TXU SUBMISSION TO THE ACCC

DIRECT LINK JOINT VENTURE
APPLICATION FOR CONVERSION TO A PRESCRIBED SERVICE AND A MAXIMUM ALLOWABLE REVENUE FOR 2005 –2014

I. Introduction

TXU does not dispute DirectLink's right to convert to a 'prescribed service' under the National Electricity Code (the Code). The regulatory precedent around a MNSP's right to convert to a regulated status was established in the Murraylink Case. As such, TXU's comments regarding this conversion will focus on some of the technical regulatory issues regarding Direct-Link's application.

TXU's position on DirectLink's application for conversion to a 'prescribed service' under the Code is that it has the following concerns.

Let me outline the concerns

1. The use of a real pre-tax WACC of 9.25% as an appropriate discount rate in applying to an unregulated interconnect to discount cash flows in determining the net market benefit. TXU would expect the equity beta of an un-regulated interconnect to be higher to ensure competitive neutrality with market- based investments.

2. The use of both $29,600 per mwh or $10,000 per mwh in the calculating the net market benefit under different scenarios.

3. Concern that the alternative projects used to determine the 'net market benefits' need to be 'relatively substitutable'.

4. Direct-Link's concern that adopting an asset valuation methodology applied in MurrayLink decision may produce results for DirectLink's regulated revenue that are inconsistent with chapter 6 of the Code.

5. The use of a 10 year regulatory period to apply to a TNSP.

6. The need to apply the up-dated principles of the DRP in setting the revenue stream for the Direct-Link.

II. Key Issues

2.1 The use of a real pre-tax WACC of 9.25% as an appropriate discount rate in applying to an un-regulated inter-connect to discount cash flows in determining the net market benefit.

TXU believes the investment in DirectLink should be competitively neutral and efficient for the purposes of the regulatory test. It has concerns regarding the value of the real pre-tax WACC applied as the discount rate to calculate the net market benefit having regard to a number of alternative projects in this case. In short, Direct Link should apply a discount rate consistent with a rate applied to other unregulated assets in the NEM to ensure competitive neutrality. TXU's concerns include

1. TXU would apply higher commercial rates to discount its cash flows in the market as part of its commercial investment strategy for investment in unregulated assets in the National Electricity Market (NEM). Whilst there is considerable debate around what an appropriate discount rate for unregulated investments in the NEM, a real pre-tax WACC of 9.25% would not be sufficient.

2. TXU notes the equity beta used to determine the commercial discount rate applied to DirectLink as an MNSP, whose business risk is different from a regulated asset, is identical to the equity beta applied to a regulated DirectLink after it has been converted to a 'prescribed service.' This implies the business risk associated with a non- regulated and a regulated transmission asset in the NEM is identical, an unsustainable proposition. TXU would expect the equity beta and the risks associated with non- regulated investments in the NEM to be significantly higher than the risks associated with a regulated TNSP.

2.2 The use of both $29,600 per mwh or $10,000 per mwh in the calculating the net market benefit under different t scenarios.

TXU believes Direct-Link should apply a $VOLL of 10,000 per MWh in accordance with the provision of the Code in calculating the net market benefit of an investment to ensure competitively neutrality. The application of a figure other than $10,000/MWh may constitute a breach of section 5.6.5(q) (1) of the National Electricity Code(NEC). Whilst the ACCC has issued a "draft decision" on the regulatory test regarding this issue, it has no yet been finalised. Hence, TXU believes the use of VOLL $10,000 per mwh is a legal requirement under sect. 5.6.5 (q) (1) for the following reasons

1. The regulatory test requires DirectLink to apply the following test to a proposed augmentation when undertaking its transmission investment analysis. It requires DirectLink to

   > " *maximise the net present value of the **market benefit** having regard to a number of alternative projects, timings & market development scenarios."*

2. The ACCC provides direction to service providers in applying the regulatory test to a proposed augmentation & states that

   > *"In determining the **market benefit**, the following information should be considered;*
   > *(b) reasonable forecasts of*
   > *(ii) the value of energy to electricity consumers as reflected in the **level of VOLL***

TXU believes that as Direct-Link has failed to apply the correct value of lost load (VOLL) in some of its forecasting analysis, it has failed to comply with the regulatory test promulgated by the ACCC. The use of any value other than $10,000/MWh contravenes the legal requirements in the Code.

2.3 The inference that the alternative projects used in calculating the net market benefits needs to be 'relatively substitutable'.

TXU acknowledge that in applying the regulatory test the alternative projects considered must be both technically and commercially feasible. However, the ACCC has stated that it is not a fundamental requirement that a proponent for a particular project be identifiable. As such, TXU hopes that the list of projects identified by Direct-Link in applying the regulatory test reflect all the projects that would maximise the net market benefit of the investment. If not, TXU supports the ACCC's right to determine the investment that would maximise the net market benefit of the investment under different credible scenarios, even if Direct-Link have not considered it as a plausible alternative scenario.

2.4 Direct-Link's concern that adopting an asset valuation methodology applied in MurrayLink decision may produce results for Direct-Link's regulated revenue that are inconsistent with chapter 6 of the Code.

Direct-Link have raised concerns regarding the precedent set by the ACCC in determining MurrayLink's regulated asset base (RAB). They believe the methodology applied to determine MurrayLink's RAB does not reconcile with the principles of chapter 6 of the Code. Whilst TXU believe that Direct Link have legitimate concerns, they do believe that these concerns are secondary to the principles of ensuring competitive neutrality and ensuring the regulatory test is applied in the spirit it was intended.

2.5 The use of a 10-year regulatory period to apply to a TNSP.

TXU believes that Direct Link should be provided with the benefit of a 10-year regulatory period where

1. The ACCC follows the regulatory precedent set in the Murraylink case and provides DirectLink with a RAB consistent with the alternative option that satisfies the 'net market benefit' of the investment having regard to a number of alternative projects.

2. The ACCC is satisfied that there is minimal scope for efficiency gains over the regulatory period in both opex and capex consistent with the regulatory precedent set in the Murraylink case.

2.6 The need to apply the up-dated principles of the Draft Regulatory Principles (DRP) in setting the revenue stream for the Direct-Link.

TXU considers that it would be appropriate to consider the principles of its application to the Draft Regulatory Principles (DRP) to determine DirectLink's regulated revenue to enhance regulatory certainty. The submission provides

1. The regulatory regime supports the view of 'locking in" the regulated asset base provided there is no deficiency with the original asset value.

2. The capex & opex required to service the asset should be set "ex-ante" over the 10 year regulatory period for Direct Link.

3. DirectLink's regulated asset base should not be subject to a re-optimisation process.

III. Conclusion

So, in summary, the concerns that TXU has with DirectLink's application to convert to a 'prescribed service' include

1. The use of a real pre-tax WACC of 9.25% as an appropriate discount rate in applying to an unregulated interconnect to discount cash flows in determining the net market benefit. TXU would expect the equity beta of an un-regulated interconnect to be higher to ensure competitive neutrality with market based investments.

2. The use of both $29,600 per mwh or $10,000 per mwh in the calculating the net market benefit under different t scenarios.

3. Concern that the alternative projects used to determine the 'net market benefits' need to be 'relatively substitutable'.

4. Direct-Link's concern that adopting an asset valuation methodology applied in MurrayLink decision may produce results for DirectLink's regulated revenue that are inconsistent with chapter 6 of the Code..

5. The use of a 10-year regulatory period to apply to a TNSP.

6. The need to apply the up-dated principles of the DRP in setting the revenue stream for the Direct-Link.