Our Ref: 03/3602, 03/3603

10 July 2003

Mr Sebastian Roberts
Acting General Manager
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Sebastian

TRANSEND'S REVENUE CAP REVIEW - SUPPLEMENTARY SUBMISSION

The attached document together with this covering letter, comprise Transend's supplementary submission to its revenue application. It is intended that this supplementary submission will be published on the Commission's web page.

The principal purpose of the supplementary submission is to respond to the broad range of issues raised in submissions by interested parties thus far. Transend is cognisant of the differences in views that will naturally emerge during a revenue-setting process. In some instances, however, the views expressed in interested parties' submissions suggest to us that Transend's revenue application may have been misinterpreted. This supplementary submission therefore provides a timely opportunity for Transend to clarify particular aspects of its revenue application, prior to interested parties making further submissions.

Ultimately, Transend and its customers must live with the outcomes from the revenue review for the next five and a half years. It is therefore essential that the Commission bases its findings on accurate information and analysis. For its part, Transend has spent 18 months developing a balanced view of its revenue requirements by looking forward to the significant challenges ahead; recognising its compliance and safety obligations; and seeking to maintain its responsible stewardship of the transmission network. The Commission has now received an independent report from its consultants, GHD, which reviews Transend's revenue application and provides an alternative view of the company's revenue requirements.

Unfortunately, in a number of respects GHD's report contains errors of fact and internal inconsistencies. The report also misrepresents some aspects of Transend's revenue application, and the additional information provided by Transend to GHD. It is not possible or appropriate to attempt to address all of these issues in this supplementary submission. Instead, Transend will respond in detail to the GHD report through a further submission.

On a separate matter, Transend recognises that GHD's report and submissions from some interested parties criticise Transend's revenue application for not providing enough information on historic expenditure. In their view, this lack of information prevents their making a judgement on the reasonableness of Transend's revenue claim. Transend has carefully considered these comments, especially in the light of GHD's report, which now provides further information to interested parties. Transend observations are as follows:

- The revenue-setting process does not rely solely on the revenue application in the way that GHD and some interested parties appear to suggest. The GHD report and the Commission's draft decision will provide further opportunities for public consultation and scrutiny of Transend's revenue proposals.

- Transend recognises that some interested parties have requested further information on historic expenditure to place Transend's revenue cap application operating and capital forecasts in context with past expenditure levels. Despite having concerns about this "backward looking" approach, Transend has provided this historic regulatory expenditure information to GHD. As part of their report, GHD have published the historic information provided by Transend that they consider to be relevant. This historic information for 2000-01 and 2001-02 appears in Figures 6-1, 7-1, 7-2, 7-3 and 7-5 and Tables 7-1, 7-2, 7-3 and 7-6.

- Notwithstanding that GHD have accurately presented this historic information, GHD have not taken it into account in reaching their opex conclusions. Instead, GHD have inappropriately relied on Transend's (Transmission Network Service Provider *and* System Controller) 2001-02 published annual financial accounts for operating and maintenance expenditure information. Transend has previously noted that basing forecast expenditure on historic expenditure is fraught with difficulty; particularly given the large scope changes the company is presently facing and will continue to face over the forthcoming regulatory period. In this instance the problem is compounded because GHD's opex analysis contains numerous errors.

In summary, Transend's view is that GHD's report contains sufficient information with regard to historic expenditure (for 2000-01 and 2001-02 in Figures 6-1, 7-1, 7-2, 7-3 and 7-5 and Tables 7-1, 7-2, 7-3 and 7-6) to address the concerns raised by interested parties. Moreover, GHD's report over-emphasises the relevance of historic expenditure in assessing Transend's future expenditure requirements.

Finally, Transend would like to emphasise that the attached responses are not intended to criticise interested parties for the observations and comments they have made. On the contrary, publishing Transend's response indicates our continued focus on discussing and explaining the relevant issues with our customers and the Commission.

In this regard, Transend would like to extend an open invitation to interested parties to discuss their concerns or issues with our project director, Stephen Clark, and his team. Interested parties can arrange mutually convenient meetings with Stephen by calling him on 03 6278 6126.

Yours sincerely

[original by mail]

Richard Bevan
Chief Executive Officer

Encl

Transend Networks – Revenue Cap Application

For the period 1 January 2004 to 30 June 2009

Supplementary Submission - July 2003

RESPONSE TO ISSUES RAISED IN SUBMISSIONS FROM INTERESTED PARTIES

The following pages summarises the issues raised in submissions to the Australian Competition and Consumer Commission (ACCC) on Transend's Revenue Cap Application (RCA). At the time of writing, submissions from the following parties have been made publicly available on the ACCC's web page:

- The Tasmanian Chamber of Commerce and Industry (TCCI);
- Senator Bob Brown (Australian Greens);
- Aurora Energy;
- Major Employers' Group and
- Hydro Tasmania.

Issue	Respondent and references	Respondent's comments	Transend's response
1a. Price level	TCCI submission, page 4, paragraph 2.1.	The State's pricing regime be competitive particularly with that applicable in Victoria and NSW.	Transend's RCA is based on the requirements of the National Electricity Code, which applies the same pricing and regulatory principles across Queensland, NSW, Victoria, and South Australia. It is important to note that these pricing principles require that the particular circumstances of each transmission company are taken into account in setting revenue. However, the regulatory regime does not allow the ACCC to set transmission revenue in Tasmania on the basis of existing transmission charges in NSW or Victoria. Instead, the ACCC is required to consider the efficient costs of running Transend.
1b. Price level	TCCI submission, page 4, paragraph 2.4.	Transend is seeking a 40% (real terms) increase in revenue - this would equate to a 4% increase in the end electricity price which TCCI views as unsatisfactory.	The overall impact on end prices to customers depends principally on generation, distribution, and retail charges which comprise around 80-90% of a typical customer's electricity bill. It is too early to speculate on the impact on prices of Transend's next revenue cap. The ACCC has a process to follow before the revenue cap can be determined and the impact on transmission prices can be calculated. However, the Tasmanian Energy regulator has released the Draft Report of his investigation of electricity prices that includes proposals for maximum prices for business and residential customers for the next three years. This draft report includes the Transend RCA forecasts, and results in average price increases of just 0.8 per cent above the rate of inflation in 2004, and then adjustments with inflation.
1c. Price level	TCCI submission, page 4, paragraph 2.5 and 2.7.	We ask that the ACCC consider whether or not Tasmanian businesses desire any further increase in electricity supply reliability and how much they are willing to pay for this. Tasmania's system performance has generally improved over recent years. Overwhelmingly business customers exhibit a high level of satisfaction with their electricity service. Research indicates that businesses believe that the greatest	Delivering substantial improvements to service levels does not primarily drive Transend's proposed expenditure. Instead, it is focussed on renewing and maintaining the existing asset base; meeting the requirements of entering the NEM; and facilitating the expected increase in wind generation. Therefore, whilst the trade-off between service level and price is an important issue, it is not a key reason for the proposed increase in revenue.

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		effort should be made to keep the price of electricity as low as possible.	
1d. Price level	TCCI submission, page 4, paragraph 2.9.	It is extremely disappointing when any monopoly providers can grant themselves the ability to automatically index charges in line with inflation. There is principle at stake here - an indexation mentality is an acceptance of mediocrity and a relegation to the status quo in terms of efficiency improvement. TCCI would argue strongly that if this system is to stay in place then a mandatory efficiency dividend (CPI - X) must accrue to customers.	The ACCC's regulatory process does not allow transmission businesses to grant themselves an increase in charges in line with inflation. Transend strongly supports incentive-based regulation that encourages the delivery of efficiency improvements. An important issue for this revenue review is that Transend's current level of revenue is unsustainably low. An increase in revenue is therefore required to address this issue.
1e. Price level	Aurora submission, page 2, paragraph 3.	We note that the Transend proposal is for a total increase in TUoS from \$70 million to \$110 million in 2004/05, and to \$130 million in 2008/09. This indicates an overall increase of about 10% to be passed on in customer prices over the period (\$60 million over \$600 million). This is well outside the ability to pay parameters from our customer research.	It is too early to speculate on the impact on prices of Transend's next revenue cap. The ACCC has a process to follow before the revenue cap can be determined and the impact on transmission prices can be calculated. However, the Tasmanian Energy regulator has released the Draft Report of his investigation of electricity prices that includes proposals for maximum prices for business and residential customers for the next three years. This draft report includes the Transend RCA forecasts, and results in average price increases of just 0.8 per cent above the rate of inflation in 2004, and then adjustments with inflation. Transend therefore does not accept that the customer research demonstrates that customers cannot pay for increases in transmission charges. The overall impact on end prices to customers depends principally on generation, distribution, and retail charges which comprise around 80-90% of a typical customer's electricity bill. Transend's RCA addresses the future costs of providing transmission services, recognising the important changes in the market and regulatory environment. These changes include changes to the system operation and control function in Tasmania: after NEM entry customers will no

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			longer be separately charged Transend System Controller fees. It would be imprudent for Transend or the ACCC to base the revenue requirements of the transmission business on an objective regarding end-prices to customers, as these prices have a number of inputs determined by other regulators and the market.
1f.	Major Employers' Group submission, page 5, paragraph 1.	In assessing Transend's application we request that the ACCC take account of the following factors which would be present in a competitive environment and mitigate pricing increases: 1. Competitive pressure to minimise price rises. 2. Customer willingness to pay.	Whilst Transend fully accepts that cost forecasts must be efficient, neither the National Electricity Code nor the Tasmanian Electricity Code allow the ACCC to consider "competitive pressure to minimise price rises" or "customer willingness to pay". The obligations placed on the ACCC were carefully developed to ensure that regulated outcomes are soundly based, transparent and consistently applied. It is not appropriate to revisit these obligations part way through a revenue application.
1g. Price level.	Hydro Tasmania covering letter, page 1, paras 2 and 3.	As you are aware, Hydro Tasmania has promoted the Tasmanian Government's energy policy by developing Basslink and wind generation, upgrading existing hydro facilities and Bell Bay, and pursuing Tasmania's entry to the National Electricity Market. Above all, these initiatives seek a level playing field across Tasmania through efficient electricity pricing. In stark contrast, the Application, as it stands, would deliver unjustified and unacceptable price shocks to transmission customers – with increases of up to 72%! The move to the Commission's jurisdiction must not enable opportunistic increases in transmission revenues, with the attendant risk of bringing the whole energy reform process into disrepute. As such, the Commission must reject this ambit claim	Transend also strongly supports the Tasmanian Government's energy policy. The tasks associated with NEM entry and the future demands the new market arrangements will place on the transmission system have been reflected in Transend's RCA (see RCA, pages 15-19; pages 48-57; page 63; pages 69-71; and pages 74-84). The justification for Transend's future revenue requirements is presented in detail in the RCA. Chapter 10, pages 96-99, also provides a breakdown of the increase in the revenue requirements between 5 major elements. It notes that 24% of Transend's total revenue requirement in 2008-09 is driven by future capital expenditure. This expenditure will deliver substantial benefits to Transend's customers. The transition to regulation under the ACCC does not provide any opportunity to present an "ambit" revenue claim.

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2a. Benchmarking	TCCI submission, page 12, paragraph 8.3.	The most efficient means of imposing competitive market forces upon Transend could be through the widespread introduction of KPIs and the use of Benchmarking. TCCI is highly supportive of the process of comparing an organisation's performance with some standard as a means of discovering ways to improve that performance. TCCI supports KPIs used to measure performance.	Transend also believes that benchmarking has a role to play in encouraging efficiency improvements. Transend participates in a number of benchmarking studies to ensure that it adopts best practice techniques, to the extent that these are appropriate to the Tasmanian operating environment. Comparing transmission businesses' cost performance is a complex and problematic task. However, Transend's work in this area shows that its current level of costs and revenue is unsustainably low when compared to other transmission businesses. This issue is explored at length in Appendix 2 to Transend's RCA.
2b. Benchmarking	Major Employers' Group submission, page 24, paragraph 2.	[In considering the validity of Transend's benchmarking approach], it should be remembered that the Transend network is required to service the need of the demand side, not the aspirations of the supply side.	Transend notes that the MEG also states on page 23, paragraph 5 that: "Transend notes that because of the seasonality of its supply the network must be sized to allow the full capacity of each of the generation units. This is no different to other networks which likewise must have this capability. If this was not the case then generators in a competitive market could justifiably complain about there being insufficient access to the regional markets." Transend's benchmarking recognises that the transmission system is required to meet the requirements of the demand side and the supply side. The information provided in the RCA explains that a hydro system has different supply-side requirements compared to thermal systems. This difference should be taken into account in making cost comparisons with other TNSPs.
2c. Benchmarking	Major Employers' Group submission, page 24, paragraph 4.	Transend notes that in comparisons under the ITOMS composite measure, the performance of Transend assets from HEC days has improved remarkably (reference figure 1.8 and accompanying comment). It should be noted that this improvement came about under capex and opex costs well below	The comment accompanying Figure 1.8 reads: "Figure 1.8 shows Transend's performance in ITOMS against the composite measures of service and cost. It shows that compared to HEC's performance in 1997, Transend has improved service performance at the

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		those now being sought.	expense of costs, which have increased. In 2001, Transend is shown to be slightly below the average performer in the group." In order to continue to maintain or improve service standards, further significant investment in the transmission system is required and this is the basis of Transend's RCA.
2d. Benchmarking	Major Employers' Group submission, page 24, paragraph 5.	Transend concludes that service levels recorded by Transend lag those of other Australian transmission businesses (despite Transend being average on the ITOMS measure) and that this is attributed entirely to a lack of capex and opex. Transend fails to mention that there are other factors causing the noted lower standard, including seasonality impacts and dam levels mentioned above, terrain and weather.	Transend has not claimed that its (lagging) service levels are "attributable entirely to a lack of capex and opex". There are a number of contributory factors, including the nature of present supply security, (discussed in Section 5.2.4, pages 36-37, of Transend's RCA) and the key features of the Tasmanian transmission system (discussed in Section 1.3, pages 2-8, of Transend's RCA).
2e. Benchmarking	Hydro Tasmania covering letter, page 2, paragraph 2.	In its Application, Transend relies on benchmarking to demonstrate that its overall level of costs are efficient. However, Transend dismisses the more widely accepted ITOMS benchmarking approach on the basis of a Pacific Economics Group report which is not provided. ITOMS found Transend to be higher cost than other Australian and New Zealand transmission utilities, using a methodology which has been developed over many years.	The RCA does not rely on benchmarking to demonstrate that its overall level of costs is efficient. On page 87 of the RCA, Transend notes: "Transend's view is that the comparison of operating costs between TNSPs lends support to the veracity of Transend's bottom-up forecasts.... However, the bottom-up forecasts remain fully justified and should be the primary basis for determining Transend's operating cost allowance." It should be noted that the ITOMS studies do not benchmark all of a transmission company's costs. Therefore, while ITOMS studies provide some cost comparisons, the study's focus is on best practice and leading edge strategies for the network operation of the business. Study participants aim to share knowledge in order to improve operating efficiency, service levels and work practices. Transend does not dismiss the ITOMS benchmarking

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			study, but rather seeks to explain the difference between ITOMS and the study presented by Benchmark Economics. The findings are summarised on page 15 of the RCA as follows: "Transend continues to find ITOMS valuable in exploring differences between TNSPs, and in ensuring that best-practice techniques are adopted. However, it is questionable whether ITOMS is the best benchmarking tool for setting revenue for a transmission business. The crucial findings shared by both ITOMS and the report from Benchmark Economics is that while Transend's benchmarked costs are not high, service levels lag behind its Australian peers. The main difference between the two studies is that Benchmark Economics strongly implies that, to improve this situation, future expenditure will need to rise. This conclusion accords with the views of Transend's Board."
3a. Transend's future expenditure plans are inefficiently high.	Senator Bob Brown submission, page 1.	Expenditure of $330 million in the next five years compared with an asset base of $603 million is extraordinarily high, especially for a small system like Tasmania serving a population of less than 500 000.	Transend considers that comparing the capital expenditure program against a written-down asset value is not an appropriate comparison. Transend also notes that the population of Tasmania is only a small consideration in developing expenditure plans. More importantly, Transend must have regard to the nature of its assets; its compliance and safety obligations; and the needs of its customers.
3b. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 17, paragraphs 3 and 4 (partial quote)	Capex is clearly needed to replace ageing assets and to accommodate growth. In some areas capex may be needed to improve reliability of the system to above current standards. Historical expenditure fully incorporates the first two areas of capex needs, and often includes some of the third. Transend has provided a little historical data on past demand and volume with its application. What is	Data regarding historic demand from 1990 to 2002 is provided in Transend's RCA in Figures 6.4 and 6.5, page 51 and 52. Information regarding the age profile of the assets is provided in Figure 1.4 on page 7. MEG's "simplistic terms" of analysis for projecting future capex levels based on historic levels is neither valid, nor meets the needs of customers. Efficient transmission capex, for both replacement and development capex, tends

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		provided indicates that based on the past 10-12 years, the growth of demand and volume will match the forecast low growth scenario. In simplistic terms this means that the rate of capex should continue at a similar rate to the current actual (and similarly opex should stay at the same level). Using this basis the total capex that would appear to be needed should match historical levels with some additional capex for NEM entry.	to be "lumpy" in nature. The Tasmanian transmission system is at a point where significant "step change" in investment is urgently required, especially in the south of the state (Southern augmentation). Even a cursory review of the age profile of Transend's assets (figure 1.4) would demonstrate that recent levels of capital expenditure cannot be relied upon to determine future needs. The RCA explains that the demands on the transmission system in future will bring substantial changes. It is essential that forecast expenditure anticipates the new challenges ahead. The future capital program includes a number of projects to accommodate past and future growth, which have been in the planning stages for a number of years and will come to fruition during the forthcoming revenue period. A more detailed explanation of Transend's forecast capital expenditure is set out in chapter 6 of the RCA.

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3c. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 18, paragraphs 1	In the current period, Transend expected to spend capex of $50m pa but failed to do so. In the new period, Transend is asking for a fixed amount of $60m pa *plus additional amounts for unidentified variable works.*	Transend accepts that it was unable to incur its preferred level of capital expenditure during the current regulatory period. There were particular planning, regulatory and resource issues which led to this shortfall in capital expenditure. These issues have now largely been resolved and Transend is confident that its proposed capital expenditure program can be achieved in the forthcoming regulatory period. Transend has clearly identified potential variable capital expenditure projects in tables 6.6, 6.7 and 6.8, pages 56 and 57, and Appendix 6, of its RCA.
3d. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 18, paragraph 1	Capex for the Southern augmentation comprises funding from the development projects and from renewal capex. The project must be assessed under the Regulatory Test for major works and this analysis must include for all costs associated with the project, rather than just the amount included in the fixed development element of the capex. All projects greater than $1m in value must be verified as appropriate under the Regulatory Test.	Transend is not presently subject to the regulatory test under the NEC. However, it is subject to a comparable test under the TEC. It is noted that the regulatory test only applies in relation to enhancements to the network, rather than asset renewals (for further information see the ACCC's discussion paper on the regulatory test, 5 February 2003, pages 26 and 27). Projects are not required to satisfy the regulatory test in order to be included in Transend's revenue allowance. Instead, Transend must forecast the cost of projects that are likely to satisfy the regulatory test in the next regulatory period. This is explained in section 5.5 of the RCA. The Southern augmentation project, Norwood-Scottsdale-Derby line and Mowbray substation have now been approved by the Reliability Network Planning Panel using the regulatory test. This provides assurance that Transend's forecasting methodology is soundly based.
3e. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 20, paragraph 3.	Transend has made no allowance for the system operating costs to be deleted from its opex from the time NEMMCo commences managing the Tasmanian electricity market. Whilst the date for connection is still unknown, Transend must build into its AARR a mechanism for the system control	The impact of the system controller function transferring to NEMMCO has been taken into full account. Transend's RCA explains this issue on page x of the executive summary and on pages, 68 and 78. The critical issue explained in these sections is that Transend as TNSP will have more responsibilities after the transfer to NEMMCO,

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		costs to be removed at the time the transfer takes place.	rather than less.
3f. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 20, last paragraph.	A review of the activities of [the Connections and Development] group does not indicate any increase in duties that they already do as part of their normal functions for the TEM. The change in reporting on these functions should not lead to an increase in the costs they will incur above what should already be carried out by an efficient organisation.	A full list of the changes to Connection and Development Group's activities is provided in table 7.1, page 70 of the RCA. The RCA explains that Transend's future operating environment is changing and that Transend must meet the new challenges ahead. It is not possible to maintain the status quo when major changes such as NEM entry necessitate change.
3g. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 20, last paragraph.	The corporate group indicates it will have a cost structure of nearly \$8m pa. This is compared to a current total opex level of \$27.4m pa. This means that the corporate group will cost about one third of the current operating expenditure. This is an extraordinary level of overhead costs. The ratio of corporate expense to claimed opex is 20% whereas competitive businesses target to operate closer to 5%.	Page 81 of Transend's RCA explains: "The Finance and Business area incurs the largest component of corporate costs. In contrast to some company structures, Finance and Business provides a wide range of support services to Transend, including administration, Information Technology (IT) and Information Management. Other TNSPs may be structured differently, thereby making functional cost comparisons problematic."
3h. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 22, paragraph 2.	Further whereas OTTER built into its decision on opex for efficiency gains, Transend has elected to delete this regulatory feature of implicit and continuous improvement. Competitive businesses are being continually being driven to reduce costs, but the application by Transend exemplifies the regulated business belief that it is already operating at the most efficient level and that further cost savings are not possible.	OTTER's assumptions regarding efficiency improvements proved to be overly optimistic. This issue is explained in Table 3.1 on page 28 of the RCA. Efficiency improvements are an important feature of Transend's RCA – O&M efficiencies are discussed on pages 71; 77; 80; and 83 of the RCA.
3i. Transend's future expenditure plans are inefficiently high.	Major Employers' Group submission, page 22, paragraph 23.	In its decision, OTTER permitted Transend a lesser amount for opex than Transend reports in its Annual Reports, indicating that Transend incurs costs outside the regulated activities of the business. However, there is no information made available which allows an assessment of what elements of the Transend current costs should not be included in the regulated opex.	On page 24 of the RCA, Transend explains that only a small amount of external work (\$926,000 in 2001) is not included in the revenue cap. On page 27 and 28 of the RCA, Transend explains that O&M expenditure has exceeded the amount provided by OTTER in the 1999 determination.

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3j. Transend's future expenditure plans are inefficiently high.	Hydro Tasmania further letter (14 May 2003), pages 1 and 2.	It is understood that the Southern augmentation project (as detailed in the Application) has not been fully endorsed by the Tasmanian Reliability and Network Planning Panel (RNPP), nor approved by the Tasmanian regulator. We understand that the RNPP's endorsement was contingent on other developments in the Hobart area and planning/environmental approvals. If the Southern augmentation project is subject to a further approval process, there are lower cost network and non-network alternatives that should be considered to address the system deficiencies that the Southern augmentation is intended to address. These could include: 1. The development of a gas-fired generator near Hobart, as envisaged in one of Transend's variable projects; 2. Alternative upgrading, modification, reconfiguring of existing transmission infrastructure to increase security (rather than needing to seek new easements for transmission lines) 3. A combination of capacitor banks and single circuit 220kV development around Hobart; 4. Reduction in load at Pasminco, either under contract as part of normal operation, or to avoid any increases in charges that result from the Southern 220kV augmentation. 5. Development of suitable contingency plans to mitigate risk of prolonged outages	With regard to Southern augmentation there are two distinct issues: 1. The qualification by the RNPP The RNPP qualified their endorsement because Transend indicated that Transend was still having discussions with Duke Energy about a possible gas fired generation in the Hobart area that may avoid some of the augmentations. Any such gas fired generation would need grid support payments to make it viable. The joint analysis to date has shown that even if Transend made grid support payments equivalent to $35 million in avoided capital expenditure, gas fired generation would not be commercially viable. 2. The qualification by the Regulator Under the regulatory test guidelines, augmentations can only be endorsed if construction will commence with 12 months of the endorsement. As the Southern augmentation consists of a number of projects spread over a number of years the Regulator has only endorsed those components starting construction within the next 12 months. Neither issue requires Transend's original cost-benefit analysis to be re-done, nor impacts on the capital allowance that should be provided in the revenue determination. In any event, the revenue setting process does not require Transend to only present projects that have passed the regulatory test. Instead, the company must present its best estimates of capital expenditure, given the currently available information. In our view, the forecast expenditure for Southern augmentation reflect Transend's best estimate.

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3k. Transend's future expenditure plans are inefficiently high.	Hydro Tasmania covering letter, page 2, paragraph 3.	However, even Transend's preferred approach demonstrates that allowing the Application would result in it becoming one of the worst cost performers in Australia, and even when discounting economies of scale (illustrated by diagram).	The diagram provided by Hydro Tasmania compares Transend's 2009 proposed revenue requirements against 2002-03 data for other TNSPs. This is not a like-for-like comparison. Moreover, it appears that Hydro Tasmania has included Transend's higher revenue requirement but excluded any increase in the MW supply side capacity that Transend will support. An appropriate recognition of the supply-side increase (as a result of NEM entry and the connection of new wind generation) will substantially affect Hydro Tasmania's analysis and conclusion. In addition to utilising robust benchmarking, Transend believes that the ACCC's consultants should independently review Transend's proposed expenditure plans.
4a. Transend's ability to deliver its planned level of capital expenditure.	Hydro Tasmania covering letter, page 2, paragraph 4.	While there is generally insufficient detail in the Application to adequately evaluate the current capital expenditure forecast, there is little to indicate that the current forecasts are any more reliable. On one of the few projects amenable to review [Southern augmentation], there are questions both about the need for the project and the forecast timing of the expenditure, due to the potential for procedural delays. We also question Transend's overall ability to progress such a high level of expenditure.	Transend accepts that its capital expenditure has been below the level forecast in the 1999 OTTER determination. Customers have received lower transmission charges to reflect this. For Transend, the challenge is not to repeat historic levels of capital expenditure, but rather to meet our customers' future requirements for transmission services. In developing forecasts for the forthcoming regulatory period, Transend has taken account of the recent difficulties in completing capital projects. These difficulties largely arose from the new regulatory requirements of the market benefits test; local planning issues; internal resource levels; and the limited opportunities to obtain plant outages. Transend's proposed capital expenditure plans appropriately balance the ideal level of expenditure against the practical difficulties of project delivery. Service levels would be at risk if future expenditure were reduced below the levels indicated in the RCA. Furthermore, the market

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			benefits of NEM entry may be muted if the transmission system is inadequately capitalised. It is also noted that the System Controller's 2002 Planning Statement (see RCA, page 9) identifies the potentially serious impact of transmission constraints in the absence of new investment.
4b. Transend's ability to deliver its planned level of capital expenditure.	Hydro Tasmania further letter (14 May 2003), page 5, paragraph 2.	There is also a general concern that some of these projects incorporate a significant element of uprating, rather than straightforward replacement. In its recent discussion paper on the regulatory test ("Discussion paper - Review of the regulatory test", 5 February 2003, ACCC), the Commission noted: "However, if a TNSP replaces an existing asset with one that simultaneously increases the capability of its network, the Commission is of the view that the part of the investment project that augments the network is subject to the regulatory test. "However, where the augmentation is not assessed against the regulatory test the Commission will conduct a thorough review of the capital expenditure undertaken by the TNSP and will assess the prudency of the expenditure against a criteria similar to that set out in the regulatory test. Where it finds that the capital expenditure is not efficient the Commission has the ability to optimise the inefficient portion out of a TNSPs asset base. TNSPs who voluntarily assess replacement or refurbishment capital expenditure against the regulatory test are less likely to face this optimisation risk." A number of these projects would appear, *prima facie*, to provide increased capability, although they do not seem to have been subject to the regulatory	Transend agrees with Hydro Tasmania's response (1 April 2003) to the ACCC's discussion paper on the regulatory test, which cautioned the ACCC against taking adopting a burdensome approach to the issue of replacement capital expenditure. Nevertheless, if the ACCC takes a different approach to the one advocated by Hydro Tasmania, Transend recognises that some further regulatory hurdles may apply. The ACCC is best placed to judge whether its requirements with respect to replacement capital expenditure are likely to delay investment occurring.

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		test. While this would appear to be a business risk for Transend to assess, if it does decide to subject its projects to the regulatory test, this would seem to introduce the scope for procedural delays in its programmes.	
5a. Transend's service incentive scheme and/or service levels.	TCCI submission, page 11, paragraph 7.8.	The majority of Tasmanian businesses are satisfied with their current electricity supply reliability. Of those businesses not happy with current standards there is only a modest propensity to fund any improvement in reliability of electricity supply. The overall Tasmanian business community should not be forced to fund improvements benefiting only a small minority of business and residential customers.	Transend notes that the research quoted by the TCCI relates to distribution customers rather than transmission customers. Over 60% of energy in Tasmanian is consumed by 5 very large customers connected directly to the transmission system. These companies are also large employers, and are highly sensitive to the performance of the transmission system. Therefore, Transend wishes to ensure that the performance of the Tasmanian transmission system does not fall further behind that of other states. The reasons for the proposed increase in revenue are detailed in Transend's RCA. Increasing service levels is not a major cost driver in the revenue review. However, the proposed expenditure should provide a firmer foundation for maintaining current performance levels in the short term, and for ensuring that service levels improve in the medium term.
5b. Transend's service incentive scheme and/or service levels.	Aurora submission, page 2, paragraph 2.	Aurora believes that ACCC and OTTER need to balance the reliability improvements of Transend and Aurora, and the timeframes of expenditure on improvements to ensure the customer gets the best value for any increase in price.	See above. Whilst Transend agrees with Aurora on this issue, it should be noted that service improvement is *not* a critical reason for the required increase in transmission revenue. See Chapter 10 of the RCA for a breakdown of the principal drivers for revenue increase.
5c. Transend's service incentive scheme and/or service levels.	Aurora submission, page 2, paragraph 2.	An incentive scheme on transmission revenues should be based on improved performance in service, reliability or quality of supply that is valued by customers.	Transend has proposed a service incentive scheme that is consistent with the ACCC's requirements. The ACCC's requirements followed a detailed study conducted on behalf of the Commission by SKM.
5d. Transend's service incentive scheme and/or service levels.	Major Employers' Group submission, page 21, paragraph 3.	It is pleasing to note that the group indicates an active approach to reducing outages. However, to include for an increase in opex to achieve this outcome and then to reward it through the incentive scheme implies a double dip, and this is not acceptable.	The service incentive scheme is challenging, and does not represent a double dip. In terms of availability measures, the company's expenditure plans will make it more difficult to achieve historic performance levels, all things being equal. This is because planned outages necessary for asset works will adversely affect Transend's availability performance. Notwithstanding this effect, Transend will not

Issue	Respondent and references	Respondent's comments	Transend's response
			receive any bonus if its future performance is on average the same as past performance.
5e. Transend's service incentive scheme and/or service levels.	Major Employers' Group submission, page 25, paragraph 4.	One element this [sic] is clearly absent is equality in setting rewards and penalties. In our view the penalty to the business should be equal to the bonus possible to be received.	Transend has set a challenging regime by imposing a penalty for poor performance on transformer availability at a faster rate than it receives a bonus for good performance. Transend believes that this proposed scheme demonstrates the company's commitment to delivering better performance.
5f. Transend's service incentive scheme and/or service levels.	Hydro Tasmania covering letter, page 2, final paragraph.	Transend has proposed a limited range of service standards which are broadly based on existing performance levels, yet Transend itself acknowledges that current performance is inadequate. The targets and incentives need to be sharpened, and other areas of underperformance subject to suitable targets.	It is important to recognise that the 1% revenue at risk under the service incentive scheme represents a significant impact on profitability. In this sense, the incentives with regard to delivering service improvements are quite strong. Moreover, a number of actions aimed at delivering service improvements will only have an impact in the medium term. Therefore, improving existing performance in the short terms remains an important challenge to the business. On average, repeating past performance will not provide any bonus to Transend. With respect to transformer availability, average performance would in fact result in a penalty payment.
5g. Transend's service incentive scheme and/or service levels.	Hydro Tasmania submission, page 6, final paragraph.	Aggregated service standards are far less effective when applied to a 'stringy' electricity transmission network as compared to a more meshed network. Given Tasmania's stringy network and Transend's acknowledged significant problems with service quality, Hydro Tasmania considers that the national approach combined with more customer-focused service standards would provide a more appropriate base service level for generators and consumers alike. For example, a programme that targets the worst performing connection sites may be appropriate to the Tasmanian transmission system.	Transend recognises the need to improve services to its customers. Naturally, the company will be focussing its efforts on the worst performing assets, and taking those measures which have the greatest value for money in terms of improving aggregate service levels. Therefore, we see no conflict between the proposed service incentive scheme and the objectives outlined by Hydro Tasmania. Moreover, a service incentive scheme which was based on the performance of specific assets would expose Transend to greater risk. This increased risk (and cost) would not be offset by any benefit in terms of performance improvements. Therefore, Transend's proposed service incentive scheme is likely to be more effective than that proposed by Hydro Tasmania.

Issue	Respondent and references	Respondent's comments	Transend's response
5h. Transend's service incentive scheme and/or service levels.	Hydro Tasmania submission, page 7, paragraph 1 and 2.	Hydro Tasmania acknowledges that a further data collection period will be necessary before there is sufficient information to establish a service standard for the volume of intra-regional constraints. Equally, at the same time, Transend should also be gathering information on the value of intra-regional constraints. This will mean that by the time of the next revenue reset application, the Commission will have sufficient information to develop incentives based on the value of constraints, rather than just their volume. We envisage that the proposal would include the following indicators, as a minimum: • intra-regional constraints generally; • constraints on specific connections; • operation of the System Protection System; and • connection enquiries and applications.	In principle, Transend has no objection to collecting new data with regard to intra-regional constraints. It is also accepted that standards with respect to connection enquiries may also be appropriate. Transend would note, however, that the operation of the SPS (and any incentive arrangements) would need to treat all generators equitably. Transend also notes that should the ACCC consider this data collection necessary, appropriate allowances (for the additional operational and capital expenditure to undertake this work) should be included in Transend's revenue cap.
5i. Service Standards	Hydro Tasmania supplementary submission (30 May 2003)	Hydro Tasmania has prepared a more detailed proposal in respect of service standards.	Transend's service standards and performance incentive scheme have been prepared in accordance with the process outlined by the ACCC, including the ACCC's draft service standards guidelines and SKM's report commissioned by the ACCC.
6a. Transend's weighted average cost of capital (WACC).	TCCI submission, page 11, paragraph 8.1.	TCCI recommends that the weighted average cost of capital for Transend be set at a level consistent with interstate benchmarks.	Transend sought expert advice in relation to the assessment of its cost of capital. This advice (included as Appendix 7 to the RCA) examines the ACCC's recent decisions and their applicability to Transend. In relation to the calculation of the risk-free rate, our expert advice is that the ACCC should adopt a 10 year Commonwealth bond rate, rather than a 5 year rate. The ACCC should consider Transend's assessment of its cost of capital on its merits, rather than simply relying on the precedent of recent regulatory determinations.

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6b. Transend's weighted average cost of capital (WACC).	Major Employers' Group submission, page 12, paragraph 2.	What is deficient in the analysis is any comparison with businesses operating in a competitive environment and of assessments made by overseas regulators. A review of MRP awarded by overseas regulators (particularly the UK which uses incentive regulation similar to that which applies in Australia) shows that the MRP [market risk premium] used in the UK is generally in the range 3-4%.	The market risk premium adopted by UK regulators is based on information relating to the UK stock market. Whilst it could be argued that the Capital Asset Pricing Model could apply on an international basis (referred to as "International CAPM"), there are a number of conceptual and practical difficulties in applying such a model.
6c. Transend's weighted average cost of capital (WACC).	Major Employers' Group submission, page 13, paragraph 4.	The Essential Services Commission of Victoria commissioned Mercer Investment Consulting to provide input to the debate on MRP. Mercer comments that:- "For the purpose of this letter, having forecast long term Australian shares returns we have derived the implied ex-ante Australian shares ERP. Thus it is as an outworking of our forecast for Australian shares returns, we identified the arithmetic ERP to be 3.0%."	Transend notes that the Major Employer's Group (MEG) has quoted evidence to the ESCV which supports its assertion regarding the MRP. However, the MEG has not reported the ESCV's conclusion on this matter – having regard to <u>all</u> the evidence presented. On page 336 of the Gas Access Arrangements Review Final Decision, October 2002: "Having regard to the information presented in the Draft Decision, the further information and other matters discussed above, the Commission has remained of the view that 6 per cent for the equity premium (for an assumption of 0.5 for 'gamma') is appropriate. While such an assumption may be out of step with the assumptions now commonly adopted by market practitioners, the Commission does not consider this evidence to be sufficiently persuasive to revise its past assumption about the equity premium, particularly when weight is placed upon the long-term consequences of the Commission's decisions."

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6d. Transend's weighted average cost of capital (WACC).	Major Employers' Group submission, page 15, last paragraph.	The Allen Consulting Group, in its July 2002 report to the ACCC points out that gas transmission companies in the UK, Canada and the USA have average equity beta's of less than 0.3 (excluding companies with negative equity beta's, and that listed Australian companies involved in energy transport have an average equity beta's of less than 0.60. Whilst it is acknowledged that this report concentrates on gas transportation, it should also be recognised that electricity transport is a more revenue stable activity than gas, as gas transport companies accept the risk of volume whereas Australian electricity transmission businesses are provided with a fixed revenue cap, effectively eliminating volume risk.	Transend's assessment of WACC is based on expert advice from NEGC which is attached as Appendix 7 to Transend's RCA. In relation to the estimation of equity beta, NECG notes (page 42 of 53) that: "Transend's cashflow is sensitive to movements in the Tasmanian economy. Transend is reliant on a few major customers for the bulk of its revenue, with five major customers accounting for over half of total revenue – a highly unusual situation in Australia."
6e. Transend's weighted average cost of capital (WACC).	Hydro Tasmania covering letter, page 3, paragraph 2.	Transend has calculated a WACC that is higher than that in recent decisions for transmission companies, particularly in respect of the cost of debt. The Commission has established sound precedent in this area and will no doubt amend the Application accordingly.	See answer to *Issue 6a.*

Issue	Respondent and references	Respondent's comments	Transend's response
7a. Insufficient information or consultation.	Aurora's submission, page 3, paragraph 5	Aurora's position is that an operation and maintenance (O&M) allowance should be driven by customer value. There is insufficient information in Transend's proposal to determine any linkage between the O&M spend and the level of service provided or the customer value delivered.	Transend agrees in principle that O&M expenditure should be driven by customer value considerations. However, in many instances the link between O&M expenditure and specific outputs valued by customers is highly complex. For example, Transend's O&M expenditure is focused in large part on meeting compliance obligations that are placed on the company. It is difficult to quantify the value that customers would place on compliance with these standards, but in any event Transend has no choice in whether or not to comply. The broader question of the overall efficiency of Transend's expenditure plans is a matter that will be considered by the Commission's consultants and by the Commission.
7b. Insufficient information or consultation.	Major Employers' Group submission, page 4, paragraph 2.	There is insufficient information disclosure to enable the ACCC, let alone users, to assess the veracity of the claim or to satisfy users that the revenues sought are fair, reasonable and are reflective of economically efficient costs.	As above. It should also be noted that Transend's submission provides substantially the same level of information provided by other TNSPs in their revenue cap applications. In a number of important respects, Transend's application provides more information than other TNSPs (for example, in relation to service incentives). It therefore fully meets the requirements of the TEC and NEC.
7c. Insufficient information or consultation.	Major Employers' Group submission, page 7, paragraph 4	By allowing a monopoly service provider to limit disclosure of information needed by interested parties to provide a competent response to an application for regulated revenues, the regulator can become exposed to perceptions of bias. Full disclosure of information to interested parties allows a strong and competent response to applications from regulated enterprises, and allows the regulator to act as an impartial umpire.	As above. The ACCC has appointed consultants to scrutinise Transend's expenditure plans in much more detail than could be achieved through a process of industry consultation. The consultants' report is available on the ACCC's web page for comment from interested parties. It is therefore unclear how claims of regulatory bias could be substantiated. The role of the ACCC is not to act as "umpire" between customers and company. Instead, the ACCC's role is to reach a soundly based judgement on the company's revenue requirements, subject to the requirements of the NEC and TEC.
7d. Insufficient information or consultation.	Major Employers' Group submission, page 8, paragraph 2.	The ACCC and other Australian regulators have, to date, not failed to require the presentation of asset registers and management plans by access arrangement seekers as part of access reviews. Transend's application should not be treated as an exception.	Transend has met the information requirements specified in the NEC. These information requirements do not require its asset registers or asset management plans to be made available. These documents are available for review by the ACCC's consultants, and expert review by these consultants is likely to be a more effective scrutiny than

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			relying on review from interested parties who are not expert in these matters.
7e. Insufficient information or consultation.	Major Employers' Group submission, page 8, paragraph 4.	Transend has failed to provide details of the actual past expenditure of capex and the accompanying documentation demonstrating compliance with the regulatory test for expenditure over $1m.	Historic levels of capital expenditure are publicly available in Transend's annual reports (although these differ slightly from capital roll-in for regulatory purposes). It should be noted, however, that Transend's historic expenditure is not a particularly useful guide for its future expenditure requirements. Transend is not presently subject to the regulatory test under the NEC. However, it is subject to a comparable test under the TEC. It is noted that the regulatory test only applies in relation to enhancements to the network, rather than asset renewals (for further information see the ACCC's discussion paper on the regulatory test, 5 February 2003, pages 26 and 27). In any event, Section 5.5 of the RCA (pages 43-45) explains Transend's approach to forecasting development capital expenditure, and why the regulatory test is not a useful tool in forecasting capital expenditure. The Southern augmentation project, Norwood-Scottsdale-Derby line and Mowbray substation have now been approved by the Reliability Network Planning Panel using the regulatory test. This provides assurance that Transend's forecasting methodology is soundly based.
7f. Insufficient information or consultation.	Hydro Tasmania further letter (14 May 2003), page 3, paragraph 3.	[Comments in relation to variable projects to meet expected load growth] While it is difficult to comment on these projects, as there is no information on their timing or probability available, it is very unclear as to whether any of these projects will proceed, or whether some could be more properly considered to be contestable projects, and hence are outside the revenue cap.	The nature of variable projects is that their timing and costs are uncertain at this stage. On this basis, Transend has not proposed that estimates for these projects are included in its revenue base in advance of the projects proceeding. Transend's proposed approach manages the uncertainty with regard to these projects in a way that appropriately balances the interests of the company and its customers. Further analysis regarding probabilities of timings and costs would not address the underlying issue of risk.

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7g. Insufficient information or consultation.	Hydro Tasmania further letter (14 May 2003), page 5, paragraph 1.	As we noted in our meeting, the level of supporting information for the renewal expenditure was disappointing, particularly given that $194.9m capex is associated with this category. In particular, there is insufficient information in respect of the need case, the costs and timing of individual programmes.	Transend accepts that the information provided in the RCA is not sufficient to judge whether the capital expenditure projections are soundly based. However, it is not feasible to provide the necessary level of substantiation in a public document, which is intended to be read by a wide-range of interested parties. The ACCC process provides for expert review of Transend's plans by an independent consultant. The consultant's report is then made available on the ACCC's webpage to allow further comment from interested parties. This process provides ample opportunity for further scrutiny of Transend's expenditure plans.
7h. Insufficient information or consultation.	Hydro Tasmania further letter (14 May 2003), page 7, paragraph 3.	The information we believe should be properly in the public domain is as follows: • Detailed history of previous capex forecasts and actual programmes; • Detailed forecasts of expenditure and timing for each significant project; • Sufficient information on the need case of particular projects to assess, whether market participants would be affected by a particular project, or could have input on the need case; • Information on the approvals status of the projects, with the RNPP, OTTER and the Transend Board; and • For variable projects, the probability of the projects.	The extent of this information request far exceeds the requirements set out by the ACCC in its guidelines or the information provided by other TNSPs in their RCAs. It is impractical to allow detailed scrutiny of each project by every interested party. Interested parties should rely on the ACCC process of review, and recognise that the RCA is only part of that process. Interested parties will have opportunity to comment on the ACCC's consultants' report. The relevance of some of the information requested by Hydro Tasmania is highly questionable. For example, the status of Board approval or approval by RNPP or OTTER is of little relevance when considering forecast expenditure up to 2008-09. In addition, the detailed history of capital expenditure is only one component in considering future needs.

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7i. Transend does not intend to consult on the formulation of limit equations.	Hydro Tasmania submission, page 3, paragraph 4.	Hydro Tasmania's concerns over the justification and timing of capex projects is further heightened by Transend's apparent intentions in respect of constraint equation formulation for National Electricity Market ("NEM") entry. As we understand it, Transend does not intend to consult on the formulation of limit equations. It would be extremely disappointing if the benefits of any capital expenditure were squandered by conservative constraint equation formulation. Transend's lack of consultation on this matter has, we understand, been driven by concerns about complying with the Trade Practices Act ("TPA") by demonstrating even-handed dealings with all existing and potential market participants. While not the primary focus of this submission, we would be grateful if the Commission were able to clarify that, notwithstanding the existing industry structure in Tasmania, Transend could consult on these matters without contravening the Act.	Transend suspects that Hydro Tasmania may be confusing constraint equations with limit equations, however the issue is tangential to Transend's RCA. Transend considers that it is properly the role of the TNSP to determine the limits on the transmission system. Transend's CEO has written to NEMMCO to confirm their views on this matter. Transend recognises the need to treat all generators (incumbent and prospective new entrants) on an equitable basis wherever possible. Notwithstanding this issue, Transend shares Hydro Tasmania's concern that an overly conservative approach to formulating limit equations should be avoided.
7j. Insufficient information or consultation.	Hydro Tasmania submission, page 2, final paragraph.	The Application does not provide sufficient information to analyse the case for and timing of each capex project. Even without sufficient detailed information in the Application, the Southern augmentation project provides a useful case study of the potential to overstate forecast costs more generally. Transend notes that "the project was submitted to the Reliability Network Planning Panel ("Panel") in December 2002; the Panel endorsed it at its meeting on 30 January 2003." However, we understand that the Panel also noted that the project would need resubmission if certain circumstances eventuated before the development of the 220kV line. At first glance, this would reduce Transend's forecast capex for this project from $55.4m to $25.2m.	The RCA is not intended to provide a detailed justification for each capital expenditure project. Instead, it provides a comprehensive overview of the company's expenditure plans and revenue requirements for the forthcoming regulatory period. It is a matter for the ACCC and its consultants to scrutinise these plans to ensure that they are fully justified. With respect to the Southern augmentation project, the RCA notes that this project has been approved by the Reliability Network Planning Panel. This means that in the Panel's view, the proposed project maximises net market benefits, given the market information currently available. Transend fully accepts that it may need to revisit the technical design of this project as new information becomes available. It is not possible to remove design uncertainty at this stage without compromising economic efficiency.

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			Please see the response to *Issue 3j* for further information. Whilst actual expenditure on Southern augmentation could be less than $55.4m, it is equally possible that it could exceed this figure. The purpose of categorising the project as "fixed" is to provide Transend with an incentive to minimise actual expenditure. Transend notes that Hydro Tasmania criticises the alternative "variable approach" to capital expenditure on the grounds that it "provides very poor incentives." (Hydro submission, page 11, final paragraph).
7k. Insufficient information or consultation.	Hydro Tasmania submission, page 11, paragraph 5.	There has also been no effective consultation with Tasmanian stakeholders on the use of these security criteria in the development of capex plans. This has denied transmission customers the opportunity to ensure that the capex forecasts proposed in the Application actually meet their needs and expectations.	The application of draft security criteria is the only practical means of forecasting capital expenditure to 2008/09. Hydro Tasmania was specifically consulted on the security criteria and all stakeholders have an opportunity to scrutinise the resulting expenditure forecasts. Since the application of the security criteria, the Southern augmentation project, Norwood-Scottsdale-Derby line and Mowbray substation were approved by the Reliability Network Planning Panel using the net market benefits test. This provides support to Transend's assertion that the application of the draft security criteria should result in similar expenditure outcomes to the application of the regulatory test.
8. Transend's efficiency bonus is overstated.	Hydro Tasmania submission, page 12, paragraph 4.	The efficiency bonus seems overstated given that Transend could and should have forecast these costs in 1999, and particularly given the uncertainty discussed above about the implication of ITOMS report.	Transend did forecast higher operating expenditure than provided by OTTER in the 1999 determination. Our case for an efficiency bonus recognises that the scope of work required during the current regulatory period is much greater than anticipated by the Regulator. Transend would be penalised twice if such forecasting errors prevented it from earning an efficiency bonus.

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9a. NEM Entry / Basslink	Aurora submission, page 3, paragraph 2.	NEM expenditure is based on competition in generation and retail providing benefits to customers that outweigh the costs. ACCC has already worked on this as part of Tasmania's case for joining the NEM. There should be some demonstration that NEM related costs will be outweighed by the benefits.	Transend must operate within the actual operating environment, which in this instance includes NEM entry. It would be inappropriate for Transend to determine unilaterally that NEM entry should not take place, and therefore to make no preparations for it. Such an approach would jeopardise the value that may be obtained from NEM entry.
9b. NEM Entry / Basslink	Senator Bob Brown submission, page 1.	In its submission to the Joint Assessment Panel on Basslink I questioned the expenditure that would be needed to augment and upgrade the transmission network if Basslink went ahead. Transend responded that 'The only additional transmission infrastructure necessary to connect Basslink to the Tasmanian transmission network are connection assets required at George Town substation….[which] will be constructed and funded by BPL…" (p.310, Basslink Joint Advisory Panel Final Report, June 2002). Now Transend is claiming Basslink as a major development that will significantly affect the transmission network (submission p.v) and as a new 'fixed' generation project which will require capital expenditure.	Transend's stands by its response to the Joint Assessment Panel's question regarding expenditure required to "augment and upgrade the transmission network to connect Basslink". It is important to distinguish between the capital costs of connecting Basslink and the subsequent operating and capital expenditure that arises as a result of NEM entry. Inter-connection to the NEM via Basslink will require significant changes to the operation and management of the power system (eg interface with NEMMCO) and capital investment will be required to facilitate NEM entry (eg IT systems and metering), but it would not be appropriate to ascribe these costs to the Basslink project.
9c. NEM Entry / Basslink	Major Employers' Group submission, page 20, paragraph 5.	Transend avers that it will incur extensive costs as a result of participating in the NEM. There is no attempt to provide any cost substantiation for these supposedly new costs. A review of them indicates that mostly these services are already effectively being provided under the current regulatory regime or will have little cost impact. It should be remembered that integrating with the NEM is meant to reduce costs, not become a vehicle for claiming increased allowances.	The impact of NEM entry is significant. Its impact on operating expenditure is summarised on page 67, and also highlighted in tables 7.1, 7.3 and 7.5. Transend notes that Government expects NEM entry to bring substantial net benefits to Tasmania. This does not mean that "costs are to reduce". The important point is that the transmission system must be capable of bringing the substantial potential benefits from NEM entry to fruition.
9d. NEM entry / Basslink	Hydro Tasmania submission page 12, paragraph 5.	Transend's shareholder instructed Transend to provide all necessary resources to facilitate NEM entry. Hydro Tasmania is fully supportive of this project. However, we would question whether these	Principles of competitive neutrality dictate that Government owned and privately owned businesses should operate on the same footing. This important principle would be breached if Government-owned businesses were not

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		costs should be borne by customers or the shareholder.	allowed to recover costs imposed by Government. Moreover, the adoption of such an approach would have much wider implications than simply disallowing NEM entry costs, and would not be a workable or economically desirable outcome.
10a. Asset revaluation	TCCI submission, page 4, paragraph 2.12.	The TCCI was disappointed with the process for revaluing Transend's regulated asset base. Such a significant increase in our view circumvented an independent valuation process and instead should have been performed by an independent body such as OTTER or the ACCC.	The revaluation of Transend's asset base corrects a number of errors made in the 1999 OTTER valuation process. The revaluation was conducted in accordance with the National Electricity Code and the Tasmanian equivalent. It was independently reviewed by consultants appointed by Treasury. In addition, the ACCC has the ability to revisit the asset revaluation during this revenue reset process if it is found that the revaluation does not conform to the National Electricity Code requirements. Transend believes that the revaluation is appropriate and that the revaluation process is robust.
10b. Asset revaluation	Aurora submission, page 2, paragraph 5.	Transend's closing asset value from the previous OTTER determination was $475 million, assuming a capital investment of around $150 million between 2000 - 2003. Transend spent less than this amount each year of the determination and therefore the $475 million should be reduced accordingly.	The asset revaluation reflects the actual level of capital expenditure undertaken since 1999, rather than OTTER's forecast amount. Transend therefore accepts Aurora's point, which has already been reflected in the RCA.
10c. Asset revaluation	Major Employers' Group submission, page 9, penultimate paragraph	The TEC precludes the ACCC from reviewing the initial RAB set by the Minister. However, the ACCC would be remiss in not commenting that the RAB is blatantly overstated, particularly as it is now aware that some $170m of the assets included in the RAB set by the Minister have been fully depreciated already in accordance with the stated accounting practices of Transend.	The ACCC is not precluded from reviewing the RAB set by the Minister. The methodology for establishing asset valuation has been extensively debated a number of years ago. Since then, the ACCC has produced its draft Statement of Regulatory Principles (May 1999) which further describes the approach that should be adopted. In addition, consulting firms have undertaken a number of asset revaluations consistent with the ACCC's requirements. Transend's asset revaluation was conducted by Sinclair Knight Merz, and reviewed on behalf of the Minister by Meritec Pty Ltd. Both reviews have been conducted in

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			accordance with regulatory practice and the ACCC's requirements. The revaluation process has been described in Transend's RCA.
11a. Impact of new generation	TCCI submission, page 12, paragraph 8.5.	TCCI believes additional energy projects planned in Tasmania can not be used as a means to justify additional revenue for the State's Electricity Supply companies. These projects are being implemented to save Tasmanian customers money yet at the same time they are being used to justify an outcome that would see the end electricity price increase by 4%.	Ultimately, new generation projects should bring benefits to customers through more competitive prices. Transend's role is in providing a transmission system that allows these new generation investments to take place. It is only sensible that Transend is allowed sufficient revenue to provide the necessary transmission services.
12a. Cost allocation	Senator Bob Brown submission, page 1.	Transend lists new generation projects (p.50) that may require expenditure on the transmission system and notes the need to develop a methodology to allocate costs in line with benefits (p.57). Excluding Basslink, about 90% of the new generation capacity listed in Table 6.1 is underwritten by the Tasmanian government, directly or indirectly. The potential for shifting costs that should properly be allocated to the generation project to Transend is a major concern.	The ACCC's regulatory arrangements prevent Transend from earning a return on investment which is not considered to be prudent investment in regulated transmission assets. There is an important distinction between • determining that investment provides a net benefit and • determining who should pay for the investment. Transend notes that NEMMCO is to conduct a review of the 'beneficiary pays' test', to determine the appropriate parties to pay for network augmentations.

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13a. Definition of revenue capped services	Hydro Tasmania further letter (14 May 2003), page 2, paragraphs 3-5.	The Application has not included reference to assets required as part of metering installations (instrument transformers and associated cables panels and wiring) for Hydro Tasmania's market connection points on Transend sites (Transend/Hydro Tasmania interface). It is understood that, in this type of circumstance, Hydro Tasmania may agree with Transend on the treatment of these assets on their property as either contestable or regulated and that either treatment would be acceptable to the Commission. It is further understood that the regulated treatment would be the default position adopted by the Commission if the parties could not agree on terms in relation to treatment of these assets as "contestable". On that basis, we would, given the current early stages of negotiation, encourage the Commission to consider including these assets in Transend's regulated asset base.	The National Electricity Code (clause 6.2.2(h)) requires the ACCC to seek outcomes that promote competition in the provision of network services where economically feasible. Therefore, rather than having a choice between regulated and contestable market outcomes, the Code requires that regulation only occurs when competitive outcomes are not feasible. Transend's view is that the provision of metering assets at the generator-transmission interface can be provided on a contestable basis. For this reason, we have excluded the costs of these services from the RCA. A reference to this issue is made in Section 2.3, page 24 of the RCA. It is also noted that the draft definition of "non-contestable transmission services" provided on page 3 of Annex 1 to the RCA clearly discloses that these assets will be excluded from the revenue cap.