COPPER URANIUM

23 May, 2002

Mr Michael Rawstron
General Manager - Regulatory Affairs - Electricity
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Rawstron

Re: ElectraNet SA Transmission Revenue Cap

In response to the ACCC's call for submissions on the ElectraNet SA Transmission Revenue Cap Application, I forward a submission on behalf of WMC Ltd.

Yours faithfully

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Group Manager – Corporate Affairs (East)

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WMC Limited

Submission to the ACCC on the ElectraNet SA Transmission Revenue Cap Application 2003-2007/08

EXECUTIVE SUMMARY

WMC Limited (WMC) makes this submission in response to the call for submissions by the ACCC on the ElectraNet SA Transmission Revenue Cap Application for the years 2003 to 2007/08. This is the first application made under the future arrangement where the ACCC will become the transmission regulator for South Australia.

WMC has long been critical of the handling of the transmission pricing regime operating in South Australia, both in relation to the very high transmission charges which apply in the State, but also in the way in which charges to specific customers have been made. WMC holds the view that the charges applicable to our Olympic Dam Operations (ODO), which consumes some 9% of the State's total electricity consumption, have been held at unjustifiably high levels under the Electricity Pricing Order which has governed transmission pricing in South Australia since 1999.

In the light of the past comments/criticisms by the ACCC, WMC believes that the ACCC should use its Determination of the ElectraNet SA revenue cap to require ElectraNet SA to eliminate the major problems inherited from the Electricity Pricing Order of 1999.

South Australia's average transmission prices are some 65% above the average of the other NEM States at the present time. Were the ACCC to accede to the claim made by ElectraNet SA, this gap would significantly widen — such that, at the end of the regulatory period, South Australia's average price would be more than double the average of the other NEM States.

This fact alone should be cause for the ACCC to take a highly critical approach to the ElectraNet SA application.

SPI PowerNet of Victoria, in their application lodged at about the same time as that of ElectraNet SA, is seeking a future revenue cap which allows them to continue to reduce the average real price of transmission services in that State, despite the fact that the average age of the Victorian system is arguably just as old as that in South Australia. A similar comment can be made in relation to the final revenue path and thus average tariffs determined by the ACCC for Transgrid in New South Wales, which also suffers from an aging asset base.

ElectraNet SA seeks to justify their extremely high revenue cap request by claiming that:

- the South Australia transmission system is less "dense" than those of the other States and that the density factor has a significant scale effect on the cost of transmission;
- the South Australian transmission system has reached an average age where substantial refurbishment and/or replacement is necessary; and

- past management and Government actions in South Australia have neglected to invest in the transmission system, leaving a back log of works needing to be undertaken.

WMC has examined each of these reasons and found flaws in each of the ElectraNet SA claims.

WMC has also analysed the four principal reasons for the high transmission tariffs in South Australia:

- the regulatory asset base;
- the level of operations and maintenance expenditures;
- the proposed future capital expenditure; and
- the level of WACC being sought.

In each case we have presented evidence which throws doubt on the ElectraNet SA claims, and shows how much higher the ElectraNet SA claimed requirements are compared to other TNSP's operating in the National Electricity Market.

Thus, it appears to WMC that ElectraNet SA is seeking a revenue cap which is quite unjustified, and for reasons which do not stand up to close examination. In our view, the ACCC needs to critically examine every aspect of the claim and reduce each element to the minimum justified level.

There is no fundamental reason why South Australian average transmission tariffs should be so much higher than the other TNSP's operating in the National Electricity market.

WMC would be pleased to elaborate on our analysis and views as the ACCC consideration of the ElectraNet SA application develops.

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WMC Limited

Submission to the ACCC on the ElectraNet SA Transmission Revenue Cap Application 2003-2007/08

1. Background

WMC Limited (WMC) makes this submission in response to the call for submissions by the ACCC on the ElectraNet SA Transmission Revenue Cap Application for the years 2003 to 2007/08. This is the first application made under the future arrangement where the ACCC will become the transmission regulator for South Australia.

WMC has long been critical of the handling of the transmission pricing regime operating in South Australia, both in relation to the very high transmission charges which apply in the State, but also in the way in which charges to specific customers have been made. WMC holds the view that the charges applicable to our Olympic Dam Operations (ODO), which consumes some 9% of the State's total electricity consumption, have been held at unjustifiably high levels under the Electricity Pricing Order which has governed transmission pricing for the last few years.

WMC's concerns were first raised in 1996 when the then ETSA Corporation suddenly revalued its transmission and generation assets — roughly doubling the asset valuation ascribed to transmission and halving the value applicable to generation. At the time, WMC were seeking to negotiate supply arrangements for a major expansion of its operations at ODO and passed up the opportunity to develop on-site generation due to the lower power prices being offered by ETSA Corporation, which unfortunately never eventuated. It was during these negotiations that the high transmission prices proposed to be charged in the State first came to WMC's attention, and were a significant factor in the higher prices which eventuated — unfortunately too late to allow the on-site generation option to be revisited without delaying the major expansion project then getting underway.

On several occasions since then, WMC has raised its objections to the State Government — and has made these objections known to the ACCC — but to no avail. The result has been that WPC has been forced to pay a transmission charge for the delivery of electricity to Olympic Dam which is well in excess of any reasonable charge given the limited use made of the transmission network, and the size and desirable characteristics of the ODO load.

WMC therefore welcomes the impending transfer of regulatory responsibility to the ACCC at for the beginning of 2003 and the cessation of the Electricity Pricing Order.

WMC hopes that the results of the ACCC's review of ElectraNet SA's transmission revenue cap application can begin to rectify the high transmission prices and pricing anomalies which have characterised transmission prices in South Australia recently.

2. The Olympic Dam Requirement

Olympic Dam Operations currently consumes almost 1000 GWh of electricity each year out of total electricity sales in South Australia of 11,500 GWh, or almost 9% of the State's total consumption. Its peak demand reaches 120MW compared to total State peak demand of around 2600MW, or 4.6%. of the State total These figures illustrate

that the ODO load has a much higher load factor than the remaining South Australian load, which, together with the fact that supply is taken directly at the highest transmission voltage in the State, makes its characteristics very desirable from the point of view of the economics of electricity supply. WMC has been seeking to have these desirable characteristics reflected in the charges which are paid for both energy and transmission services, as the cost of supplying such a load is self-evidently much less than the cost of supplying the general State load.

The Olympic Dam load is the largest single customer in South Australia and therefore the largest single industrial customer of ElectraNet SA. Supply is physically taken at 275kV from the ElectraNet SA Davenport Substation, located adjacent to the Northern and Playford power stations (with their total of 760MW of capacity) via a 260 km privately owned 275 kV transmission line which WMC constructed in 1997 as part of the last major expansion at Olympic Dam.

Irrespective of contractual relationships, physical power flow is from the Northern power station into Davenport at 275kV and thence directly into the ODO transmission line. This local load off-loads the long 275kV transmission lines delivering power to the Adelaide area and brings benefits to ElectraNet SA in avoided capital expenditure which would otherwise be required on this part of the system. The chance of ODO needing to draw power from the remainder of the ElectraNet SA network is remote, being confined to occasions when both Northern and Playford power station units are all simultaneously out of service.

Despite this minimal use of the ElectraNet SA system, under the Electricity Pricing Order WMC is forced to pay in excess of $7/MWh for transmission charges to ODO. The many estimates made by WMC over the years have indicated that proper cost reflective pricing (as is supposed to apply in the National Electricity Market) would result in transmission charges as low as $2 50/MWh, similar to the cost if WMC bypassed the ElectraNet SA transmission system altogether, and took power directly from Northern/Playford complex to ODO. This is a realistic alternative available to WMC.

By comparison, comparable loads located close to major base-load power stations in Victoria and NSW, and taking supply at EHV transmission voltages, pay transmission charges in the range $1.8-2.5/MWh in Victoria[1] and also $1.8-2.5/MWh in NSW[2].

It goes without saying that, if the current ElectraNet SA application were to succeed, the whole level of transmission charges in the State would rise, and lift those payable by WMC above the already unacceptable levels.

Olympic Dam Operation is currently increasing production from a nominal 200,000 tpa of copper to around 240,000 tpa, and alternatives for expansion up to as much as 600,000 tpa of copper are in various stages of examination.

Olympic Dam competes on the world market for copper and uranium and is under constant pressure to reduce its cost of production to remain competitive with producers operating in parts of the world that face lower costs than are possible in

[1] Victoria (VPX) publishes its TUOS charges for each node in the Victorian Network. These are the prices for a high load factor load at Morwell and Yallourn.

[2] IPART published separate revenue caps for the supplies to the aluminium smelters in the Hunter Valley and the BHP Steelworks at Newcastle and Port Kembla. These prices are developed from the IPART revenue requirement and the size of the loads supplied by Delta Electricity and Macquarie Generation as appropriate.

Australia. The cost of electricity purchase and delivery is the largest single input cost item at the Olympic Dam and, has a major impact on the competitiveness of the operations and therefore its prospects for expansion in the longer term..

This explains WMC's intense interest in this matter.

3. The existing South Australian Network Pricing Regime

South Australia derogated from the application of the National Electricity Code until the end of the year 2002. This meant that the handling of transmission pricing remained with the South Australian Government until that date. The Government initially agreed to move to a series of zones in which transmission prices were to be averaged as from the end of December 2000, but although provision was made in the Electricity Pricing Order for four zones, the same prices were applied to each of them — effectively creating a single zone for South Australia — and losing any semblance to the notions of cost-reflectivity and locational pricing.

The existing pricing regime, as detailed in the Electricity Pricing Order (EPO)[3] is characterised by:-

- common Transmission Use of System Charges (TUOS) and Distribution Use of System Charges (DUOS) applying throughout the State;
- a special price category applying to customers connected directly to the EHV transmission system. This is applicable only to TXU Torrens, NRG Flinders Power and Synergen, ETSA Power and WMC ;
- prices applying to the following components (for customers connected direct to the transmission system):-
  - ¶ Agreed Maximum Demand (expressed as $/MW/day);
  - ¶ Usage between the hours of 0900 and 2100 on working weekdays (expressed as $/MWh);
  - ¶ Common Service, applying to all energy usage in the day (expressed as $/MWh)
- South Australian prices are based on South Australian determinations of Depreciated Optimised Replacement Cost (DORC) and Weighted Average Cost of Capital (WACC).

The application of the prices listed in the EPO results in:-

- extremely high transmission prices - in fact the highest in Australia by far. In 2001/02, the ElectraNet SA average revenue was equivalent to over $11.50/MWh delivered, compared to figures in the range of $6.5-7.8/MWh in NSW, Victoria and Queensland[4];

  South Australian TUOS charges should be very low, given the relatively small and compact supply area compared to a State like Queensland. Instead, TUOS charges are almost 70% higher than those of NSW;

[3] Gazetted on the 2nd April 1998.

[4] See the analysis in later sections of this submission.

- extremely high levels of profitability for ElectraNet SA. Pretax profitability in 1997/98 was an extremely high 53% of revenue and still 31% in 1998/99 — far higher than that of other Transmission Network Service Provider (TNSP) in Australia and well above the 8.5-9.0% recorded by the top 150 listed companies in Australia in the same financial years;[5]

  As an aside, WMC notes that average revenue to ElectraNet could be reduced to about 60% of current values before the pretax return on sales falls to comparable levels to those earned by major listed companies in Australia[6] .

- the maximum degree of averaging possible is used, due to the use of a single common zone for the whole State.

  WMC understands that this practice was adopted to equalise charges to end users throughout the State and to avoid high prices at the system extremities. However, such gross averaging leads to very significant distortions for major, high voltage loads, such as the ODO load. The problem of maintaining uniform tariffs would be better dealt with by averaging at the distribution voltage level, or better still, by explicit Government payments of any cross subsidy required.

  WMC further notes that the Victorian and NSW Governments continues to calculate and apply cost-reflective transmission tariffs in their States, while providing compensation by adjustments and averaging at the distribution level.

- Inappropriate prices for loads taken at high voltage and operating at a high load factor, due to the absence of full voltage segregation; the application of charges based on energy usage rather than on maximum demand; and the use of a common price for all transmission usage in the State. In fact, the effect of these factors is to actually penalise loads taken at high voltage and operating at high load factor — the very opposite of what might be expected to happen in a rational, fair and cost-reflective pricing system.

4. Past ACCC Comments on South Australian Transmission Prices

The ACCC, in its past Determinations on the National Electricity Code provisions has been very critical of the interpretations applied in South Australia. To remind the Commission of past statements, the following quotes and references are offered.

In general, the ACCC,

> "is not convinced that cost allocation provisions for transmission use of system services are efficient and that this deficiency will significantly undermine the long term benefits of the electricity access code."[7],

and

> "urges Jurisdictional Governments to adopt more cost reflective allocations

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5 Taken from a study conducted by the Business Council of Australia Energy Working Group.

6 Readily calculated by assuming that the cost base remains constant and revenue is decreased to match a given pretax profit.

7 On p34 of Determination dated 16/9/98.

of TUOS charges."[8]

It was expected by the ACCC that a revised Transmission and Distribution Network Pricing system would result from the major review which was being conducted by NECA — but the outcome has been disappointing, to say the least. The ACCC required that NECA include in their assessment:-

- A review of the incidence of TUOS Charges between generators and customers, with the implication that generators are to bear a significant portion of TUOS charges (rather than customers as at present);
- Bypass was to be explicitly allowed;
- IPART-like negotiation guidelines were to be included for embedded generation to enable them to gain the benefit of savings in TUOS charges;
- Differences between the approach to TUOS and DUOS charges are to be eliminated (including the implication that differentiation by voltage level is to be adopted for both TUOS and DUOS charges);
- TUOS/DUOS charges were to be unbundled.

These past comments by the ACCC, their criticisms of the current pricing system, and the direction of the proposed changes, were and are still, fully supported by WMC.

In relation to the South Australian practices as described in the Derogations to the Code, the ACCC noted that:-

> "the proposed derogation's use of average network prices is a further move away from cost reflective network prices which, in the case of the uniform NEM arrangements, the Commission argued are already significantly flawed in terms of the likely efficiency signals it will provide."[9]

WMC is aware that changes have been made to the National Electricity Code which, when the ACCC takes over regulatory responsibility for ElectraNet SA, should allow WMC to gain better recognition of its high load factor and also of the obvious ability which exists for WMC to bypass the ElectraNet SA system, and Davenport substation in particular. When it is able to do so, WMC intends to pursue these opportunities in an endeavour to reduce the payments made for transmission services associated with ODO supply to more reasonable levels.

In the light of the past comments/criticisms by the ACCC, as well as the criticisms by major customers and customer organisations, WMC believes that the ACCC should use its Determination of the ElectraNet SA revenue cap to require ElectraNet SA to eliminate the major problems inherited from the Electricity Pricing Order of 1999.

5. General Comparison of Transmission Prices in the NEM

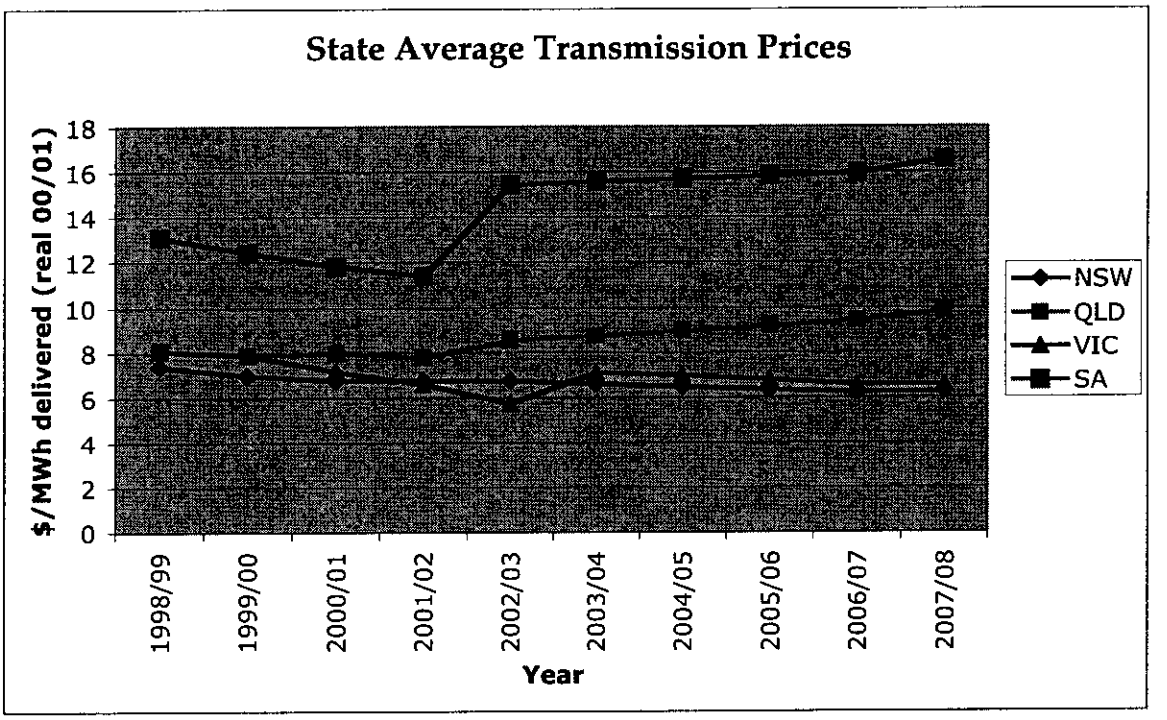
In order to place the revenue requested by ElectraNet SA in proper perspective, WMC arranged for an analysis to be conducted of past and prospective average transmission prices in the various NEM States.

[8] On p31 of Determination dated 16/9/98.
[9] On p71 of Determination dated 16/9/98.

This analysis expresses the comparative average price paid for transmission service in each of the States, in constant 2000/01 money terms. Note that:

- The future average prices for New South Wales and Queensland have been developed from the final ACCC Determinations in each case;
- The future average price for Victoria has been taken from the revenue cap application lodged by SPI PowerNet for application beyond the end of this year, with an appropriate adjustment for new works expected to be required by Vencorp, based on their latest 10 year Planning Report;
- The future average price for South Australia has been taken from the ElectraNet SA revenue cap application.

The results of the analysis are shown in the graph below.



The graph shows how South Australia's average transmission prices are some 65% above the average of the other NEM States at the present time. Were the ACCC to accede to the claim made by ElectraNet SA, this gap would significantly widen such that, at the end of the regulatory period, South Australia's average price would be more than double the average of the other NEM States.

This fact alone should be cause for the ACCC to take a highly critical approach to the ElectraNet SA application, which seems on basic principles to be excessive in the extreme.

In relation to WMC at ODO, were the increase in average prices be applied to the ODO transmission price, WMC could find itself paying some $9.4/Mwh for a service which WMC claims is worth around $2.50/MWh. WMC would find itself in

a position where bypass of the ElectraNet SA system, and the option of onsite generation would both start to look very attractive — with the result that ElectraNet SA would lose some 9% of its revenue and transmission prices would increase for all other customers in the State.

The graph also shows how SPI PowerNet in Victoria, in their application lodged at about the same time as that of ElectraNet SA, is seeking a future revenue cap which would allow them to continue to reduce the average real price of transmission services in that State, despite the fact that the average age of the Victorian system is arguably just as old as that in South Australia. A similar comment can be made in relation to the final revenue path and average tariffs determined by the ACCC for Transgrid in New South Wales, which also suffers from an aging asset base.

ElectraNet SA, in its aggressive application, seeks to justify their revenue cap request by claiming that:

- the South Australia transmission system is less "dense" than those of the other States and that the density factor has a significant scale effect on the cost of transmission;
- The South Australian transmission system has reached an average age where substantial refurbishment and/or replacement is necessary; and
- past management and/or Government actions in South Australia have neglected to invest in the transmission system, leaving a back log of works needing to be undertaken.

We examine each of these claims in turn:

System Density and Economies of Scale

WMC attempted to replicate the data used to compile Fig. 3.2 in the ElectraNet SA submission, which purports to show that the South Australian transmission system suffers from a lack of economies of scale compared to the other transmission systems in Australia. WMC could not replicate the numbers and we are at a loss to understand their source and derivation..

Furthermore, WMC has grave doubts about their accuracy, for the simple reason that, in Fig 3.5 of the ElectraNet SA submission, they make the astounding claim that if the South Australian transmission cost were to be corrected for transmission line length and connection point density effects, the average transmission price would drop from $11.5/MWh to just $2.40/MWh — half the average cost of the other States.

With due respect to ElectraNet SA, this is an absurd outcome, and shows that the so-called economy of scale has been greatly exaggerated.

To follow this up further, WMC had an analysis conducted using data extracted from ESAA published statistics, to logically analyse the likely impact of economies of scale between ElectraNet SA. and the other State transmission companies, but especially comparing with Queensland, which has a long and sparse transmission system covering a large populated area.

This analysis came to the following conclusions:

- transmission investment is largely determined by the peak load of the system concerned, and therefore measures which relate to the peak load are the most relevant;

- looking at the ratio of km of EHV transmission line to MW of maximum demand, South Australia has a figure of 2.14, compared to 1.99 for Queensland and an Australian average of 1.44. While the South Australian figure is higher than the Australian average, it is insignificantly different to that for Queensland;

- looking at the ratio of the installed transformer capacity to the MW of peak demand, South Australia has a figure of 2.36 compared to Queensland at 2.33 and an Australian average of 3.02. Again, South Australia is insignificantly different to Queensland and both are less than the Australian average;

- looking at the ratio of the number of transformers to MW of peak demand, South Australia has 44, compared to Queensland at 33 and an Australian average of 32. South Australia may have too many small transformers for full economy to be achieved;

- the most significant difference lies in the system load factor. South Australia has an annual average load factor of just 52% compared to Queensland with 71% and Australia at 64%. This means that a dollar of investment to meet a peak load will earn less revenue than the same dollar applied in the other States;

- apart from load factor effects (which will be dealt with next), there is little basis in this comparison to expect that average transmission charges in South Australia would be significantly higher than those applying in Queensland;

- approximately 66% of ElectraNet SA's transmission charges are related to the actual maximum demand or the energy taken in peak periods, which is close to a demand charge. ElectraNet SA can directly obtain revenue from the peak load imposed on its system for this proportion of its charges. Adjustment for load factor would apply primarily to the 33% of charges which are energy related, and which would generate less revenue than that which would apply in Queensland.

- correcting for load factor affects, led to a prime facie case that led density and economy of scale effects might justify a differential of the order of 15% between average transmission tariffs in South Australia and Queensland, but no more. This superficial analysis points to average South Australian transmission tariffs of around $9/MWh — some 20% below current average charges.

WMC assumes that ACCC will follow their usual practice of engaging specialist consultants examine the detail of ElectraNet SA's application. WMC respectfully suggests that the specialist consultant should critically examine ElectraNet SA's claim for cost disadvantages due to load density and economies of scale, as it appears to WMC that their claims on both counts have been grossly exaggerated and fail to justify the very high levels of revenue being sought.

Average age of equipment

Mention has already been made that WMC would not expect that the average age of the South Australian transmission system is significantly greater than that of New

South Wales and Victoria. This view appears to be justified by comparing the information provided by ElectraNet SA (especially Fig 3.4), and that provided by SPI PowerNet in their submission.

The difficulty is that the information is not provided on a comparable basis and it is thus impossible for WMC to be more precise in our comments.

We simply point out that it seems highly anomalous that both Transgrid and SPI PowerNet say that they can refurbish/replace their aging asset base while still achieving a reduction of average real transmission tariffs, whereas ElectraNet SA feels obliged to seek a much increased revenue cap.

WMC again suggests that ACCC have their expert consultants examine ElectraNet SA's claims with respect to system age with a critical eye, as they fail to pass the test of reasonableness on the information provided.

Lack of Past Attention and Investment

Again, WMC finds it difficult to support a claim that the ElectraNet SA system has been robbed of attention and investment by past management and Government actions, to any greater extent than has been experienced in the other States. Indeed WMC expects that SPI PowerNet in Victoria could make an equally valid claim in that respect, given the extent to which the very high expenditure on the Loy Yang Project tended to dominate the management time and financial resources of the previous SECV.

This lack of attention in Victoria is rather graphically illustrated by Fig 2.6 in the SPI PowerNet application, which shows that almost half of the Victorian connection points operated with no redundancy during the peak periods of 2000/01. WMC is aware that the Transmission Code in South Australia prevents this situation arising in that State, and thus it is difficult to sustain a claim that ElectraNet SA is in a worse situation than that facing SPI PowerNet in Victoria.

To repeat what has been said earlier, SPI PowerNet is not seeking an increase in its average real transmission price, and yet it intends to address all of the outstanding issues facing that States' transmission system .

Thus, it appears to WMC that ElectraNet SA is seeking a revenue cap which is unjustified, and for reasons which do not stand up to close examination.

The simple fact that, if granted by the ACCC, ElectraNet SA's average transmission price would move towards double the level which applies in the other States, shows that the ElectraNet SA claim needs to be dealt with in a highly critical fashion by the ACCC and its experts.

6. Reasons for the High South Australia Price

WMC 's analysis of the ElectraNet SA application discloses that the high regulatory revenue cap being sought is due to four principal reasons

- the regulatory asset base;
- the level of operations and maintenance expenditures;

- the proposed future capital expenditure programme; and
- the level of WACC being sought.

We deal with each of these in turn.

The Regulatory Asset Base (RAB)

ElectraNet SA is seeking an increase in the opening asset base from the jurisdictional determination in July 1999 of $685 million, to a figure of $994 million (to apply early in 2003).

The difference is made up of a combination of rolling forward of the 1999 jurisdictional valuation and adding to it, allowances for interest during construction, easement costs and the re-admission of assets optimised out of the regulatory asset base at the time. The total amount claimed for these three additional items is almost $180 million.

WMC objects to the addition of these components, both on grounds of consistency of ACCC treatment of TNSP's , and also as a matter of principle in the case of the treatment of easements.

In its Final Determinations for the of revenue cap for both Transgrid and Powerlink, the ACCC has elected to roll forward the jurisdictional regulators asset base and to reject claims akin to those being made by ElectraNet SA.

For example in Powerlink Decision, the ACCC states:[10]

> "The Commission has been advised that, in setting the revenue cap for the initial regulatory control period, the Commission is required to value sunk assets at the value determined by the jurisdictional regulator or consistent with the regulatory asset base established in the jurisdiction, provided that this does not exceed deprival value. Further the Commission's power to require the opening asset value to be independently verified in a process agreed to by the NCC, is limited to verifying that the opening asset base does not exceed deprival value."

The Commission further comments that:

> "...it was always the intention of the Code's authors that the Commission has limited flexibility and discretion in setting the opening asset valuation. In undertaking its role as transmission network revenue regulator it has been the Commission's understanding that it would accept the 1999 jurisdictional regulators valuation. The sunk valuation of the assets would only be revisited at the first regulatory reset, where the Commission will be able to undertake a ground up valuation of the network assets."

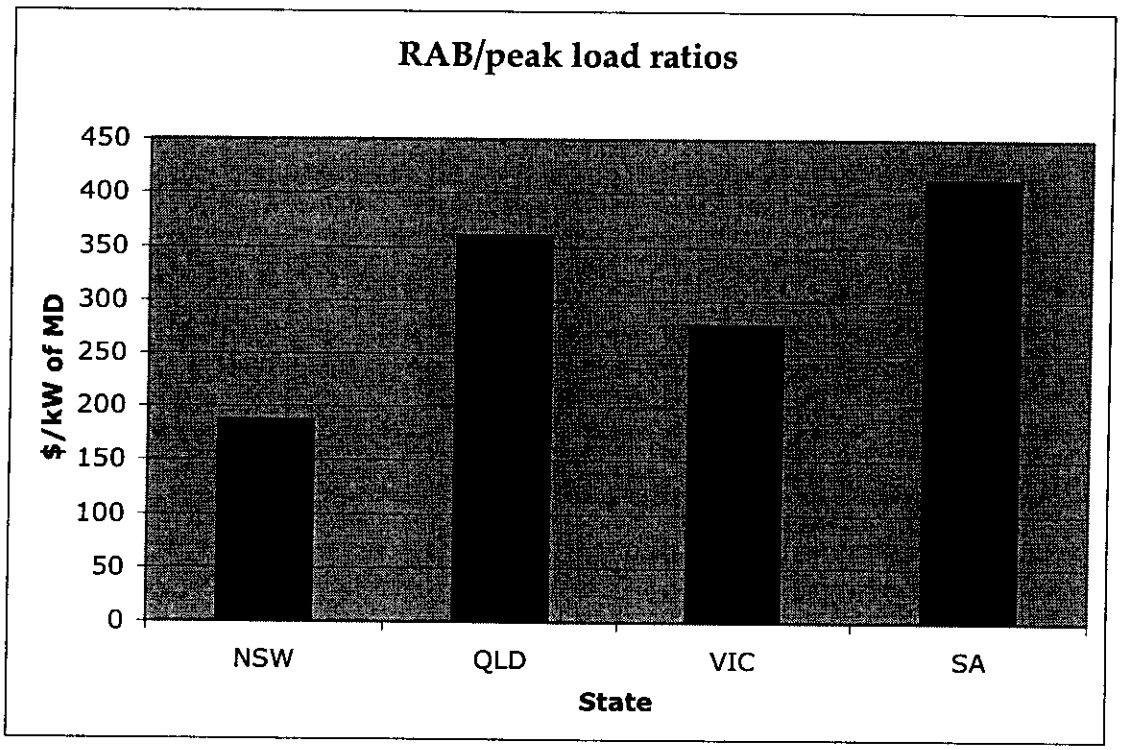
As mentioned previously, WMC has long harboured a suspicion about the methods used to value transmission and generation assets in South Australia, stemming from the sudden doubling of transmission asset values in 1995/96. WMC has no real confidence that the jurisdictional regulator's valuation (effectively set by the SA Government rather than SAIIR) is itself correct, and to simply roll forward this valuation and then add the three new factors in isolation — without reviewing the entire basis of the valuation — would be quite incorrect.

[10] At page 41.

Furthermore, since the transmission task is highly capital-intensive, the asset base adopted by the jurisdictional regulator must be a major contributory factor to the extremely high current South Australian transmission tariffs, and therefore must be subject to suspicion for this reason alone.

WMC believes that the ACCC should maintain consistency with the stance it has adopted in the case of Transgrid and Powerlink and do no more than to adopt the rolling forward of the 1999 jurisdictional regulators valuation of the ElectraNet SA network. Indeed, that valuation itself needs to be checked against deprival value.

To illustrate our concern about the initial RAB, WMC arranged for a comparison to be made between the RAB's assigned to other TNSP's (or requested in the case of SPI PowerNet) compared to their expected peak load in 2003. The comparison is shown in the graph below. It provides further evidence that the RAB being sought by ElectraNet SA is excessive.



WMC would also like to comment separately on the matter of the inclusion of easements in a regulatory asset base of a TNSP. WMC objects in principle to the inclusion, on any other basis apart from the actual cost of acquisition. Indeed, given ElectraNet SA's origins as an agency of the South Australian Government, many of these easements may well have been acquired by the Government and ElectraNet or its predecessors would have born none of the cost.

In the final decision of the NSW and ACT transmission network revenue caps, the ACCC listed some comments attributed to the SKM Group relating to the fact that electricity easements have unique characteristics:

"• a registered easement is the right to construct, operate and maintain the power

line and does not involve a ownership of the land under the line;

- a registered easement is usually granted in perpetuity. The corporation thereafter does not have to provide for replacement of the assets in the future nor to provide for depreciation;

- there are only minimal administration costs to the corporation associated with maintaining and operating the asset. The original vegetation clearing and access track construction are included in the line costs. Regrowth control and access track maintenance are included in the cost of line maintenance as it is mainly performed to ensure safety and security of the line .

- if the line is removed, the value in the books cannot necessarily be recovered."

SKM stated that these characteristics meant that it could be argued that the use of deprival value is inappropriate in its application to easements. All of the user organisations argue that easements should be valued at the actual cost of acquisition and no more.

WMC is in agreement with these sentiments and believes that easements cannot be included in the regulatory asset base on any other basis except the actual cost of their acquisition.

Future capital expenditure

ElectraNet SA has sought an estimated future capital expenditure programme which would add some 40% to the initial regulatory asset base which they seek, and over 50% of the rolled forward jurisdictional asset base. They have employed a complex probabilistic scenario approach in developing the capital expenditure forecast and adopted the weighted average of the results of the simulations.

There is insufficient information provided to make detailed comment on what they have assumed (the description covers a bare six pages of the submission) except to say that WMC must voice suspicion that, since every other element of the claimed revenue cap appears to be inflated significantly, it is logical to expect that future capital expenditure estimates may well be inflated also.

WMC expects that the ACCC will follow its usual practice and have the detail of the ElectraNet SA approach to future capital expenditure examined in detail by expert consultant and reduced to the minimum justifiable level

Future operations and maintenance expenditures

ElectraNet SA is seeking a future level of operations and maintenance expenditure of over $70 million per year from 2003 onward.

This represents an extraordinary increase over current levels, as is shown by the fact that the South Australian Transmission Code, issued by the SAIIR in October 1999, establishes a target level for operations and maintenance expenditures equivalent to $12.47/MW of maximum demand. When GST is taken into account, this amounts to an annual figure of only $38.4 million.

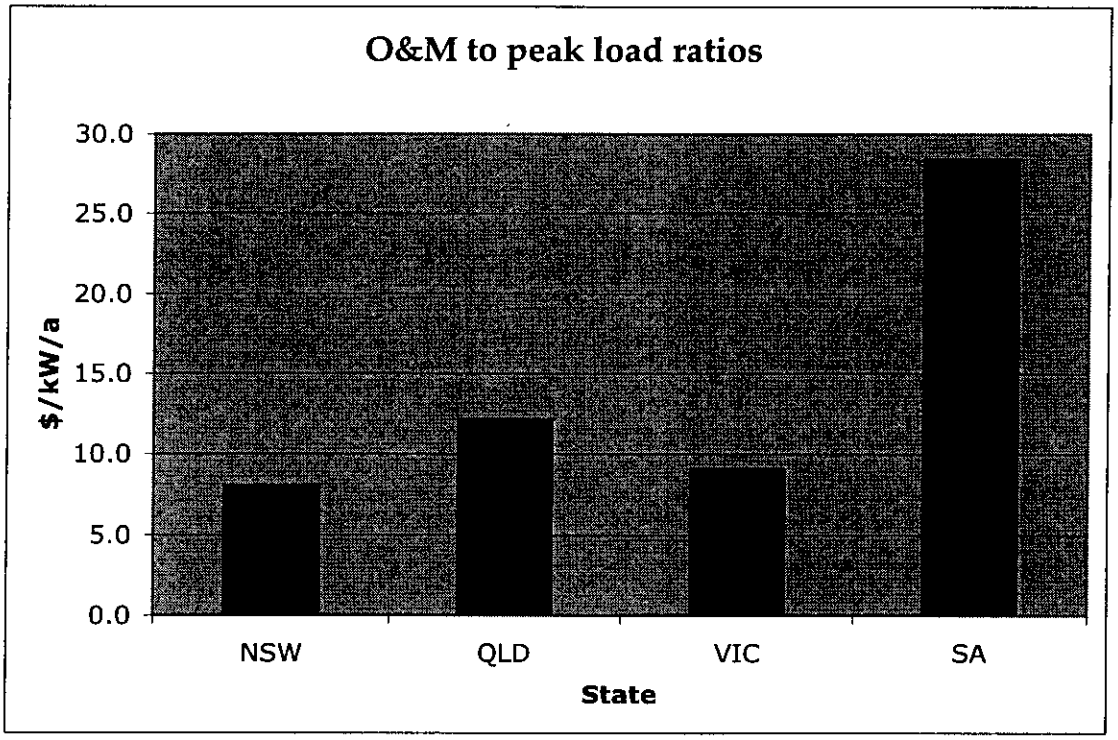
To put this another way, ElectraNet SA is seeking an 82% increase in the level of operations and maintenance expenditure felt to be justified by SAIIR and used as their

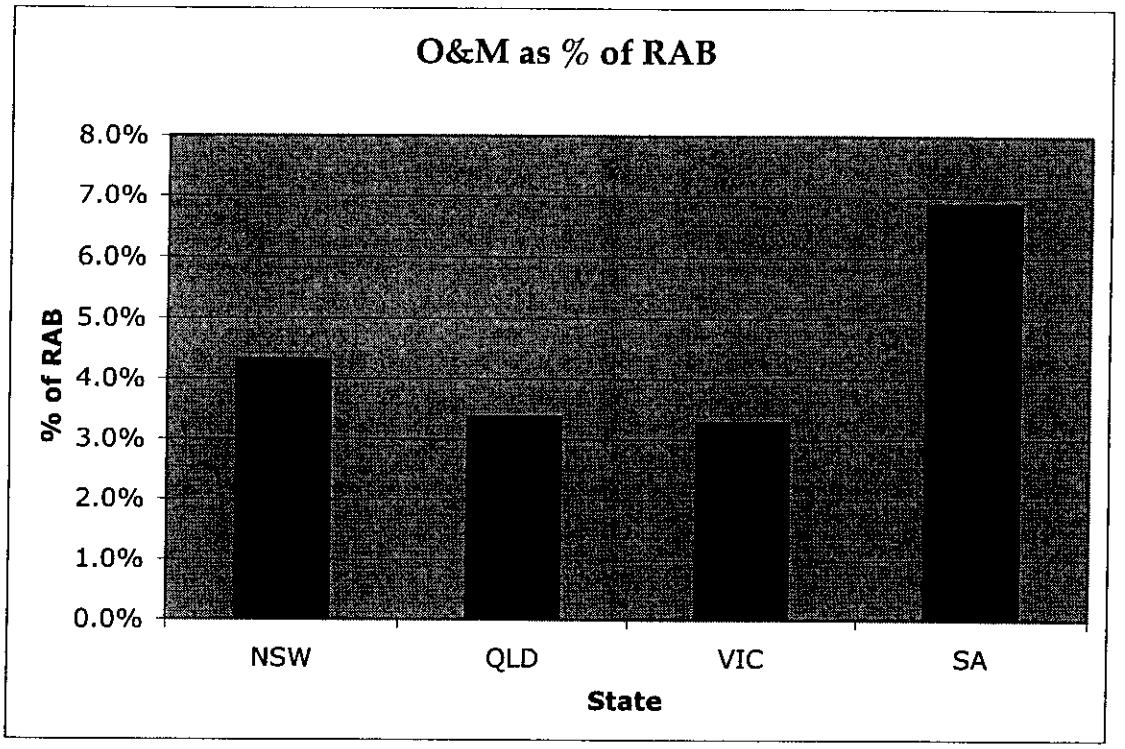
target in the SA Transmission Code. This level of increase seems unjustified at first glance.

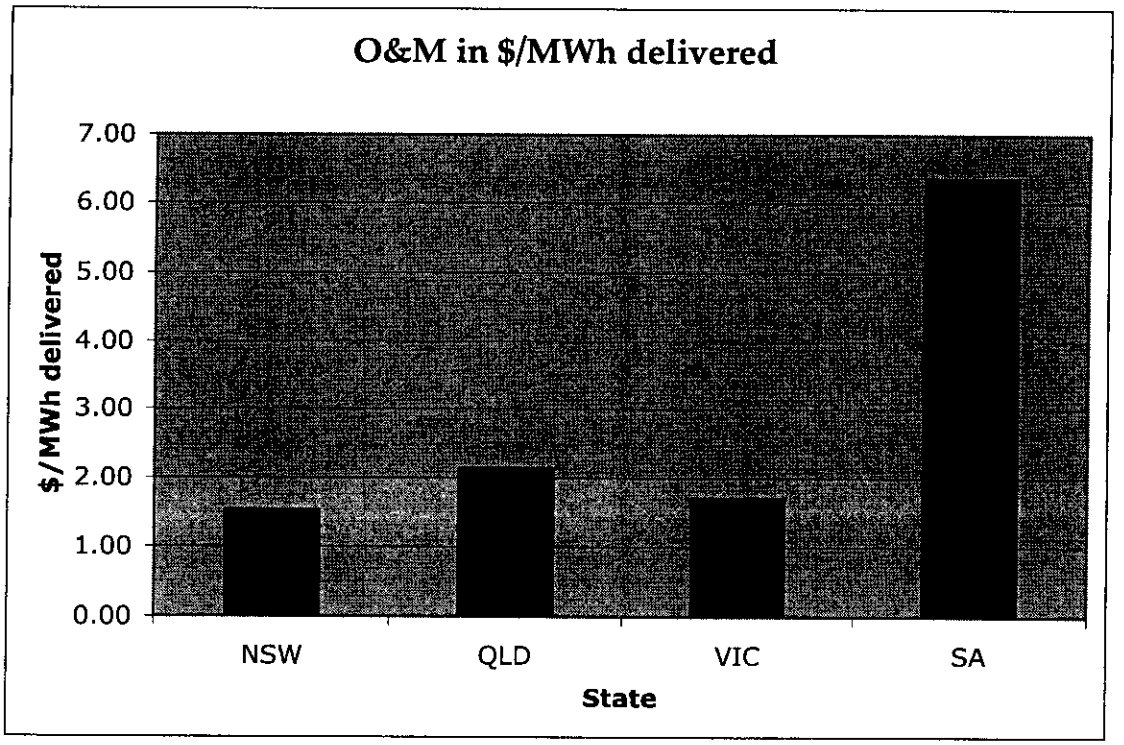
To further assess the reasonableness of ElectraNet SA's claims, WMC arranged to have a comparison made of the level of operations and maintenance expenditure authorised or claimed by the various TNSP's for the year 2003. This comparison was made on three different bases, as follows:

- total expenditure on operations and maintenance per MW of peak demand;
- total expenditure on operations and maintenance expressed as a percentage of the regulatory asset base (approved or sought as the case may be);
- total operations and maintenance expenditures expressed in dollars per MWh.

The results of this analysis is shown in the three graphs following:







Irrespective of the method used to compare the level of operations and maintenance expenditures, the levels claimed by ElectraNet SA are clearly excessive. Even if the target levels set in the SA Transmission Code were to continue to apply, ElectraNet SA would still exceed the levels of all other TNSP's on each of the above measures.

WMC expects that the ACCC will follow its usual practice and examine the detail of the calculations and assumptions used to produce the operations and maintenance sought by ElectraNet SA, and that it will reduce the level to minimumjustifiable levels.

Weighted average cost of capital

WMC has not had the time or resources to analyse in detail the date and assumptions which ElectraNet SA. and its external consultant have used in the establishment of its claimed WACC..

WMC expects that the ACCC will follow its usual practice and examine the detail of the calculations and assumptions used to produce the WACC sought by ElectraNet SA, and that it will maintain consistency with previous Determinations.

WMC notes however, that the "vanilla" WACC sought by ElectraNet SA is higher that sought by SPI PowerNet in its application, and also higher than that which emerged from the Commission's most recent Determination — that relating to Powerlink in Queensland.

We would also comment that WMC sees little merit in the repeated claims being made by the infrastructure owners that the Commission is allowing insufficient returns on invested capital, and that future levels of investments may suffer. One only has to look at the financial results which are achieved by ElectraNet SA and the other TNSP's to see that they are able to achieve levels of profitability well above those of listed companies operating over the same period. We further comment that that there is little real evidence — despite many threats — of a lack of incentive to invest in electricity and gas networks, and indeed plenty of evidence to the contrary.

7. Conclusions

WMC has long been critical of the handling of the transmission pricing regime operating in South Australia, both in relation to the very high transmission charges which apply in the State, but also in the way in which charges to specific customers have been made. WMC holds the view that the charges applicable to our Olympic Dam Operations (ODO), which consumes some 9% of the State's total electricity consumption, have been held at unjustifiably high levels under the Electricity Pricing Order which has governed transmission pricing in South Australia since 1999.

In the light of the past comments/criticisms by the ACCC, WMC believes that the ACCC should use its Determination of the ElectraNet SA revenue cap to require ElectraNet SA to eliminate the major problems inherited from the Electricity Pricing Order of 1999.

South Australia's average transmission prices are some 65% above the average of the other NEM States at the present time. Were the ACCC to accede to the claim made by ElectraNet SA, this gap would significantly widen — such that, at the end of the regulatory period, South Australia's average price would be more than double the average of the other NEM States.

This fact alone should be cause for the ACCC to take a highly critical approach to the ElectraNet SA application.

SPI PowerNet in Victoria, in their application lodged at about the same time as that of ElectraNet SA, is seeking a future revenue cap which allows them to continue to reduce the average real price of transmission services in that State, despite the fact that the average age of the Victorian system is arguably just as old as that in South Australia. A similar comment can be made in relation to the final revenue path and thus average tariffs determined by the ACCC for Transgrid in New South Wales, which also suffers from an aging asset base.

ElectraNet SA seeks to justify their extremely high revenue cap request by claiming that:

- the South Australia transmission system is less "dense" than those of the other States and that the density factor has a significant scale effect on the cost of transmission;
- The South Australian transmission system has reached an average age where substantial refurbishment and /or replacement is necessary; and
- past Management and Government actions in South Australia have neglected to invest in the transmission system, leaving a back log of works needing to be undertaken.

WMC has examined each of these reasons and found serious flaws in the ElectraNet SA analysis and claims.

WMC has analysed the four principal reasons for the high transmission tariffs in South Australia:

- the regulatory asset base;
- the level of operations and maintenance expenditures;
- proposed future capital expenditure; and
- the level of WACC being sought.

In each case we have presented evidence which throws doubt the ElectraNet SA claims and shows how much higher the ElectraNet SA claimed requirements are, compared to other TNSP's operating in the National Electricity Market.

Thus, it appears to WMC that ElectraNet SA is seeking a revenue cap which is quite unjustified, and for reasons which do not stand up to close examination.

WMC would be pleased to elaborate on our analysis and views as the ACCC consideration of the ElectraNet SA application develops.

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