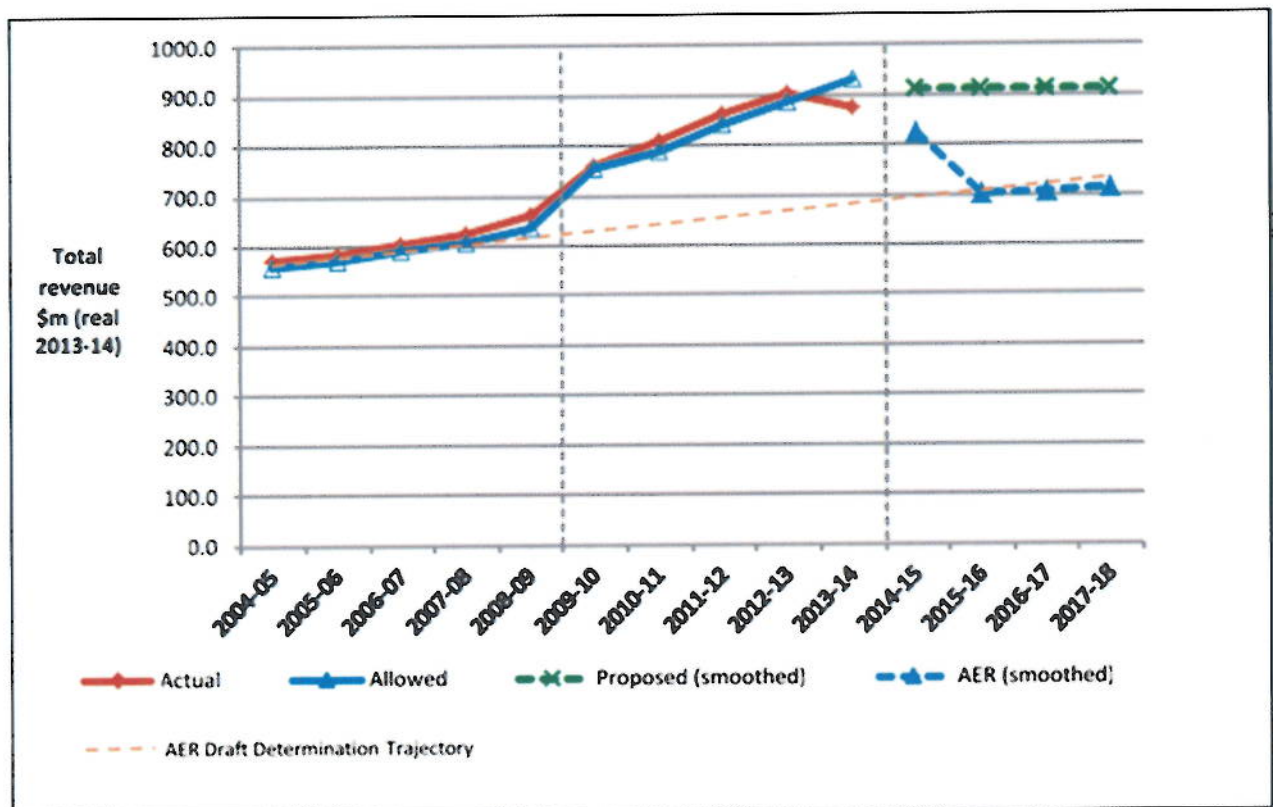


Figure 1: AER draft decision revenue allowance.¹

NSA was anticipating that the regulated MAR from 2015-16 would be significantly lower than that proposed in the AER draft decision. That it isn't, indicates that the AER has moved towards the top end of the range allowed under the Better Regulation guidelines and together with a generous MAR transition decision for 2014/15 the AER in its final decision needs to progress

¹ Reproduced and amended from AER Overview | Draft decision: TransGrid transmission determination 2015-18 Figure 1.1 p12.

TransGrid (TG) towards a more efficient and cost effective MAR such as that adopted by TasNetworks².

The Better Regulation Program provides the Australian Energy Regulator (AER) with greater discretionary powers and the guidelines show stakeholders how the AER intend to use this discretionary power for an equitable outcome for all parties.

As in its original submission, NSA still considers the AER has a clear responsibility to ensure a balanced approach to the revenue reset, that all costs presented are justified, are at the lowest and most efficient level reflecting best practices used by competitive business and are economically efficient.

While both the AER and TG support that the National Electricity Objectives (NEO) must be met by promoting efficient investment in and efficient operation and use of electricity services for the 'long term interests of consumers, both the AER and TG need to consider:

- That the interest of a business user of the network is to remain viable now (the immediate term) by paying the lowest and most efficient costs now. This must be balanced with the provision of long life expensive transmission network assets which must operate and be maintained with costs recovered over the longest period possible to provide the lowest overall cost to consumers. The two timeframes don't necessarily converge resulting in some inefficiencies which must be shared by both TG and consumers,
- Unless there is commonality of efficiency consumers will use the assets less with stranded assets increasing, placing further strain on NSW customers' ability to pay,
- That for consumers the bargaining power they have with network providers is minimal and the only recourse for consumers is for their views to be represented by the AER in its decisions in the revenue reset process
- Consumers very limited bargaining power with the network provider is evidenced by TG's lack of adoption of customer views through its customer engagement process³ (except where the consumer views provide a benefit to TG) it is difficult for NSW consumers to see how TG's revised revenue proposal satisfies the long term interests of consumers.

The conclusion from all of this is that in a dynamic market, competitive firms have to react quickly. They don't have a transition year to react or 5 years of predetermined regulated revenue. For the newsprint industry, Asian prices⁴ announced in early December 2014 for January 2015 delivery have fallen US\$40 per tonne or an annualised position for Norske Skog Australasia by some A\$10 million⁵. Our options are to curtail production or to reduce costs. Oil prices have fallen considerably and Oil Search's reaction is to "immediately respond...by reassessing capital spending for 2015...look at our cost base...and we would act early rather than leave it."⁶ A regulated monopoly isn't subject to these fast moving pressures and must therefore be placed as

² TasNetworks Revised Revenue Proposal (1 July 2015 – 30 June 2019) p4.

³ TransGrid Revised Revenue Proposal 2014/15 - 2017/18 section 3.

⁴ RISI PPI Asia Vol. 17 No. 46 published 5th December 2014 or at <http://www.risiinfo.com/content-gateway/marketprices/global/archive.html?action=browse&newsletter=2&page=0&year=2014> as at 2 Jan 2015.

⁵ The impact has taken into account softer USD:AUD currency rates in December 2014 of some 4.1% reducing the impact to the A\$10 million indicated. Currency user defined reports are available from <http://www.westpac.com.au/personal-banking/services/historical-rates/> as at 30 December 2014.

⁶ "Oil slump will make industry fitter, leaner" Financial Review, 3 December 2014.

close as possible to the maximum allocative frontier⁷ by the regulator. The AER's draft decision moves TG's MAR back towards this frontier, but the frontier is further away than that which the AER is proposing. However the AER's position is a lot closer to the optimum level than that proposed by TG in its revised revenue proposal.

In its original submission, NSA showed that of firms traded on the Australian Stock Exchange (ASX), the utilities sector index⁸ was only outperformed by the health care sector over the past five years, indicating that investors are willing to pay a premium for companies providing shareholders with better than normal market returns and certain revenue streams. NSA is disappointed the AER didn't move closer to the lower end of its WACC guidelines in its draft decision as WACC is at its lowest level for some time and this benefit needs to be passed through to NSW customers through the complete cycle with the AER taking a less conservative position. After all, the WACC increases when the historically low risk free cost of money increases causing network prices to again increase.

Overall both NSA and NSW consumers expect considerably lower costs for electricity transmission services for this next regulatory period. While the AER has returned the regulated maximum allowable revenue to that of the longer run position, it provides no return to NSW customers for network unnecessary over investment from 2009-14. TG's revised revenue proposal moves TG even further away from the economic efficiency frontier.

TransGrid's Revised Revenue Proposal

It is unacceptable that TG is proposing that its Revised Proposed MAR increase back to the level of its original revenue proposal by 2015/16⁹ and that TG ignores and disregards:

- That the network is already able to cater for the forecast demand at least until 2019/20¹⁰ and possibly later than this
- That the network only requires limited augmentation due to few network bottlenecks
- That despite both the AER and TG agreeing that TG's operating costs were efficient in 2012/13¹¹, TG is still insistent that it needs further increases in spite of this being a move away from accepted practices adopted by competitive true market businesses seeking to survive for the long term
- That it over invested in replacement capex during the 2009-14 regulatory period by \$140 million
- That it underspent total capex in the order of \$450 million
- The customer feedback TG gathered from its consumer forums (other than the adoption of demand based charging for the postage stamp component) with TG certainly not meeting the main consumer view requiring TG to be a more efficient and lower cost transmission network for NSW customers.

⁷ "Maximum allocative efficiency occurs when no resources are wasted" McTaggart et al, *Economics*, 1994 Addison Wesley, p 280-281.

⁸ Comprising companies providing similar services as those provided by TransGrid.

⁹ TransGrid's Revised Revenue Proposal 2014/15 Chapter 1 p11 and 12.

¹⁰ AEMO's NEFR_final_published_Nov_2014.pdf p4-4.

¹¹ TransGrid Revised Revenue Proposal 2014/15 – 2017/18 Chapter 1 s1.2 p6.

Given TG's underspend in the 2009/10-2012/13 regulatory period and the declining electricity consumption in NSW, NSA is unsure if the increased MAR proposed by TG for the next period will all be needed by the network to achieve the national electricity objective. The amounts proposed certainly don't appear to be efficient when compared to the actual revenues needed in regulatory periods prior to 2009/10.

While the AER has proposed to reduce TG's replacement CAPEX by 30%¹², NSA considers more can be achieved in capex reductions. For example, following the release of the AER draft decision and a short period before the submission of its revised revenue proposal, TG consulted with NSA in regard to an upgrade of the ANM sub-station¹³ which serves NSA. In this example, TG advised that the renewal project for ANM was some \$5m¹⁴ but that the necessary works can be carried out for \$1.5-\$2m. This indicates that TG overstated this renewal cost by nearly three times and that its initial proposal was an enhancement project with some 18 years payback. For an NSA project, a payback of this length would not gain approval. Extrapolating this example across the board, then a reduction of at least 50% in renewal capex would seem to be achievable. TG also indicates that risk will increase, NSA disagrees and considers that risk will not increase above the risk that is already present under the current arrangements.

TG has underspent the previous regulatory period capex by approximately \$475 million. The avoidance of this investment by NSW consumers has been paid by way of dividends to TG's owner, who plays a somewhat silent role in regulated decisions, unlike in a normal competitive business. In a normal business some of these funds would be re-invested back into the business for many reasons, such as one which was expressed at the public forum hosted by the AER in Sydney¹⁵ on 8th December 2014. At this forum, the TG Managing Director expressed disappointment that the AER had cut security and compliance capex stating this posed fire and public safety risk due to some of TG's transmission lines being too low. This raises the question that if TG MD is so concerned with this risk, why didn't TG use some of the capex under-run to address the concern - this is what the NSA Board would have insisted on. Another option is that if NSW had a time of day demand management tariff incentive such as that in Victoria, load on lines on previous high load days would reduce and so reduce line heating impacts on line sag. In a business such as NSA, an issue arising from say an insurance audit such as fire doors¹⁶ not meeting new standards, NSA would seek funds to remedy this from its owners and implement the work immediately rather than seeking agreement from its customers to increase their prices to allow this to occur. This is where regulation seems to have failed, namely that the owner has a role in reinvesting back into the business to keep the business up to standard or to remedy possible previous projects poor workmanship without the option of increasing prices.

¹² AER Overview | Draft decision: TransGrid transmission determination 2015-18 p47.

¹³ TransGrid's discussion on this can be found at TransGrid Revised Revenue Proposal 2014/15 – 2017/18 Chapter 5 commencing at p59.

¹⁴ Table 5.3 page 74 of TransGrid's initial revenue application.

¹⁵ AER Forum held at the Menzies Hotel at 1.00pm.

¹⁶ Fire and papermills are mutually exclusive so fire doors are an integral part of fire mitigation and are always closely scrutinised by insurers.

Despite TG being happy that the AER recognises TG's efficient operating expenditure in 2012-13, it challenges that this base year is understated due to a contractor issue¹⁷ causing an underspend of \$2 million in that year suggesting it needs to be reset by this amount. TG in effect:

- didn't subsequently reduce the MAR by an equivalent amount during 2012/13 (or 2013/14) and
- is seeking, on average in its revised revenue proposal, an increase in operating expenditure of \$15.7 million for each year from 2014/15 to 2017/18 and by inference from 2012/13 to 2013/14 for an increase in the base year of some \$2 million.

What TG is seeking to implement is not what occurs in a competitive market. NSA recommends that the AER ensure TG's opex is at the most efficient level possible, commensurate with its spend in 2012/13 and that a conservative approach isn't taken by the AER due to both the AER and TG agreeing that 2012/13 is the efficient base year.

It is extremely disappointing that all of TG's proposed NCIPAP projects were approved by the AER. This is not an efficient allocation of resources and the end result will be that TG will undertake several projects with short payback and bank the remaining project allocation, again at the cost of investment by NSW customers for no return.

NSA recommends that the NCIPAP scheme requires a fundamental overhaul as it isn't meeting the National Electricity Objectives (NEO) of promoting efficient investment in and efficient operation and use of electricity services for the 'long term interests of (NSW) consumers'.

Transmission Pricing

The impact of the AER's regulatory decision is the prices that are charged by the TNSP to consumers.

For NSA, there is a major disconnect between MAR and the price (cost) incurred which for NSA is depicted in Figure 2 below. NSA has demonstrated to TG using several different methods that NSA is paying a disproportionate amount (well over 20% more per annum) for transmission services than would be derived from increases in the MAR. This amount is even greater when the NSW transmission rates are compared to those in Victoria, some 25 km away. NSW charges are in the order of 37% more expensive than Victorian rates for the same MD and load profile.

NSA is still concerned that TG (the co-ordinating network service provider for NSW) isn't able to adequately explain the anomalies raised by NSA in its pricing discussions with TG.

¹⁷ TransGrid Revised Revenue Proposal 2014/15 – 2017/18 Chapter 6 s6.5 p87-88.

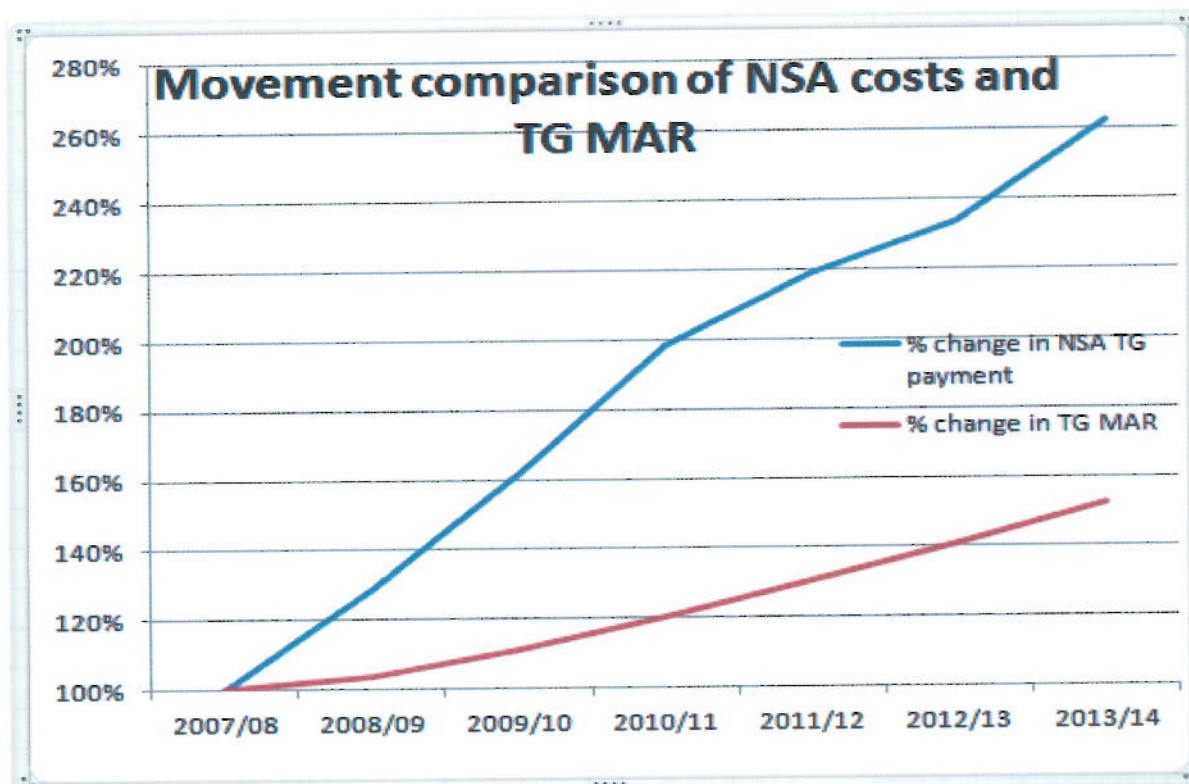


Figure 2: NSA's Cost Increase Compared to TransGrid's MAR Increase

The AER in its draft decision indicates that the indicative transmission price expressed as \$ per MWH (nominal) for NSW and ACT customers has risen by 48% during the 2009-2014 regulatory period based on Figure 3.

Under the AER draft decision, MAR falls back to 2009/10 levels (refer to Figure 1) and pricing only falls to 2012/13 levels due to decreased electricity consumption in NSW, showing the impact that both energy efficiency measures and business closures has on the price being paid by NSW customers.

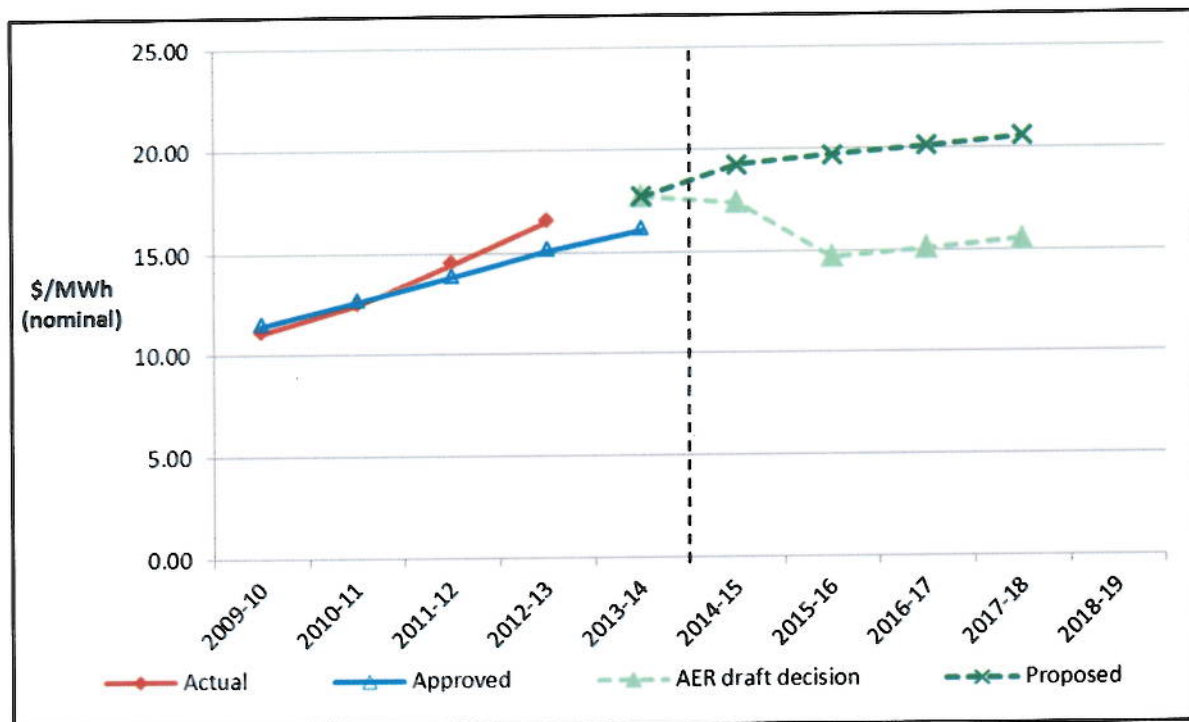


Figure 3: AER Indicative transmission charges from 2009–10 to 2017–18 for NSW and ACT (\$/MWh, nominal)¹⁸

NSA's actual \$/MWh cost (indexed to 2009/10) during the same period has risen 77% as shown in Figure 4.

Due to the evident anomalies that currently exist with TG pricing as applied to NSA, NSA is not confident that its future pricing will be reflective of the AER final decision on the change to the MAR.

As stated in its original submission, NSA indicated that unlike smaller customers, NSA's transmission cost is not insignificant as it is more than a 25% of its total electricity cost, not the approximately 8% of a consumers electricity bill¹⁹ indicated by TG.

¹⁸ Reproduced from the AER Draft decision: TransGrid transmission determination 2015-18 | Attachment 1, p20.

¹⁹ TransGrid Revised Revenue Proposal 2014/15 – 2017/18 Appendix K p7

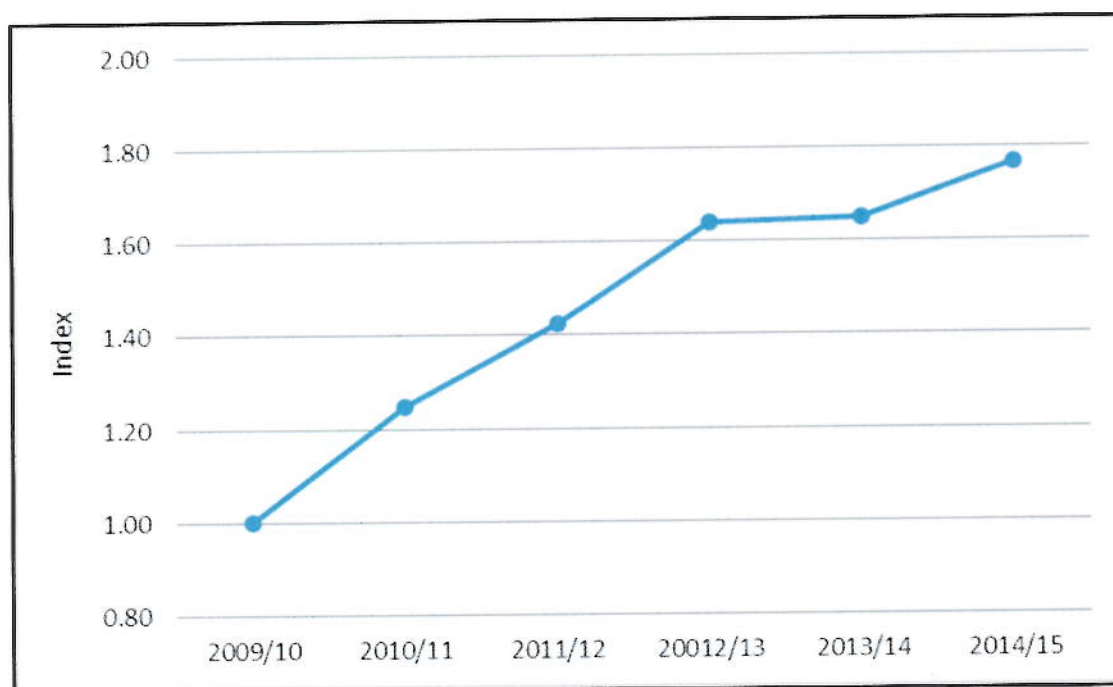


Figure 4: Index of NSA Actual transmission charges from 2009–10 to current.

While NSA supports the move by TG to universal demand based pricing for the postage stamped elements, TG in its pricing methodology update²⁰ indicates it would require significantly more than 10 peak days to gain an effective outcome for locational TUOS and will instead apply a 365 day basis.

NSW total demand²¹ for January 2015 (month to date) has been graphed in Figure 5 below. Four weekdays have been selected from this data and graphed in Figure 6. The total demand pattern appears to be consistent leading to the question, why aren't 10 peak weekdays adequate and a time of day load shedding incentive unsuitable for NSW despite its application in Victoria?

²⁰ TransGrid Revised Revenue Proposal 2014/15 – 2017/18 Appendix Z p4.

²¹ <http://www.aemo.com.au/Electricity/Data/Price-and-Demand/Aggregated-Price-and-Demand-Data-Files> for NSW, January 2015, as at 27th January 2015.

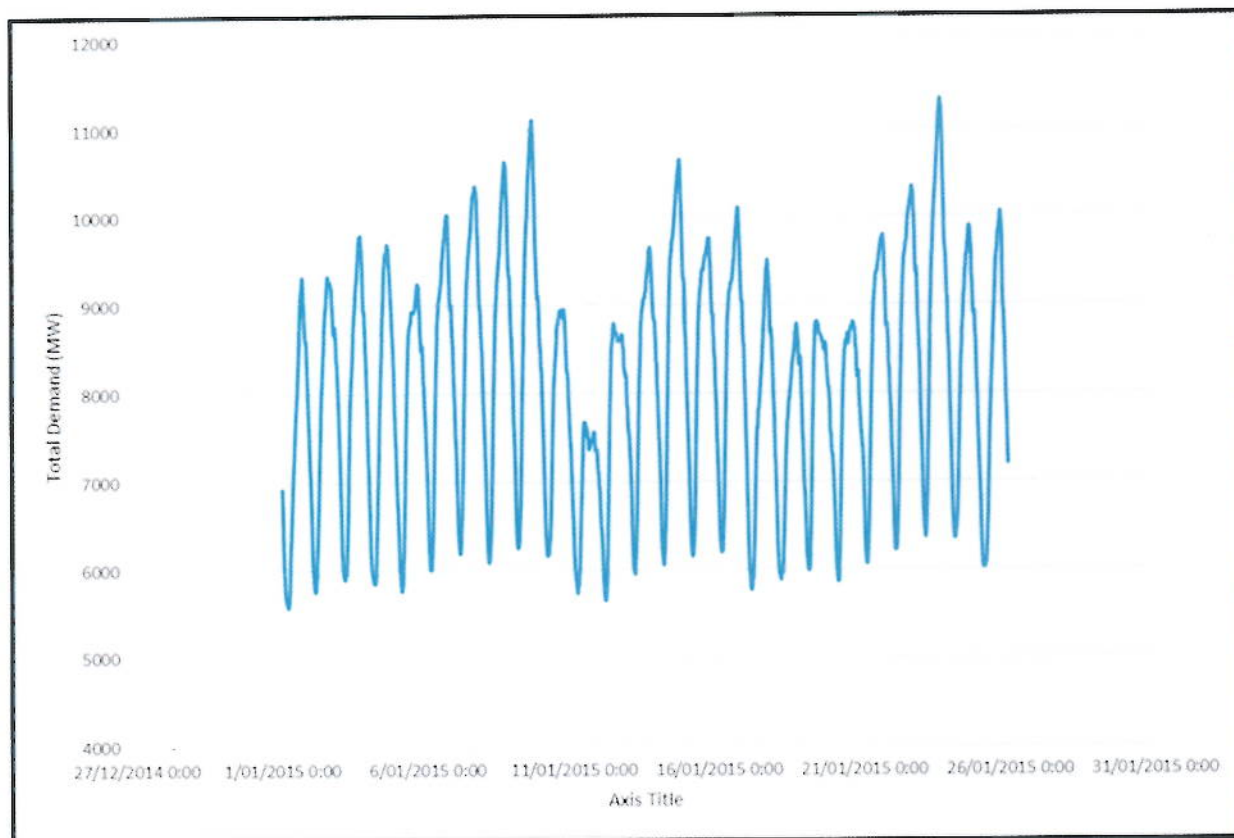


Figure 5: NSW Daily Total Demand for January 2015 (month to date).

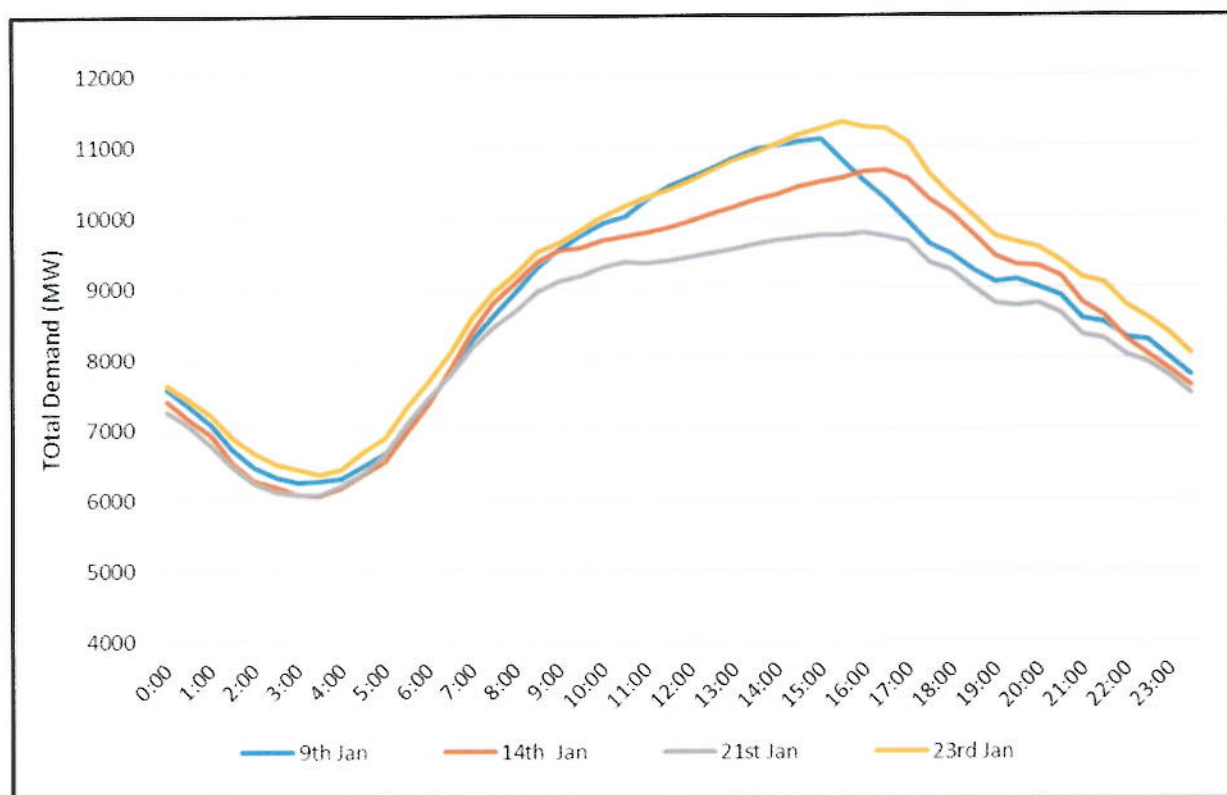


Figure 6: NSW Time of Weekday Peak Demand for four randomly selected days in January 2015.

A 10 peak weekday pricing methodology will be indifferent for a small consumer²² whereas for a customer that is capable of load shedding, it can make a significant pricing difference in the order of 15% per annum and provide valuable impacts to the dynamics of network investment, sizing and utilisation. For TG to achieve its desire to 'Provide a strong price signal...via highly utilised areas'²³ it is only larger customers who are price sensitive. Despite this TG provides NO pricing signals to support the network by demand management, unlike Victoria.

NSA recommends that until TG provides network demand price signals, no further investment occurs in demand management as there is no demonstrated return on this investment for NSW customers.

As noted above, NSA is located only 25 km from the nearest Victorian substation yet the massive cost differential between the TG charges and the Victorian charges results from just from being in NSW. A true NEM would have the same pricing methodology irrespective of region with similar prices for exit points located near each other - not a premium for being on the wrong side of a dotted line on a map.

Customer Engagement

Following the AER draft decision, TG continued with its consumer engagement process.

TG's consultant states that

From the start, TransGrid was focussed on meeting the AER's requirements. ...Participants were advised what the goals and objectives of the engagement were, and what their feedback would be used for, but the participants' ability to influence in practice is somewhat unclear.²⁴

NSA considers while TG has conducted a customer engagement process, TG has paid scant regard to the customer feedback gathered from its consumer forums in its revised revenue proposal, except for the adoption of demand based charging for the postage stamp component. NSA estimates TG has adopted no more than 10% of customer recommendations and expectations, and is certainly not addressing and meeting the main concern of a more efficient and lower cost transmission network for NSW customers. It is quite apparent that where TG has accepted the outcomes of consumer engagement, it is where TG sought additional funds, this totally overlooks the consistent observation from customers that the TG prices were too high.

NSA questions the ongoing benefits to NSW customers of such a program and recommends that no funding be allocated to this activity, again on the basis that there has been no return on the investment for NSW customers.

²² An electricity bill of \$1,000 per quarter will include \$80 transmission cost.

²³ TransGrid Revised Revenue Proposal 2014/15 – 2017/18 Appendix Z p7 last dot point.

²⁴ Ibid Appendix A p1-2.

Excess Demand Charge

NSA is disappointed that no change²⁵ will occur to the excess demand charge, as this charge has no resemblance to the actual costs incurred by TG nor is it reflective of the impact on the network.

End of the Submission
4 February 2015

²⁵ Reproduced from AER Draft decision: TransGrid transmission determination 2015-18 | Appendix Z s2.1 p4.

Acronyms

AER	Australian Energy Regulator
GW	Gigawatts (1,000,000,000)
kV	Kilovolts (1,000)
MAR	Maximum Allowable Revenue
MD	Maximum Demand (in MW)
MW	Megawatts (1,000,000)
NEM	National Electricity Market
NEO	National Electricity Objective
NCIPAP	Network Capability Incentive Parameter Action Plan
NSA	Norske Skog Albury Mill
TG	TransGrid
TNSP	Transmission Network Service Provider
TUoS	Transmission Use of System