8 August 2014

Mr. Chris Pattas
General Manager – Networks Branch
***Australian Energy Regulator***
GPO Box 520
MELBOURNE VIC. 3001.

Dear Mr. Pattas

**SUBJECT: TAS NETWORKS REVENUE PROPOSAL 2015 - 2019**

Nyrstar Hobart welcomes the opportunity to provide a submission to the Australian Energy Regulator (AER) in relation to Tas Networks revenue proposal for the period 2015 to 2019. In recent years the Nyrstar Hobart smelter has seen significant increases in its transmission charges of over 200%. This has come at a time when commodity markets and macro factors such as the exchange rate are unfavorable. We strongly believe that whilst Tas Networks have reduced consequent charges in the transitional year the period beyond 2015 transmission charges will rise again. This is concerning to our business and we consequently urge the AER to use a 'hard' approach to regulatory control and impose a much tighter revenue path where nominal transmission charges are reducing. Nyrstar's expectation is that a status quo scenario in future years is **not acceptable.** Whilst we welcome Tas Networks strategic intent to "Transform Practices" from December 2014 in their business, as a large user our expectation from this transformation is that a material reduction in charges actually occurs. We have reviewed the proposal and make the following responses and comments:

**Operational Expenditure**
Nyrstar urges the AER to focus more closely on operational expenditure (opex) claims made by Tas Networks. The proposal uses a baseline year of 2007/ 2008 for opex. This is highly unlikely to be an efficient baseline thereby Transend are overstating their opex efficiency efforts. Also the metric showing the ratio of opex to RAB is not an appropriate representation of their opex efficiency as this is largely influenced by movements in the RAB.

The Tas Networks proposal does not incorporate a stretch for synergy benefits which should arise from the merger of Aurora distribution and Transend. An ambitious but realistic synergy benefit target should be included in the opex allowance. It is not inconceivable that synergy benefits of 15% of the combined opex of the merged entities could be used as a stretch target.

There is an absence of clear productivity improvement targets with regard to Tas Networks opex. Tas Networks have not built in clear and tight opex productivity improvement targets which are over and above any purported synergy benefits from the merger. Whilst the EBSS provides an incentive for a TNSP to find further savings Nyrstar is concerned that the EBSS alone may not be sufficient to reduce opex in this case.

Furthermore, the high amount of capital expensed in the previous regulatory period would have reduced opex in some areas. Tas Networks have not provided any evidence that past asset renewals/ replacements have indeed had a positive impact on operational expenditures. If there has not been any improvement in their cost structure from past capital investment then it is questionable on what basis the capital was approved and was it supported by a rigorous cost/ benefit justification. It should be highlighted that the real drivers of opex are the age and numbers of assets.

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The younger the asset base the less opex, so if the average age of the assets has fallen (as might occur with a large renewal/ replacement expenditure program) then opex should fall. So benchmarking opex should be related to average age and numbers of assets rather than an inefficient baseline year prior to the major capital expenditure program.

**Capital Expenditure**

It should be noted that Tas Networks and its predecessor Transend have spent ~$1 billion in capex over the last ten years and are still claiming ~$280 million in capex from 2015 to 2019. Tas Networks also have compared the 50% reduction in capex against the high capex in the previous period. This is not a valid comparison. Nyrstar cautions the AER that this level of renewal and replacement capex is still too high especially in light of the significant 'rebuilding' of the network over the past two regulatory periods. It is not clear whether the proposed $280 million in new capital investment has been critically risk assessed and whether justifications have been scrutinized. Furthermore, the proposed augmentation capex (~$41 million) could be reduced and/ or even deferred given the implementation timing of some of these assets is in 2017+.

The Tas Networks capex program comes against a backdrop of reducing energy consumption and Maximum Demand. It should be noted that in the last regulatory period a forecast Maximum Demand of 2100MW was the basis of the revenue proposal (see below chart 1 in Appendix). This level has not been reached and conversely the on-island Maximum Demand has reduced with a consequent reduction in overall asset utilization of the network leading to a stranded asset situation. The basis of the instant proposal has an increase in Maximum Demand to 2019 by approximately 100MW. Our expectation is that at least the AEMO low demand forecast should be used as a basis for the capex program and revenue control.

Another observation is that Tas Networks have failed to properly account for and include in their proposal the minimum capex required based on economic depreciation of a largely renewed asset base.

Nyrstar's position is that if the capex claim was reduced significantly further it is unlikely the network would suffer any loss in reliability or system performance.

**Financial Returns and WACC Issues**

The level of profitability of Tas Networks is extraordinary. The charts 2 and 3 in the Appendix show the total benefit generated from the Tas Networks business as a proportion of revenue and in absolute terms. Indeed the regulated network industry per se enjoys very favorable returns based on utilities indices compared with other industry sectors. Whilst the AER will review the WACC parameters Nyrstar recommends that the Market Risk Premium (MRP) should come down to 6% rather than 6.5%. Furthermore, the $\beta_e$ is at the upper end of the estimate range and should be moderated given the Tas Network business is highly profitable and the risk on its returns are well below the risk of an average asset in the market.

Yours faithfully
NYRSTAR HOBART

R. Curtis

**Richard Curtis**
**PLANT MANAGER.**

Copies to: Greg Zooeff, GM Files (Nyrstar Hobart)

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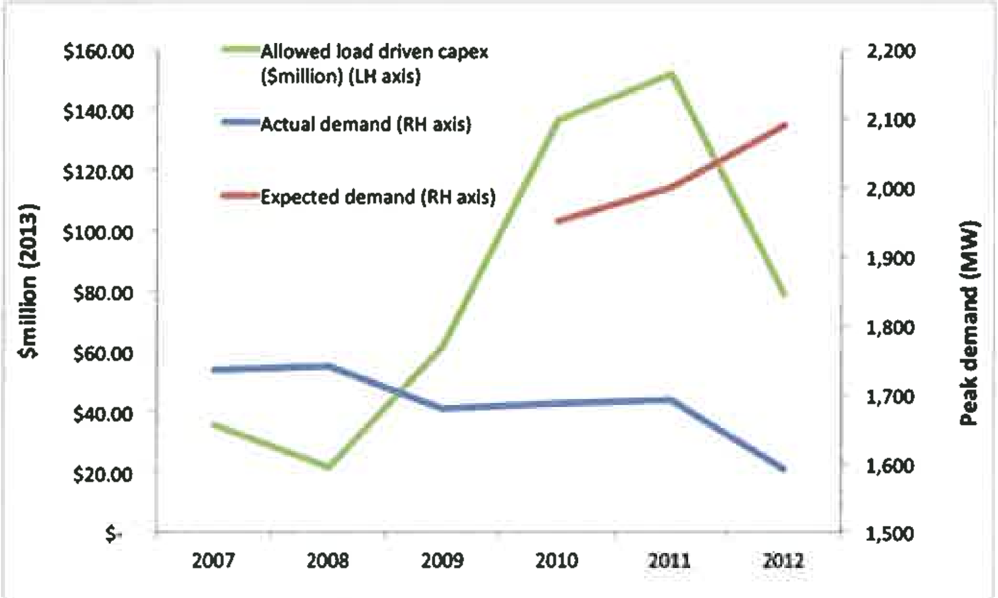
## APPENDIX

### Chart 1: Load Forecast and capex Spend Profile




### Chart 2: Total Pecuniary Benefit from Transend as a Percentage of Revenue

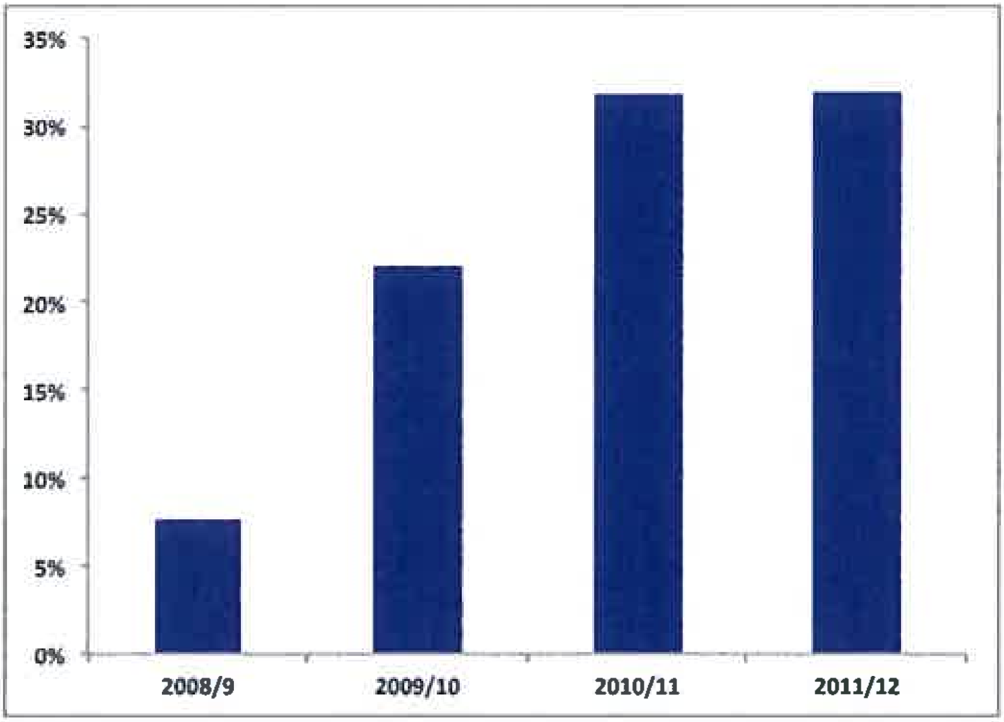



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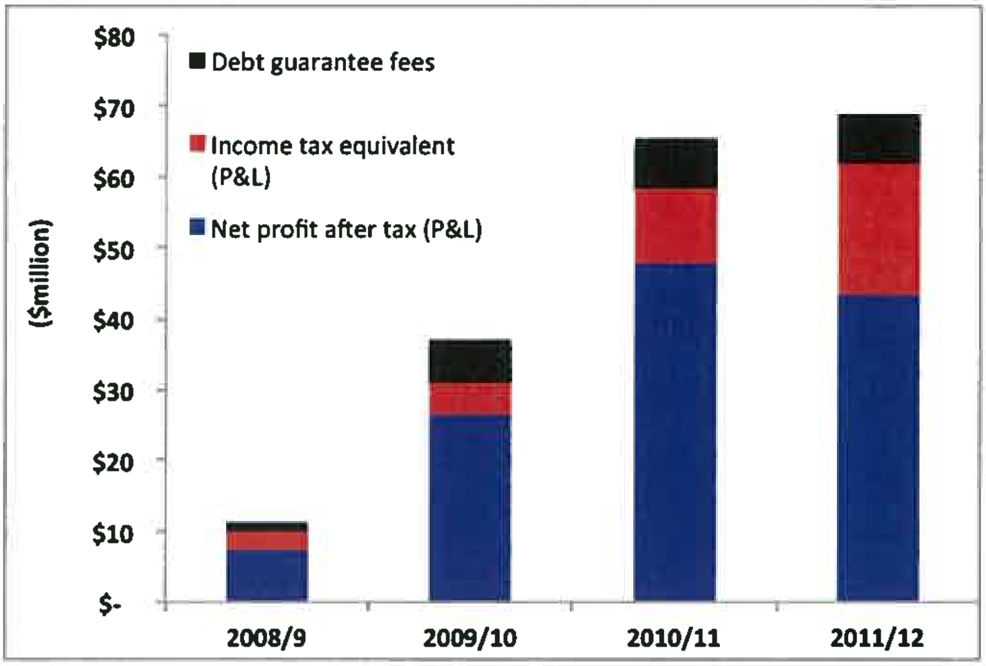
**Chart 3: Absolute Pecuniary Benefit from Transend**





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