Minutes from Transend Revenue Cap Public Forum

Date: 17 October 2003

Location: Hadleys Hotel, Hobart

Chairperson: Commissioner John Martin

1. Richard Bevan (Transend)

Transend stated that Transend took the opportunity to call the public forum as it believes it is important to explain their views on the draft decision, especially in the light of some concerns about the price impact of the revenue cap application.

Main messages

- Transend consider that there are two main myths that the ACCC's draft decision relies on:

(a) That Transend's application is an ambit claim.

(b) That substantial efficiency gains can be obtained.

- Transend believes that it understands some criticism made by interested parties and concerns on price levels. It notes that the consequences of the draft decision will remain for a very long time and there is a joint responsibility on everyone to understand the facts objectively.

- Transend indicated that it is facing genuine increases in costs and that you cannot rely on the past to predict the future. It believes that the revenue cap needs to be forward looking as its future is one in a very dynamic environment.

Myth: Transend is making an ambit claim

- Transend states that the Tasmanian energy sector is changing and that we need to look to the future and that cannot rely on the past.

- Transend believes that the increased revenue is driven by:
  - an inappropriately low asset base and starting opex.
  - large increases in activities since 1998.
  - change in the cost recovery mechanism for system controller.
  - future scope changes (eg. NEM-entry, wind and gas).
  - an old network in poor condition requiring augmentation.

- Transend believes that GHD recognised all these changes in their narrative but ACCC has only gone part of the way in their draft determination.

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Myth: Substantial efficiency gains can be obtained

- Transend stated that it had already delivered efficiency improvements through use of asset manager- service provider model, use of competitive market prices and use of condition based maintenance. It also notes that it is a world leader in the use of dynamic ratings. Despite this, Transend noted it is still looking to do things better in the future.

- Transend states that the regulatory regime should share future efficiency gains between the company and its customers. The Draft Decision's 2 per cent efficiency factor does not achieve this objective.

Benchmarking

- Transend considers that it has one of the most difficult networks in Australia because it is long and stringy, supports a large number of hydro generators (increased complexity in terms of transmission), the age of its asset base, its relatively small customer base, large number of non-firm connections and lack of security or reliability criteria.
- Transend believes that any benchmarking should recognise the differences in systems.
- Given its diseconomies of scale and operating conditions Transend believes that its operating costs should be relatively higher than the mainland TNSPs

- Transend believes that you can use benchmarking to tell a lot of different stories. It believes that the ACCC's benchmarking is inconclusive.
- Transend believes that, given its circumstances, its opex request is efficient.

Consultation with customers

- Transend acknowledges that it can improve consultation with its customers and indicated that it is improving consultation through a number of means including more papers and information to the RNPP and the establishment of generation and Aurora account managers.
- Transend noted that it had previously invited customers to discuss the revenue cap with it and that this invitation remains open.

Concerns with the draft decision

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- Transend considers that the ACCC draft decision relies heavily on GHD's report

- Transend believes that GHD spent a lot of time and undertook a detailed review of Transend's costs but:
  - Elements of GHD's conclusions not supported with evidence.
  - Inconsistencies between GHD's analysis and conclusions.

- Transend believes that the draft decision compounds these weaknesses by accepting GHD's conclusions; it imposes severe operating cost reductions and applies an arbitrary cut to capex.

Opex implications

- Transend considers that the ACCC has allowed an average opex which equals the 2002-03 actuals and that this is equivalent to assuming that:
  - No wind generation proposals proceed.
  - Future interface with NEMMCO, an extra regulator and new service standards regime has no impact on operating costs.
  - Regulatory, community and market environments are unchanged.

Transend noted these implied assumptions are clearly incorrect.

Concluding comments

- In concluding Transend:
  - states that its application is not an ambit claim and there is no fat to cut.
  - asks ACCC to look again at the GHD report and the comments that Transend has made in response.
  - asks the ACCC to recognise that Transend's future is changing and not to rely on the past.

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2. Isaac Katz (Harding Katz for Transend)

Basic design issues

Question 1: What should be regulated?

Transmission services that are not contestable (where one party has significant market power) - other services should be subject to light handed or no regulation.

Question 2: What are the objectives of regulation?

Outcomes must foster efficient investment as provided in the code.

Question 3: Is there a mandated form of regulation?

Incentive based revenue cap or some other variant as determined by the code.

Question 4: What are the properties of the mandated form of regulation?

Incentive to minimise opex and capex

Question 5: What additional controls/rules are needed to deliver the objectives?

For example, this might include a service incentive scheme to ensure service quality is not compromised.

Harding Katz believes that these are the fundamental questions you need to ask yourself in designing a regulatory framework.

How the regime currently works

- Harding Katz believes the code provides that non-contestable transmission services must be revenue capped.
- Further it believes the code requires the ACCC to apply the building block approach to revenue caps.
- Harding Katz interprets the code's revenue and pricing process as:

  (1) identify non-contestable services
  (2) set the revenue cap (part B of chapter 6 of the code)

(3) set prices (part C of chapter 6 of the code).

ACCC's alternative capex approach

- Harding Katz state that GHD, in its report to the ACCC, asked 'who will pay' to determine whether the service should be revenue capped. Harding Katz considers that this is not what the code envisages.

- Harding Katz believes that the ACCC's alternative capex approach also puts pricing first (shared versus non-shared). By doing this Harding Katz believes that it perpetuates GHD's mistake.

- Harding Katz state that the ACCC has proposed a solution but did not say what problem the proposed solution is trying to address. Good regulatory design should identify "problems" and then proposes solutions. Harding Katz believes the alternative approach is a solution without a problem.

- Harding Katz states that what is regulated should be driven by the issue of market power, not who pays. It considers that the code is clear that contestable services should not be regulated:
    - Contestable new connections could fall outside the revenue cap.
    - Details of this arrangement need to be worked through.
    - This approach could be accommodated without need for an alternative approach.
- Harding Katz also raise a wider concern that the ACCC's approach to capex is not properly designed.

- Harding Katz noted that the ACCC has three pillars of capex regulation. It notes that the ESC (Vic) only has one pillar (the revenue reset process) and questions why the ACCC requires any more.

- Harding Katz considers that the ACCC's alternative capex proposal suggests that a fourth pillar should be added.

- Harding Katz questions whether the alternative approach has been thought through and states that the detail has not been set out. It also questions what "problem" the fourth pillar is intended to address.

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Clawback on capex

- Harding Katz believes that clawback is a much more serious design issue. It notes that the draft decision states that underspent capex will be clawed back. Harding Katz considers that this does not provide any incentive for the TNSP to deliver capex efficiencies and is inconsistent with the code requirement for incentive-based regulatory regime.

- Harding Katz also believes that the use of clawback in relation to Transend is a major inconsistency with what the ACCC has stated in its recent discussion paper on regulatory principles, and with incentive-based regulation, which it believes is required by the code.

Concluding comments

- Harding Katz considers that:
  - Design of the regulatory framework needs to be considered with care.
  - GHD confused the question of who should pay with the issue of revenue setting and that this confusion has been carried across to the ACCC's alternative capex approach.
  - ACCC is developing contradictory views in relation to clawback
  - the ACCC should concentrate its efforts on developing a regime which delivers on the code objectives to provide an incentive based regime which delivers efficient investment.

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3. Terry Long (Major Employers Group)

- The MEG does not believe that it is appropriate for Transend to say that it is not an ambit claim and that most economists would find this difficult to swallow.
- MEG intended to lobby the government to review its asset base valuation. however it believes it is now unlikely that the government will change its view.
- MEG stated that it wrote to the Treasurer trying to get talks on the asset base valuation but was unsuccessful. It also noted that it had only received a response to its most recent letter 4 working hours before the forum, consequently it states that there has not been enough time to circulate the letter to its members and consider it by today's forum – MEG considers this to be a tactical response by Treasury.

- MEG believes that the ACCC draft decision has made some gains but does not believe that the cuts are hard enough or deep enough and that the draft decision could be described as alarming.

- MEG noted that industry in Tasmania was small and that there has not been a new major industrial customer for 10 years and that there does not appear to be any on the horizon. MEG states that the result is that Transend's revenue application will be spread over the same number of customers, not a growing number.

- MEG states that the application asks for a 50 per cent increase in revenue and therefore there is a large price shock coming down the wires. MEG questions whether customers can afford the increase and that the answer to this question may have a large impact on the Tasmanian community.

- MEG questioned whether Treasury had estimated the impact on major industrials and didn't believe that they understood the issues. Hopes that the RAB issue is not an indicator of things to come as otherwise there will be a need for strong social programs.

- MEG also noted that only one of the five mines in Tasmania was making a profit at present and increase in revenue could worsen this situation.

- Considers that the revenue cap decision may result in a fat Treasury and thin industry.

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David Headberry (Headberry Partners for MEG)

Prices in competitive markets

- MEG discussed the proposed increase for Transend in the context of price changes over the past eight years for zinc, car manufacturers and for newsprint.
- MEG stated that the prices of manufactured products has fallen or improved quality for the same real price.
- MEG noted that these price reductions are inclusive of concurrent major capex injections.
- MEG believes that we are seeing 10% to 15% increases in prices here but for no change in quality.
- Does not consider that the draft decision compares well to the zinc, car and paper examples.
- MEG believes that the ACCC decision fails the basic test of replicating the competitive market. It believes that the decision does not come close to imposing any competitive pressures at all.
- MEG considers that the draft decision will increase the electricity transmission price to be the highest in Australia.

Reasons for Transend's non-competitive revenue

- MEG considers the main reasons to be:
  - The government has increased the asset base by about $70m, resulting in customers paying a premium of nearly $1/MWh.
  - The WACC awarded is way too high compared to the real world.
  - Opex is set to rapidly increase despite the large injection of capital. .
  - Users are expected to provide a larger return on assets (RAB + Capex), without receiving increased benefits.

The MEG considers that the draft decision does not benchmark returns, which it considers is essential to test the answer calculated. Believe that an after tax WACC of 8.3 per cent does not compare to real world returns where NPBT/Assets average between 2 and 4%..

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Benchmarking of the equity return is missing. The ACCC has awarded 11.41% after tax WACC but MEG believes a competitive return on equity has fallen over the recent years to be currently about 5% based on the ASX accumulation index which is a surrogate for equity returns.

MEG stated that the MRP allowed in the draft decision was 6%, but that its benchmarking shows that it should be around 3%.

MEG stated that the ACCC, in its current review of SoRP acknowledges the equity beta is too high. The MEG questions when it will be reduced to more realistic levels to replicate a competitive environment?

Capital expenditure

- MEG considers that:
  - Capex must result in reducing opex (Transend opex is increasing, but in a competitive market capital is invested when it will reduce operating costs).
  - Capex must show a benefit (Transend seeks to increase capital investment just to maintain current service levels)
  - Capex is used to accommodate growth (minimal growth in Tasmania).
  - Transend must be able to spend the capex requested (MEG notes that Transend has had trouble spending lower amounts of capital allowed by OTTER and questions why this will change).
  - Transend must demonstrate an ability to manage the capex they request (twice their current level).

- MEG considers that the application fails on all counts and the ACCC still permits it to spend in five years approximately half of its RAB as capex.
- Although MEG considers that the draft decision fails in many areas it supports:
  - clawback of the unspent capex.
  - a strict application of the regulatory test to new assets.
  - a requirement that refurbishment capex be reviewed by OTTER.

- MEG however questions who will ensure that the allocation of costs will match the usage of assets?

Operational expenditure

- MEG considers that GHD undertook a reasonable approach and supports the approach but still has some questions:
    - the starting point gives $2m pa. over the average opex for the past period – believe it equates to $2m for doing nothing.
    - why add another $1.8m pa. for clearing when it has already been doing this work within the current budget.
    - Why add $3.5m for NEM entry, when Powerlink was only allowed $2.4m; yet has five times the RAB and three times the demand growth. MEG believes that Transend gets an average increase of $3.5m pa for doing what it should be doing anyway.

Concluding comments

- MEG believes that 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 that consumers get very little for all of this.

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4. Greg Jones (Hydro Tasmania)

- Hydro indicated that it was pleased with the openness and the consultative nature of the revenue cap process.

- Hydro considered that the fundamentals of the draft decision appear to provide a reasonable outcome from Hydro's perspective. It considered that the focus should now be on delivering value in terms of pricing and service.

- Hydro considered the capex and opex allowances appear to be reasonable. Capex provides for renewals and development capex needs. It notes that the reduction from Transend's application is unlikely to significantly delay projects (Hydro estimates that the reduction equates to a delay of six months). In terms of opex Hydro considered that there was a sound basis for the development of the opex forecast.
- Hydro noted that Transend's revenue would have significant and immediate impact on customers with revenue increasing by 60% over the regulatory period. It noted that Transend's pricing policy will have the potential to significantly affect individual outcomes.

Regulated service standards

- Hydro considered the adopted service standard performance targets appeared adequate. It indicated that the collection of data for additional service standards will allow their inclusion at the next reset. Hydro considers that additional performance measures will improve the effectiveness of the current scheme.

Alternative capex approach

- Hydro sees some merit in the ACCC's approach, however it is not sure how it would work in practice and therefore would need to see more detail.

Competition depreciation

- Hydro noted that competition depreciation is discussed in the draft DRP and is also mentioned by Transend and TransGrid.
- Hydro considers that the pricing impact could be minimised without long term financial impact to Transend.

- With rapidly increasing prices the impact can be spread over multiple periods. Hydro recognises that such an approach would bind the ACCC for future resets and that it relies on the assumption that future capex and opex plateau. However, Hydro that the approach is worth consideration by the ACCC.

Service standards development

- Hydro acknowledged ACCC's engagement of industry in the development of market based service standards and indicated that it was keen to get involved in the process.

- In addition to regulated service standards Hydro indicated that it would explore options for tailored enhanced arrangements and that the success or otherwise of these negotiations should inform decisions about the development of regulated market based service standards.

- Hydro indicated that the ability for market participants to effectively enter into commercial agreements for network solutions is essential.

- Hydro believes that the general approach is reasonable and that ACCC recognises the need for additional performance measures overtime.

Concluding comments

- The draft decision seeks to balance service outcomes and financial needs in light of the upcoming challenges for the Tasmania electricity industry – focus should now be on achieving value in terms of pricing and service.

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5. Phil Gall (TransGrid)

TransGrid complimented the Commission on the transparency of the Transend draft revenue decision noting that, regardless of one's position on the issues, it was easy to see the reasoning behind each decision the Commission had made in coming to its final position.

TransGrid's primary concern was the continuing downward drift in regulated returns in recent Commission decisions. The Commission's move to 5-year bond rates instead of 10-year bond rates as the basis for determining the risk free rate used in CAPM was cited as an example of this. In the Transend draft decision the reduction in the risk margin on debt was cited as another example of this trend. TransGrid also noted the Commission had signalled the potential for reductions in the equity beta, both in the draft Transend decision and in the recently released discussion paper on the Commission's Regulatory Principles.

In relation to the risk margin on debt proposed for Transend, TransGrid noted that this was based on a benchmark credit rating for a set of regulated network businesses that included Government owned businesses. TransGrid proposed that this increased the benchmark credit rating above that intended by the National Electricity Code resulting in a benchmark rating of A instead of an A- or BBB+. As a result, the Transend risk margin on debt over the risk free rate was at least 40 basis points too low.

In support of its position, TransGrid noted that Schedule 6.1, Clause 2.1 of the Code requires that the cost of capital be measured by the:

> "Rate of return required by investors in a privately owned company with a risk profile similar to that of the network company."

TransGrid contended that the inclusion of Government owned companies (including SPI Powernet which is owned by the Singaporean Government) in the list of companies used by the ACCC for arriving at a benchmark credit rating is inconsistent with this requirement. The resulting benchmark is biased upwards because the credit rating agencies factor in the "an element of government support"[1] into the company's rating.

The negative implications of this continuing downward trend on discretionary transmission investment, and other vital infrastructure was questioned by TransGrid.

In this regard, TransGrid noted that at a time when people are expressing concerns about the lack of inter-connector development in the NEM it is important to recognise

[1] Standard and Poor's Report in Snowy Hydro Ltd, 30 Jan 2003

that this investment is entirely discretionary. The rates of return on transmission investment are the prime motivator for transmission companies like TransGrid to carry vital projects through the extensive approval processes associated with transmission investment. These processes involve risks. In TransGrid's case millions of dollars have been spent on some projects only to see them stalled or abandoned as a result of failure to achieve regulatory approval. In other cases, projects have had to be substantially amended to accommodate new environmental requirements at TransGrid's cost. As yet, the means by which these costs are to be recouped through the revenue process remain unclear. The key driver on TransGrid, and other regulated businesses, to take on these risks and push these projects through the essential approval process is the regulated return.

According to TransGrid, the draft decision in relation to Transend is not only significant to other organisations such as TransGrid, but to other transmission businesses, gas businesses and telecommunication businesses. Investment in long-lived assets may simply not be worth it over a length of time. TransGrid asked the Commission to heed the advice of Industry Advocate Rob Booth at the recent Electricity Users Association Conference in Sydney that we establish, once and for all, a national standard for regulated returns at an appropriate level that will remain stable for a period consistent with the life of these investments.

TransGrid concluded by citing the paper presented on 2 October 2003 by Productivity Commission Chairman, Mr Gary Banks entitled "The good, the bad and the ugly: economic perspectives on regulation in Australia" at the 32nd Annual Conference of Economists Business Symposium in Canberra. The Chairman was quoted, and reiterated the need for:

> "greater legislative recognition – both in the application of regulation and the setting of terms and conditions – of the trade off between cheap services today and inadequate services tomorrow. A particular and insidious danger here derives from the often protracted lags between the effects of regulated prices on investment and observed supply …. There needs to be systemic allowance for the fact that getting regulated prices 'right' is very hard. This reflects the technical and economic complexity of the infrastructure, the need to compensate investment owners adequately for commercial risks, the changing nature of technologies, costs and demands, and the inherent information disadvantages of regulators. While evidence of adverse impacts on past infrastructure investment in Australia has been difficult to verify, the potential risks of adverse consequences from regulatory action appear to be looming larger" (page 7).

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6. John Dick (Energy Action Group)

Regulated entities are unique

- The EAG considers that regulated entities are unique for the following reasons:
    - They have minimal risk of non-payment.
    - Far lower risks than almost all listed companies in a competitive market.
    - A relatively high degree of freedom of action once a determination is made – the light hand.
    - Indexed against inflation and have a real asset base, unlike all other companies who use DAC.
- EAG indicated that every revenue determination new things creep into the revenue stream – referred to revenue regulatory creep.

Competitive outcomes

- An important objective for the ACCC is to emulated competitive outcomes in determinations – a determination can be seen as a benchmark. If the business provides better results than the benchmark it gets rewarded while worse results get penalised over the regulatory cycle.
- Generous regulatory determinations fail to deliver competitive outcomes to consumers.
- EAG believes that TNSP's have been honing and refining their regulatory approach and incrementally creeping the revenue upwards raising their revenue requests, determination after determination and that the ACCC should be trying to minimise the process of regulatory revenue creep.
- EAG believes that they have seen five years of regulatory games and that the Commission needs to do substantially more work.
- Considers that the ACCC ripped consultants through TransEnd particularly on the issues related to the Asset Base and Capex ensuring that there was little forensic investigation of the businesses Application. This is in marked contrast to the more detailed approach of the previous regulator OTTER who managed to regulate TransEnd without giving the same price shock as the ACCC draft Determination. However EAG believes that GHD did a better job on the TransEnd Application than Meritec has done in the case of the IPART Distribution Pricing Review 2004-9.

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Consistency

- EAG considers that the ACCC needs to co-ordinate its gas and electricity determinations along with its submissions to the Australian Competition Tribunal (eg. on 11 June 2003 submission to ACT suggests that a lower equity beta number could have been appropriate in the GasNet determination).
- EAG questions why the ACCC suggests that it may have erred on the side of generosity but written a determination that repeats a generous outcome.
- Do need consistency across the board, believed the benchmarking was insufficiently challenging.

WACC

- EAG considers that the draft determination fails to consider the following:
    - Why Australian customers are paying a higher MRP when there is no evidence that the Australian financial market is less efficient than the UK and US market – no evidence that overseas markets are less efficient.
    - An equity beta of 1.0 means a risk profile similar to the general market. With 99% of revenues guaranteed, Transend market risk is nowhere near that of the market.
    - The ACCC commissioned Allen Consulting report which indicated that an equity beta of around 0.5.
- EAG questions why the ACCC exploring beta options as low as 0.35 in the draft SRP yet still using a beta of 1.0?
- The EAG also questions whether the ACCC takes notice of customer group's inputs – EAG states that customer groups have been making representations on this issue since 2002 but believes there has been no response from the ACCC.

Transparency

- EAG considered that there was poor/no justification in the draft determination as to why an ageing network similar to PowerNet, TransGrid and ElectraNet with minimal load growth has such significant capital expenditure requirements other than to trade energy over Basslink.

- EAG questioned why Aurora has a lower capex than Transend.

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- EAG consider that there appear to be minimal/no incentives in the draft determination to encourage Transend to make any efficiency gains – real incentive is to increase capex.

Performance standards

- EAG suggests that there is a need for TNSP's to be provided with both positive and negative incentives especially for service standards that relate to their impact on the energy market.
- EAG belives that the ACCC is moving too slowly to introduce some service standards for TNSP's and suggests that these be applied to Transend.
- EAG considers that performance incentives would be more effective if applied uniformly across the NEM. It considers that revenue reviews for all regulated TNSP's at the same time would facilitate this. It belives the staggered approach is costly, inefficient and reduces the benefit to end users of regulation.

Non-network alternatives

- Non-network alternatives like demand management and embedded generation were not promoted or considered in the Transend Application or the draft determination – noted that a couple of embedded generators hadn't got up.

Performance incentives

- ACCC has only placed a maximum of 1% of revenue at risk for underperformance, EAG considers that this is insufficient incentive for improved performance with 99% of revenue guaranteed regardless of the level of performance.
- EAG applauded the ACCC's finding that Transend's proposed service standard benchmarks are insufficiently challenging and have suggested alternative targets but failure to achieve these targets only represents 1% of total revenue at risk.

Regulatory Asset Base

- The EAG considers that Transend's asset base has been unreasonably revalued from the level accepted by OTTER. It states that the increase in the asset base represents over 10% of transmission charges.

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- EAG considers that there is an unacceptable conflict of interest with the Tasmanian Government's role in approving the revaluation and that the ACCC has failed customers by meekly accepting this valuation.
- EAG as a consumer across the NEM believes that it is the worst decision of all the ACCC's decisions.
- EAG questioned how much consumers pay TNSP's for revenue cap determinations and stated that consumers cannot meet the resources of the industry.

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7. Roman Domanski (EUAA)

- The EUAA thanked the ACCC for an open and transparent process.
- The EUAA belives that Tasmanian already has difficulty in holding major industries let alone attract new ones.
- The EUAA questions whether or not the ACCC really thinks that Tasmania can be helped in this struggle by a Transend led recovery.
- Believe that the draft decision will only exacerbate the problems facing Tasmania.

Regulatory Asset Base

- The EUAA believes that the ACCC has not justified the opening RAB and has simply accepted the Treasury's inflated valuation. It also believes that permitting inflated capex forecasts will further inflate the RAB.
- The EUAA stated that the Tasmanian government would not pay for this but rather Tasmanian customers.

Capital expenditure

- The EUAA notes that although Transend has underspent its previous periods capex it has sought a 100% increase in capex for the upcoming revenue cap period.
- The EUAA does not believe that alternatives to capex such as embedded generation or demand management have been considered when these alternatives can be more cost efficient than network augmentation.
- In terms of the ration capex to RAB the EUAA considers that the ACCC's decision still leaves Transend at the top of the heap.

Operational expenditure

- The EUAA states that the current application results in a increase of almost 100% over the two regulatory periods and questions whether Transend has become so grossly inefficient that it needs to more than double its opex.
- The EUAA questions whether or not it is engaging in strategic behaviour – an ambit claim.

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- The EUAA referred to graphs in its presentation that it considered highlighted that Transend has been one of the more inefficient TNSP's up until now and that the ACCC has only made them slightly less efficient, but still at the bottom of the pile.
- The EUAA stated that if finds it difficult to reconcile opex and capex increases.
- The EUAA states that incentive regulation is meant to make regulated networks more efficient but says that the draft determination does not do this.
- The EUAA believes that Tasmania will soon have the highest opex cost per MWh of all TNSP's in the NEM even though they believe that the network characteristics suggest there is no justification for this.

Drivers of expenditure

- The EUAA believes that a number of capex and opex items are directly Basslink or generator driven.
- The EUAA states that some provision for Basslink has already been made in the current regulatory period and wants some assurance from the ACCC that there is no double dipping on Basslink.
- The EUAA considers that Basslink and new generator capacity driven costs should be borne directly by either Basslink or the generator not by the end use customer (whether or not the augmentation is a connection asset or embedded within the shared network).
- The EUAA also considers that cost increases associated with any increased complexity in operating the Tasmanian system due to the commissioning of Basslink, or because of the intermittent nature and non-dispatchable nature of wind farms, should be borne by the causers.

Business performance

- The EUAA is concerned that the draft determination will substantially increase Transends EBIT (by the end of 2008/09 profits will almost triple from their level at 2002).
- The EUAA believes that the main reason for the jump is by government fiat, the revaluation of its asset base not through efficiency gains.
- The EUAA believes that low risk high returns businesses do exist.
- Bottom line for users is not putting any information about prices in your decisions- does – doesn't believe that it is good enough.

- The EUAA believes that if OTTER had made the determination then prices would have been stable.

Concluding comments

- The EUAA states that Transend's application will result in customers paying 70% more in transmission charges by 2009 compared with forward projections by OTTER and that the ACCC's draft decision only reduces the increase to 60% - wants the ACCC to remedy this in our final decision.
- The EUAA believes that the draft decision contains no mention of price impacts.
- John Martin responded to this by pointing out that the draft decision did in fact include some analysis of the price impact of the decision.
- The EUAA believes that the analysis referred to was not adequate.
- The EUAA believes that the ACCC needs to go into more detail and that it still contains a monopoly rent.

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8. Jenni Jarvis (Comalco)

Comalco's operating environment

- Bell Bay aluminium smelter is the largest consumer of electricity in Tasmania (around 25% of the state load).
- Comalco indicated that a lot of new capacity is entering the market as new, larger and efficient smelters come on line and China and Russia have moved from importers to exporters of aluminium.
- Comalco competes globally and is a price taker (price set by the London Metals Exchange).
- Comalco stated that the Aluminium industry has been going through some tough times lately with the price of Aluminium declining in real terms by 1.5% per annum. It indicated that in order to maintain its margin, it must reduce its operating costs in all areas annually to offset the decline in the Aluminium price.
- Comalco states that its operations are small and it has diseconomies of scale but that it is operating in an environment where electricity suppliers work on cost plus margin.
- Comalco indicated that electricity is a major raw material for them account for more than one third of the total cost of converting alumina to metal. Comalco states that the outcome of the draft determination is that smelter transmission rates will increase by 35% and questions where it will be able to cut costs to fund this increase.
- Comalco indicates that the increase will impact substantially on the viability of industry revealing that the five major industrials account for about 2/3 of the electricity load. These five major industrials are non-tariff customers
- Comalco considered that the cost of delivered energy in Tasmania is not internationally competitive even before the transmission price increase applied and that indications are that NEM-entry will see these price increases continue.
- Comalco noted that in other jurisdictions load growth has helped to absorb transmission price increases, however in Tasmania has experienced only marginal load growth which means that existing customers must carry the full burden of price increases. Comalco considers that in the event of a large customer closing down that burden will be even greater. Comalco noted that according to a survey by the Tasmanian Minerals Council only one Tasmanian mine is currently operating at a profit.

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- Comalco considered that as a monopoly service provider Transend, unlike commodity producers, enjoys a secure an predictable income and is not subject to fluctuations in price/revenue.
- Comalco considered that Transend adopts a cost plus approach with little incentive to reduce costs or seek operating or capital efficiencies. It noted that GHD identified an absence of a rigorous process to ensure lowest net cost option is adopted and capital efficiency is demonstrated.

Asset Valuation

- Comalco noted that it has been unable to get consultation on this issue. It noted the ACCC's estimate that the asset revaluation would increase the revenue stream by about $7m per annum.
- Comalco noted that the Tasmanian Government has rejected requests for consultation on the issue and refuses to open or review the valuation. It urged the ACCC to look at this issue and questioned that if the ACCC is not able to intervene than who can.
- Comalco requested the ACCC to use the OTTER asset base valuation to ensure a fair and reasonable outcome.
- Comalco also stated that assets being replaced should be regarded as fully depreciated.

Operational expenditure

- Comalco questioned how both capital and operational expenditures could be both increasing.
- Comalco believes that the increase in opex is at odds with significant capital expenditure and historical levels of opex. It also believes there has to be a better balance between reliability and cost.
- Comalco believes that the ACCC should direct Transend to provide information previously requested and detailed on page 37 of the draft determination.

Capital expenditure

- Comalco quoted GHD as saying "it is difficult to assess the right level of investment in a review process such as this." Comalco considered that the ACCC must ensure that a rigorous external review of all capex is implemented to ensure lowest net option is consistently adopted and capital efficiency demonstrated.

- Comalco stated that it was concerned that the majority of the capex is spent early in the revenue cap period and that past performance indicates that the value will not be delivered.
- Comalco considered that the assertion that the technical solutions are correct has not been tested.
- Comalco supported the ACCC's approach to clawback

In conclusion Comalco indicated that if the draft decision is accepted in its current form that the viability of the Tasmanian industry would be negatively affected.

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9. Rainer Korte (ElectraNet SA)

ElectraNet raised a number of concerns it had with the Commission's draft decision for Transend. In particular asset valuation, capex, the alternative capex approach, opex and cost of capital. It was stressed that ElectraNet would not be commenting on the appropriateness or otherwise of Transend's revenue cap.

Asset valuation

- ElectraNet notes that the Transend draft decision adopts the jurisdictional asset valuation but expresses concerns about this valuation in regards to easement compensation costs (land owner costs), easement acquisition costs (route selection, survey, environmental approvals, legal costs) and interest during construction.

- ElectraNet considers these costs to be legitimate costs and that they must be recognised in the regulated asset base for TNSP's to recoup and earn a fair and reasonable return on their investments.

- ElectraNet notes that the Transend draft decision states "The ACCC considers that easements should be valued at actual historical costs adjusted for inflation… The ACCC used this approach in its last two revenue cap decisions, for the SA and Vic transmission decisions" (Draft Decision p26). ElectraNet states that this is not correct and that in its revenue cap decision easement compensation costs were not valued at actual cost adjusted for inflation and easement acquisition costs were omitted altogether.

- ElectraNet states that easement acquisition costs have not generally been included in transmission line valuations, but should be recognised in the asset base. It believes that easement acquisition costs should be valued on a replacement cost basis, as they are unrelated to land values.

- If the ACCC insists on adopting a historic cost approach to easements ElectraNet would support a benchmark approach for easement compensation where historical cost records are unavailable.

Capital expenditure

ElectraNet considers that capex cannot be sensibly benchmarked between networks or with historical levels of expenditure due to the lumpy nature of capex. ElectraNet notes that the primary drivers for capex are load growth and service standard obligations and that these must be met irrespective of capex comparisons.

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Alternative approach to capex

- ElectraNet noted the inclusion of a proposed more light-handed regulatory approach to non-contestable capex funded by individual network users (eg. prescribed connection assets and funded network augmentations). Costs would be excluded from the capex allowance but allowed as a pass-through.

- ElectraNet supports a more light-handed approach but questioned how this would work. ElectraNet considers that treatment outside the revenue cap and separate pricing would appear to be preferable to a pass-through under the revenue cap (eg. EPO arrangements in South Australia).

- ElectraNet questioned whether the code allowed such an approach to be adopted.

- ElectraNet considers that the approach would need to be supported by appropriate contractual arrangements with transmission customers.

- ElectraNet believes that if this proposal is to be considered further this should be undertaken as part of the DRP review.

Operational expenditure

- ElectraNet notes that the ACCC's DRP foreshadows that it will consider the use of an incentive mechanism where a TNSP is able to demonstrate management induced efficiencies. It also states that the ACCC's preferred position in the current review of the DRP is far a more light-handed approach that strengthens the incentives for opex efficiencies.
- ElectraNet believes that the application of an efficiency factor to opex appears heavy-handed and is inconsistent with the ACCC's preferred position and will not achieve the strengthening of incentives.
- ElectraNet believes that such an approach forces efficiency without the TNSP being able to share in the efficiency gains.

Cost of capital

- Rainer indicated ElectraNet's belief that the draft decision sends very negative signals to investors. He believed that we had received a timely wake up call from the recent overseas blackouts of the need to encourage investment in transmission.

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- ElectraNet considers the regulated return is only a small margin above the risk free rate.
- Noted that the ACCC in its draft decision had floated the idea of using market data to determine the equity beta, suggesting a reduction in the margin above the risk free rate.
- ElectraNet indicated that even floating this idea significantly increases uncertainty and regulatory risk for investors and impacts negatively on investment.
- ElectraNet noted that the ACCC likes to be transparent in its processes
- Rainer stated that a recent survey of international WACC decisions shows that regulated rates of return in the US are higher than those in Australia.
- ElectraNet believes that the US recognises the importance of a reliable transmission grid and is taking steps to attract more investment through providing higher rates of return.
- David Headberry questioned whether the recent overseas blackouts were initiated by transmission. Rainer replied that he was not making such a link only that the blackouts clearly illustrate the substantial impact and cost of widespread failures of the transmission network.

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10. David Asten (DA Electricity)

Before making his formal presentation David responded to a number of points raised by other presenters:

- DA Electricity referred to Comalco's presentation and noted that Comalco had not properly recognised their load growth over the previous revenue cap period. DA Electricity observed that Comalco may have had a good deal in using up spare capacity in the transmission network and so avoided any contribution towards upgrading of the network, or alternatively increases in TUOS.
- DA Electricity observed that the claim by the MEG that there had been no change in major industries in Tasmania overlooked the significant increases in electrical load taken by some members in the past 5 years.

Asset boundaries

DA Electricity presented a number of diagrams illustrating the differences in boundaries in each of the NEM jurisdictions. DA Electricity stated that these were not wrong but different and questioned whether the ACCC wants to maintain this difference. In summary, Tasmania is the only state where distribution feeder circuit breakers (typically 11kV or 22kV) are owned and operated by the transmission NSP. DA Electricity stated that:

- Transend's energies are spread more widely than mainland authorities (300 distribution feeder 11kV and 22 kV circuit breakers, as well as transmission assets and System Controller responsibilities).
- Operational and maintenance expenditure relatively higher as a result.
- Capital expenditure by Transend relatively higher as a result
- Supply reliability boundary not as clear.

- DA Electricity believes that it would be more consistent for ACCC, if Auroraassumed all distribution responsibilities in Tasmania and Transend focuses fully on transmission issues.

Energy losses

DA Electricity indicated that transmission losses in Tasmania include station services at 40 substations (one substation per 6000 customers). While substation services energy is a small part of the overall energy transmitted but a much larger proportion of the transmission losses.

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DA Electricity stated that substation energy is accounted for in South Australia (one substation per 7,000 customers). It noted that it isn't accounted for in Vic/NSW but is much less per customer (one bulk supply substation per 100,000 customers). In Qld (one substation per 20,000 customers) if the energy is supplied from outside the substation it is accounted for but if supplied downstream of the wholesale metering point, then it is excluded from transmission losses. DA Electricity indicated that energy losses in the transmission system were not fully accounted for nationally. This situation contrasts with the wider effort to improve energy efficiency and reduce greenhouse gas emissions.

DA Electricity questioned whether the ACCC sought consistency between States in the areas of asset valuation and energy accountability. If the answer is yes DA Electricity suggests that for Tasmania the transition should start in this regulatory period:

- Redevelopment of a bulk supply points to include transfer of operational and maintenance responsibilities for distribution feeder circuit breakers.
- Responsibilities for zone substations at 110/11kv should be transferred.
- Energy used inside all transmission substations should be accounted for.

DA Electricity considers that the benefits of this approach to be:

- Transend would be able to focus on transmission.
- Asset boundaries would align with supply reliability boundaries.
- ACCC would have better bases for performance comparisons between TNSPs.

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11. Other issues

Commissioner Martin asked the forum participants if there were any other issues that anyone wanted to raise.

Mr Bevan (Transend CEO) responded to earlier comments that non-network solutions had not been considered by Transend. Mr Bevan indicated that alternatives to network augmentations were routinely considered and their economic viability examined. He gave the example of the examination of a gas fired power station as an alternative to the southern augmentation.

Please note the minutes of the public forum, which were taken by Australian Competition and Consumer Commission staff, are only intended to be an indication of the issues discussed on the day. This is not a word-for-word transcript.