Ref. GHJ:m/L872

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27 May 2002

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Dear Mike

SPI PowerNet Revenue Cap Application

We would make the following observations in relation to SPI's application:

1. Price trends and relative cost efficiency

We note the comparisons of "unit costs" on *pages ii, iii and vii of the Executive Summary,* and in particular, *Figures 2 and 6*.

These comparisons beg the question of what "unit" is the appropriate measure for comparing costs for the activity of electricity transmission, which is fundamentally a transportation activity.

A key determinant of the relative economics of a transportation activity is not only "how much" is being transported, but also "how far" it is being transported. The greater the transportation distance, the higher the transportation cost.

In this regard, *Figures 2 and 6* are, in our opinion, not a particularly good measures of the relative cost efficiency of electricity transmission in the four States, as they overlook the critical "how far" component of the costs.

Such a simplification could be accepted if the "how far" component was similar across all States. However, this is not the case. The "average" MWh transmitted in Queensland has to be transported about three times the distance of the "average" MWh in Victoria. This is too significant a difference to be ignored.

Indeed, given the large disparity in the "how far" factor, the most salient observation one could make on *Figure 2* is how surprisingly close the cost per MWh for the most geographically dispersed State (QLD) is to the cost for the most geographically compact State (VIC).

A more useful measure of relative cost efficiency between States with materially different geographies is to compare the costs as a percentage of the asset values – as both the numerator and the denominator incorporate the "how far" component which is so critical for a transportation activity like electricity transmission.

Further, any comparisons between Victoria and other States needs to merge the non-common costs of both Vencorp and SPI.

2. Value of easements

We note that the value proposed for easements includes both the land value and the cost of "assembling" the land into a usable easement.

We note that in the Powerlink revenue cap submission in 2001, and in various follow up documents at that time, we encouraged the ACCC to recognise that its draft regulatory principles needed to be updated to reflect the soundness of a similar approach to easement values proposed then by Powerlink. That approach was also, at the time, seen as sound by the ACCC's consultants.

This sound approach not only should be applied to SPI (and ElectraNet SA) but also needs to be enshrined in the regulatory principles.

3. WACC – risk free rate

We support SPI's arguments that the ACCC should be using the 10-year bond rate (rather than a shorter-term bond) as the risk free rate. SPI has clearly articulated the reasons why this is the most appropriate approach. Above all, the ACCC's regulatory regime is based on the capital asset pricing model, which in its purest form, should use a cost of capital which reflects the life of the asset and not the regulatory period.

It is accepted that—for transparency—the model should use a published risk-free rate, in which case, the longest term published rate (10 years) should be used.

Yours sincerely

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