3 December 2007

Mr Chris Pattas
General Manager - Network Regulation South
Australian Energy Regulator
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BY EMAIL: aerinquiry@aer.gov.au

Dear Chris

SP AUSNET TRANSMISSION DRAFT REVENUE DETERMINATION

The Energy Users Association of Australia (EUAA) appreciates the opportunity to provide a submission to the Australian Energy Regulator (AER) on SP AusNet Transmission Draft Revenue Determination Proposals and the subsequent revised application by SP AusNet for the period 1 April 2008 to 31 March 2014.

The EUAA commends the AER on the thoroughness of the review that it has undertaken. The reset process is always a challenge with the asymmetry in knowledge and information and end users are very dependent on the AER to play the role of informed regulator. This applies even more in the absence of advocacy panel funding for this review which applies to the EUAA in this case and caused us to assess the application without the benefit of expert advice on engineering and other technical aspects. The SP AusNet application reinforces this importance.

The EUAA is disappointed that the AER review found that SP AusNet had not adequately documented key stages in its investment decision making process and found several "errors" in calculations and it is systematic that SP AusNet did not propose to pass back the overestimate of capex for the nine months to 31 December 2002, amounting to $27.06 million, to end users. Further, the AER identification of several issues, such as aggressive timing and the lack of a clear economic and risk – based justification for elements of SP AusNet's proposed forecast works resulting in reductions for:

- Corrections for an unjustified approach to the proposed timing of some replacements;
- Lack of a clear economic justification for some elements of SP AusNet's proposed forecast capex; and
- Over-scoping of some projects.

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Similarly, in respect of opex, it is disappointing to see claims being made for unsubstantiated amounts for “other” opex costs of $68.6 million, equity raising costs and easement costs having to be adjusted to properly take into account the proportion of easements that are in rural, as opposed to metropolitan areas.

We provide further comments on specific issues below:

Weighted Average Cost of Capital

The recent decision by the Essential Services Commission of Victoria in respect of the recent gas determinations again reinforces how “generous” certain WACC parameters are to network service providers. While the EUAA acknowledges that the AER is to commence a review of WACC parameters to be completed in 2009 the continuing “generosity” will lead to a substantial transfer of wealth from end users to SP AusNet shareholders over the regulatory period. SP AusNet elected to open the issue of the value of the WACC parameters in their application and we are disappointed that the AER did not avail itself of the opportunity to seek a rule change particularly in light of the ESC decision.

On the issue of the Risk Free Rate the AER has quite rightly not accepted the arguments advanced in the NERA papers prepared for the Energy Networks Association. While we note that the issue is still open we believe that the work the EUAA has presented to the AER on this issue clearly demonstrates the fundamental flaws in the arguments advanced in the two NERA papers. The EUAA accepts the decision of the AER to move away from the usual method for determining the inflation rate and notes the advice of the Reserve Bank and Treasury. We do not agree however that it is appropriate that the rate be set at 3% the upper value of the Reserve Bank range of 2% to 3%. Given the uncertainty that surrounds the forecast we consider that it would be more appropriate to assign a value of 3% for the first two years of the regulatory period and the mid range of 2.5% for the remainder.

Capital Programme

The EUAA concurs with the findings that SP AusNet fails to provide a clear economic justification for elements of its capital programme and, in particular, elements of SP AusNet’s proposal appear to be premised on an unjustifiable approach to the timing of replacements. These were both elements that we raised in our original submission.

However, we note from the draft decision that, while the AER has focused on the sample of projects undertaken by PB, the recommendations appear to be directed only at this sample and the results not extrapolated to the overall capex programme. Given the findings that the capex programme is over aggressive, coupled with the problems identified in economic justification, we would have expected that the capex programme should have been subject to further revisions. While the detailed project assessments revealed little evidence of systemic inflation of costs overall, we find it particularly damming that:

> *“PB identified several issues such as aggressive timing and the lack of a clear economic and risk-based justification for elements of SP AusNet’s*

proposed forecast works that it considered may be prevalent across other areas of the proposed forecast capex program."

Accordingly, we suggest that the AER should revisit this aspect and ensure that only economically justifiable projects are included in this determination.

In our initial submission we also highlighted that we considered that some synergies would have been available from the integration of SP AusNet. None of these potential synergies appear to be have been realized and we urge again the AER to address this aspect

Operating Expenditure

The EUAA fully supports the reduction in the proposed opex programme from $1,034.34 million to $929.50 million. As noted in our original submission, we believe that the amount sought was excessive and raised similar issues to those identified by the AER.

Of particular concern to the EUAA are:

- The proposed allowance for equity raising costs associated with the initial capital base;
- The proposed annual allowance for rebates payable under the Availability Incentive Scheme;
- The proposed expenditure on corporate; and,
- The forecast allowance for easement land tax.

In addition, PB's assessment is highly critical of the asset maintenance/replacement programme for assets which appears to be significantly inferior to the programme utilized by some other TNSPs'. Against this background, we believe that the AER should scrutinize the revised SP AusNet application with a view to finding further savings in the opex area.

If you have any questions about the submission or would like to discuss it further, please do not hesitate to contact Mr Jeremy Romanes, Manager – Policy & Regulation, on 03 9898 3900.

Yours sincerely

Roman Domanski
Executive Director