SA Water

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Mr Michael Rawstron
General Manager
Regulatory Affairs - Electricity
Australian Competition and Consumer Commission
PO Box 1199
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Dear Mr Rawstron

ACCC Regulation of South Australian Transmission Network Transmission Revenues

I refer to the application to the ACCC by ElectraNet SA for a revenue cap decision relating to the non-contestable elements of its network, and the invitation for interested parties to comment on issues relating to the determination of an appropriate revenue cap.

SA Water, in its capacity as the operator of water and wastewater infrastructure and services on behalf of the Government of South Australia, is a major consumer of electricity from connection points to the high voltage transmission system. We have held discussions with ElectraNet and its predecessor, ETSA Corporation, over transmission charges since 1996.

With the assistance of consultants Burns and Roe Worley (BRW), SA Water has reviewed the ElectraNet submission and identified specific issues of concern, as follows:

- The substantial increase in capital expenditure sought by ElectraNet (averaging $81M per year over five years) is not supported by adequate detail. The ElectraNet SA application indicates the projections have considered demand growth, generation growth and replacement of ageing assets, and that a probabilistic scenario basis has been used. The application lacks sufficient detail to make an assessment of this expenditure, and in particular:

    - no details are provided regarding the components for asset replacement, system and demand growth, generation connection, interconnection, NEC compliance, NEMMCO and system security
    - No details have been provided on the assumed lives of respective asset classes, or the breakdown of expenditure into these asset classes. By contrast, the current SPI PowerNet Revenue Cap Application to the ACCC provides a detailed breakdown.
    - The potential for development of the South Australian transmission grid by new entrants has not been recognised – ie ElectraNet assumes it will supply all demand growth when in fact elements of the system are potentially contestable and likely to be developer funded.

- ElectraNet provides no details on its valuation of system assets. An independent valuation carried out in 1999 of connection assets supplying SA Water pumping stations indicated that the replacement cost of these assets was significantly lower than the costs included in the regulatory asset base. In addition, optimisation of the assets had not been allowed for in the asset base. We are concerned that these identified problems may be representative of ElectraNet's general approach, and that rolling forward the regulatory asset base will lock in anomalies in the next regulatory period.

- High easement valuations are included in the proposed regulated asset base in the Revenue Cap Application and the subsequent *Regulated Costs of Easement Acquisition* document. While we acknowledge recent regulatory precedents allow for inclusion of easement costs, there seems to be some ambiguity on the most appropriate mechanism. Under the ACCC's Draft Statement of Regulatory Principles, easement values should be based on historical costs of acquisition including compensation, escalated by CPI. There is no evidence of what was paid by ElectraNet for the existing easements or that the costs associated with easement acquisition today would have been required in the past.

- SA Water is also concerned by ElectraNet's proposal to hold separate discussions with the ACCC over additional landholder compensation values in the regulated asset base.

- If substantial easement re-valuation is endorsed by the ACCC, SA Water believes that a compensating downward adjustment should be made to the ElectraNet Weighted Average Cost of Capital (WACC) with the objective of obtaining a neutral on-balance effect.

- The proposed ElectraNet WACC (8.66% post tax nominal) is biased to the high side in a low risk revenue cap regime, due to:

  - An excessive Market Risk Premium of 6.5%
  - The use of the 10 year Commonwealth Bond rate to determine the risk free rate
  - Asymmetric risk is not a component of the Capital Asset Pricing Model (CAPM) and therefore the asymmetric risk premium added by ElectraNet (0.5%) to its proposed WACC should be excluded.
  - Assumption of a debt premium (172 points) well in excess of the industry benchmark
  - Beta coefficients derived from a deliberately restricted set of comparators

As a general observation, excessive exit charges would give SA Water an incentive to by-pass ElectraNet by building its own connection system to the grid. This would create an inefficient duplication of the transmission natural monopoly.

We would welcome the opportunity to review detailed ElectraNet valuation and system planning assumptions should this information become publicly available via the ACCC draft determination.

Jeremy Randell
Head of Economic Development
& Procurement