



Draft decision

**Upgrade of electricity supply of the premises  
owned by Sietel Limited (ACN 004 217 734) at  
463–467 Warrigal Road, Moorabbin Victoria**

7 March 2011

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## Request for submissions

This document sets out the Australian Energy Regulator's (AER) draft decision on the proposed standard lease, provided by United Energy Pty Limited (ACN 064 651 029), on 31 July 2009 for an upgrade of electricity supply of the premises owned by Sietel Limited (ACN 004 217 734) at 463–467 Warrigal Road, Moorabbin, Victoria, 3189.

Interested parties are invited to make written submissions regarding this draft decision to the AER by **Wednesday, 6 April 2011**. The AER will deal with all information it receives in accordance with the ACCC/AER information policy. The policy is available at [www.aer.gov.au](http://www.aer.gov.au).

Submissions can be sent electronically to [AERinquiry@er.gov.au](mailto:AERinquiry@er.gov.au).

Alternatively, submissions can be mailed to:

Mr Chris Pattas  
General Manager  
Australian Energy Regulator  
GPO Box 520  
Melbourne Victoria 3001

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim; and
- provide a non-confidential version of the submission.

All non-confidential submissions will be placed on the AER website, [www.aer.gov.au](http://www.aer.gov.au).

Inquiries about the draft decision or about lodging submissions should be directed to the AER on (03) 9290 1436 or alternatively emailed to [AERinquiry@er.gov.au](mailto:AERinquiry@er.gov.au)

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# 1 Purpose of this draft decision

Sietel Limited (Sietel) requested from United Energy Pty Ltd, (United Energy) an upgrade of electricity supply at 463–467 Warrigal Road Moorabbin, Victoria, 3189 to accommodate Sietel’s tenants. On 31 July 2009, United Energy offered Sietel its standard contract which included its standard lease of 30 years with a 30 year option over the land, owned by Sietel, where the upgraded 750 kVA transformer would be situated. United Energy subsequently presented Sietel with a draft of a revised lease (‘the revised lease’) for Sietel’s consideration.

This paper outlines the AER’s:

1. Draft decision regarding the fairness and reasonableness of the terms and conditions of the lease, and hence the offer, offered by United Energy for the upgrade of electricity supply to the premises owned by Sietel Limited.
2. Draft view on the fairness and reasonableness of the revised lease.
3. Indicative views as to the steps United Energy could take to ensure that the terms and conditions of the lease, and hence the offer would be fair and reasonable.<sup>1</sup>

The AER welcomes submissions on this draft decision and the possible amendments United Energy could make to ensure that the lease is fair and reasonable.

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<sup>1</sup> While the AER can determine whether an offer is fair and reasonable, it cannot compel a DNSP to make specific offers.

## 2 Background

This draft decision relates to the offer, provided by United Energy Pty Ltd (United Energy) on 31 July 2009 for an upgrade of electricity supply to the premises owned by Sietel Limited (Sietel) at 463–467 Warrigal Road Moorabbin, Victoria, 3189 ('the Land').

Sietel's tenants required an upgrade of Sietel's site which would require more electricity post expansion. Therefore, Sietel requested an upgrade of electricity supply from a 500 kVA transformer to a 750 kVA transformer to accommodate the electricity need. Sietel contends that United Energy's first firm offer of 11 October 2006 to upgrade the electricity supply did not contain the requirement for a lease over the Land where the new transformer would sit and according to Sietel, based on this offer it undertook the upgrade of its site.

However, in United Energy's standard offer of 31 July 2009, United Energy offered to undertake the upgrade works for a cost of \$36,527<sup>2</sup> and under the condition that Sietel enters into a lease agreement with United Energy. The terms of the proposed lease run for a period of 30 years with a 30 year extension at the option of United Energy. Sietel contends that the requirement for the lease was only mentioned after the upgrade of the site was almost complete.

The AER understands that the current industry practice for supplying electricity to large customers, such as office buildings and large factories, is for the DNSPs to establish a customer dedicated substation inside the customer's premises because street low voltage mains would not have the required capacity to supply these customers. Such customer substations will contain one or more transformers to convert high voltage supply to low voltage supply. Other equipments, such as high voltage switches, may also be required inside the substation.

DNSPs typically enter into a lease agreement for the substation building/room to establish their rights to house their equipment as well as rights to access the equipment.

Sietel has, to date, declined to sign the connection offer from United Energy and considers that the terms of the connection offer are not fair and reasonable. Specifically, Sietel considers that the proposed 30 year lease with a 30 year option, exercisable only by United Energy, is not fair and reasonable.<sup>3</sup>

In the period since the offer of 11 October 2006, both Sietel and United Energy have proposed amendments to the standard offer. Sietel has also approached the Energy and Water Ombudsman (Victoria) and the Victorian Small Business Commission to resolve the dispute. However, parties have not been able to reach agreement on a suitable offer.

On 22 October 2010, United Energy provided a draft of a revised lease ('the revised lease') to Sietel. This draft decision paper also presents the AER's draft view on the

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<sup>2</sup> This amount was not required as an upfront capital contribution.

<sup>3</sup> Sietel, *email*, 19 July 2010.

fairness and reasonableness of the terms and conditions of United Energy's revised lease provided on 22 October 2010.

### 3 Authority to make a decision

The AER is responsible for compliance monitoring and enforcement of United Energy's Electricity Distribution Licence conditions which was previously undertaken by the Essential Services Commission of Victoria (ESCV). The power is conferred on the AER by the operation of the National Electricity (Victoria) Act 2005 (NEVA) in accordance with the Trade Practices Act 1974 and the Australian Energy Market Agreement.

Clause 12 of United Energy's EDL states that:

12.1 The charge for and terms and conditions on which, in the conduct of its distribution business, the Licensee provides any excluded service other than an excluded service contemplated by clauses 6, 7, 8, 9 or 10 must be fair and reasonable and consistent with:

(a) the Price Determination or any other applicable price determination made by the Commission; and

(b) any applicable approved statement

12.2 Any question as to the fairness and reasonableness of such terms and conditions is to be decided by the Commission on the basis of the Commission's opinion of the fairness and reasonableness of the terms and conditions.

Under the Tariff Order, part A paragraph 3 of the attachment, services for the specific benefit of any third party (and requested by the third party) that are not made available as a normal part of standard service to all customers are excluded services.<sup>4</sup> The upgrade of United Energy's transformer at Sietel's site, which is an asset for the sole use of Sietel (or its tenant), is not available as a normal part of standard service and would be installed at Sietel's request, meets the requirements of an excluded service. Therefore, the AER may determine the fairness and reasonableness of the terms and conditions of the offer to upgrade the transformer, which includes the lease.

The AER has issued this draft decision on the matter in accordance with clause 12 of United Energy's EDL and on the basis of the AER's opinion of the fairness and reasonableness of the terms and conditions.

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<sup>4</sup> The AER has classified excluded services as alternative control services.



## 4 Lease conditions

United Energy's revised lease terms of 22 October 2010 to Sietel differed from the lease terms in its offer of 31 July 2009 in that United Energy provided Sietel with the right to request the removal of the assets from the Land and in the event of the removal of the assets, United Energy would, on request, provide an executed deed of surrender. The key clauses of the Lease terms, including the length of the Lease are summarised below:

- The term of the lease is 30 years, with an option for a further term of 30 years (subject to earlier termination in accordance with clause 7 of the revised lease).
- The rental is set at the nominal fee of 10 cents per year payable on demand.
- Sietel will pay all rates, taxes, assessments and outgoings of every description payable in respect of the Land.
- United Energy may use the Land only as a site for an electrical substation and for other purposes incidental to the receiving, distributing, transforming and supplying of electricity.
- Sietel grants United Energy the easement rights set out in the Lease involving access to Easement Areas.
- United Energy has the option (to be exercised before the expiration of the Term by giving not less than 2 months' notice to Sietel) to renew the Lease for a further term of 30 years on the same covenants and provisos as the Lease.

United Energy's revised lease terms included a termination clause:

- Sietel may request United Energy to, at Sietel's cost, remove or relocate the electrical substation and other electrical apparatus and related equipment and installations from the Land prior to the expiry of the Term. Sietel acknowledges that United Energy may, at its sole discretion, determine whether to remove or relocate the substation from the Land having regard to a range of factors, including but not limited to:
  - the supply requirements of United Energy's customers; and
  - the suitability of potential replacement premises.
- If the electrical substation is removed from the Land prior to the expiration of this Lease, the Lessee will, upon request by the Lessor, provide the Lessor with an executed deed of surrender of this Lease.

## 5 Assessing the fairness and reasonableness of the offer

The EDL has no definition of what is fair and reasonable. As stated above, the NEVA specifically confers economic regulatory functions, powers and duties on the AER. This also includes the powers and functions to administer the ESCV's Guideline No. 14, which specify how DNSPs may charge for excluded services. This guideline does not define what could be considered as "fair and reasonable"; however, the ESCV's Guideline No. 1 which preceded Guideline No. 14 did provide some clarification.

Although Guideline No. 1 has been superseded by Guideline No. 14, it is useful, in conjunction with the EDL, to help the AER form its opinion on the fairness and reasonableness of United Energy's offer.

Electricity Guideline No.1 stated:<sup>5</sup>

Clause 4.8.4 The words *fair and reasonable* will be applied according to their ordinary meaning.

Clause 4.8.7 While the words *fair* and *reasonable* do not have identical meanings and the fairness and reasonableness of an offer may be assessed separately, if an offer is determined to be not *fair* or not *reasonable*, it cannot be said to be *fair and reasonable*.

Clause 4.8.9 Other general matters to which the Office may have regard in determining whether a term of an offer is *fair and reasonable* include –

- the relative bargaining strength of the parties;
- whether the term would be likely to have been negotiated by parties dealing at arms length;
- whether the term goes beyond what is required to protect the legitimate interests of the licensee; and
- terms offered by other licensees and retailers in similar circumstances.

Clause 4.8.10 Particular matters that may be taken into account by the Office in determining the fairness and reasonableness of a term of an offer relating to a matter not covered by the Tariff Order, these Guidelines or an Approved Statement of Charges include –

- the period for which connection services and supply (delivery services) is sought;

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<sup>5</sup> Office of the Regulator-General, *Electricity Industry Guideline No. 1*, 8 August 1995.

- the incremental impact of the applicant's load on the licensee's local capacity, including the nature of *augmentation* work needed to guarantee the level of service requested by the customer;
- the likelihood of an applicant ceasing to take supply (delivery) from the licensee's network.
- whether the term is consistent with the terms offered by a licensee to its retail arm in similar circumstances;
- whether the term offered to a franchise customer is different from a term offered to a non-franchise or contestable customer;
- in respect of an offer to a new generator, whether the term gives proper recognition to any enhancement of the distribution system by virtue of the generator's location within the system.

Clause 4.8.11 The above examples of matters that the Office may take into account in deciding whether a term of an offer not covered by the Tariff Order, these Guidelines or an Approved Statement of Charges is *fair and reasonable* are not exhaustive. Each matter will be decided on its merits having regard to the information available to the Office.

## 6 Factors under consideration

In forming the AER's draft decision on whether:

- the terms and conditions of United Energy's offer to upgrade electricity supply are fair and reasonable
- in the AER's view, the terms and conditions of United Energy's revised lease are fair and reasonable

the AER has considered:

1. the existing connection arrangements in place with respect to the Land and the anticipated period of connection
2. the cost of the requested upgrade
3. the financial imposition on Sietel from accepting the terms and conditions offered by United Energy
4. the financial and planning impositions on United Energy, in the absence of a 30 year lease
5. Sietel's right to request the removal of the transformer and subsequently terminate the lease early.

### **The existing arrangements in place with respect to the Land and the anticipated period of connection.**

The AER understands that there is no lease or ongoing agreement between Sietel and United Energy covering the existing 500 kVA transformer located at the premises and that the existing transformer is used solely for the purposes of Sietel's premises. Based on discussions with Sietel, the AER also understands that the existing transformer was installed many years ago and that the building, which is the subject of the connection, is now approximately 50 years old. Sietel has indicated that the existing building is likely to be repurposed sometime within the foreseeable future and that the new transformer will no longer be needed at that point in time.<sup>6</sup>

### **The cost of the requested upgrade**

The connection offer from United Energy places the cost of the upgrade at \$36,527.<sup>7</sup> This amount was not required as an upfront capital contribution, but required Sietel to enter into an agreement where it was required to pay a minimum kVA demand component. The AER understands that Sietel is not contesting the cost of the upgrade.

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<sup>6</sup> Sietel, *email*, 19 July 2010.

<sup>7</sup> Letter from UED to Aqua Max Pty Ltd, 31 July 2009.

### **The potential financial imposition on Sietel from accepting the terms and conditions offered by United Energy**

Sietel has contended that a 30 year lease (with a 30 year option) will significantly impact on the value of its landholding. Sietel has suggested that the property will be developed in the foreseeable future and that the transformer will not be required from that point in time.<sup>8</sup> Sietel has contended that the transformer is located in a prominent position and that while this position is acceptable for an industrial site, it would significantly impact the value of the land if re-developed and used for a different purpose.

The AER also notes that the rental amount contained in the lease agreement is a nominal fee and does not represent a commercial return on the Land.

### **The financial and planning impositions on United Energy, in the absence of a 30 year lease**

United Energy contends that a substation is a valuable asset, which benefits the customer and broader community and only a portion of the costs are recoverable from the customer. United Energy also contends that the 30 year lease is standard in the electricity industry and that as the assets have a life of around 50 years, 30 years is not unreasonable.<sup>9</sup>

United Energy stated that it has a large number of substations across their network and it is not practical to renegotiate these leases at the landowners request every few years. United Energy cited concerns that if it sets a more flexible lease with this customer, this may set a precedent and it would be required to offer shorter term subleases across their network and this would leave it with unsecure tenure for its assets.<sup>10</sup>

United Energy considers that should Sietel have the right to terminate the lease at any time, this puts at risk United Energy's ability to recover its costs as allowed by Guideline No. 14.<sup>11</sup>

### **Sietel's right to request the removal of the transformer and subsequently terminate the lease early**

The revised lease provided on 22 October 2010 includes a clause giving Sietel the right to request United Energy to remove the 'electrical substation and other electrical apparatus and related equipment and installations from the Land prior to the expiry of the Term'. If the substation is removed, then the revised lease requires that United Energy will upon request provide an executed deed of surrender of the lease.

However, whilst Sietel may request the early removal of the assets from its site, under the revised lease of 22 October 2010, the decision remains at the sole discretion of United Energy. The lease states that in making this decision United Energy may have regard to a range of factors, including but not limited to:

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<sup>8</sup> Sietel, *email*, 19 July 2010.

<sup>9</sup> Letter from United Energy to the AER, 28 May 2010

<sup>10</sup> Letter from United Energy to the AER, 28 May 2010

<sup>11</sup> Letter from United Energy to the AER, 28 May 2010

1. the supply requirements of the United Energy's customers; and
2. the suitability of potential replacement premises.<sup>12</sup>

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<sup>12</sup> Revised lease, 22 October 2010

## 7 AER considerations

The AER is not aware of any reasonable commercial, technical or safety reason that would prevent United Energy from offering a connection agreement which more closely reflects the needs of Sietel. In forming this view, the AER is aware that the transformer is for the dedicated use of Sietel (or its tenants), and does not form part of the shared network serving other customers. Therefore, the AER considers that United Energy's arguments in relation to network planning and benefits to the broader community are not as relevant as the asset is not used by any other customers. The transformer does not provide a service to the broader community and so its costs are only recoverable from Sietel. Therefore, the AER does not share United Energy's concern that it will not be able to recover the costs of the transformer because only a portion of the costs are recoverable from Sietel.

The AER considers that the 30 year lease (with a 30 year option) appears overly onerous and goes beyond what is required to protect United Energy's legitimate interests when compared to the incremental nature of the upgrade and the total cost involved in performing the upgrade. Whilst, as noted by United Energy, the transformer may have a life of around 50 years, this does not in itself justify the term of the lease. This is especially the case since United Energy has options available to ensure that it can recover the fair costs of the asset over the period for which it is installed at Sietel's premises and prior to the end of the asset's useful life.<sup>13</sup> In addition, the AER understands that United Energy can continue using the transformer (assuming it has not reached the end of its useable life) at another site once it has been removed from Sietel's site.

Further, the AER considers that were the two parties negotiating this connection with equal bargaining strength, it is unlikely that commercial negotiations would result in a lease being agreed which is substantially longer than the period for which the asset is likely to be required by the customer.

The existing building and transformer have been in place for many years and there is currently no lease over the Land which holds the transformer. The AER accepts United Energy's contention that this is not a desirable position to be in. Further, the AER considers that before performing this upgrade it may be fair and reasonable that United Energy be granted a lease over the land and that United Energy be provided with reasonable certainty that it will recover its costs. However, the AER considers that Guideline No. 14 provides sufficient flexibility to allow United Energy to recover its costs for the period of time which the asset is installed at the location, including installation and removal costs, whilst allowing for alterations from a standard contract. Therefore, United Energy's concern that it may not be able to recover its costs as allowed by Guideline No. 14, is not justified.

In Sietel's circumstances it appears appropriate that, under clause 3.3.3(a)(1) of Guideline No. 14, a life shorter than 30 years is assumed. It appears unlikely that Sietel will take supply from the 750 kVa transformer for 30 years and so a shorter

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<sup>13</sup> United Energy can achieve this by altering the default 15 year connection life assumed for a non domestic customer under Guideline No. 14, as allowed under clause 3.3.3(a)(1).

term will better provide United Energy with the certainty of recovery of the costs associated with the transformer. The AER considers that United Energy should take account of the period for which the service is sought and adjust the lease term accordingly in this situation.

The AER considers that if United Energy adopt a customer connection life shorter than 30 years, then United Energy should have regard to the principles the AER outlined in *'The AER's Conclusion on The Benchmark Upstream Augmentation Charge Rates for CitiPower's Network'* guidance paper when recalculating Sietel's capital contribution. Although the guidance paper was in relation to upstream augmentation charges, the AER considers that the following principle could apply for adjusting connection charge for a shorter connection life:

Where there is zero possibility for reuse of an asset once a customer leaves the network, then it would be appropriate for the connecting customer to meet the full cost of installing those assets. However, where there is a reasonable likelihood that a distributor can reuse the asset or recover some of the cost of the assets once a customer leaves the network, it would receive a windfall gain if it charges the connecting customer the full cost of these assets. ..

...The AER considers that in calculating the component of incremental costs attributable to upstream augmentations, CitiPower must take into consideration the prescribed connection life of the connecting customer. That is, CitiPower should only charge new connecting customers for the costs attributable to their connection life, Guideline No. 14 assumes this to be either 15 or 30 years.<sup>14</sup>

The revised lease includes provisions allowing Sietel to request removal of the sub-station and a subsequent early termination of the lease. However, it remains at United Energy's sole discretion whether or not to remove the assets and terminate the lease. As such, the full 60 year term of the lease could be enforced by United Energy with no recourse available to Sietel. The AER does not consider the termination clauses fair and reasonable.

The AER accepts United Energy's preference to offer standard lease terms to all connecting customers. However, the AER considers that inflexibly applying a standard period lease to all connections regardless of the size, cost, location of the assets and the circumstances of the land may, in some cases, result in the terms and conditions not being fair and reasonable. In some circumstances, having regard to factors such as the ones considered in this draft decision, including; that the transformer is for the sole purpose of Sietel, the incremental nature of the upgrade, and the time Sietel expects the transformer to be on its land, United Energy may consider offering contracts which differ from its standard contract.

The AER considers that customers would generally prefer longer term connection arrangements rather than short-term agreements—as short-term agreements would involve additional administration costs for the negotiation of a non-standard lease and may also result in higher connection charges because of shorter pay back period for the DNSP and the associated cost of removing a DNSP's connection assets at the end of the short-term lease. However, it is likely that short-term connection agreements

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<sup>14</sup> AER, *The AER's Conclusion on The Benchmark Upstream Augmentation Charge Rates for CitiPower's Network'* guidance paper, 25 June 2010, pp. 10, 11.



would be more appropriate for situations such as this Sietel case and other short duration projects.

The AER does not expect this draft decision to set a precedent for a significant number of United Energy's customers not choosing to have a contractual arrangement departing from United Energy's standard practice. Where a dispute arises the AER will assess each customer's specific circumstances in determining whether the terms and conditions of the offer are fair and reasonable.

The AER notes that there is merit in having standard offers and this decision is not a decision on the fairness or reasonableness of United Energy's standing offer. Rather it only relates to the specific request by Sietel on the fairness and reasonableness of United Energy's offer to this specific Sietel site. This decision is not intended to impede United Energy's ability to provide a standard offer to its customers.

## **8 AER draft decision, draft views and preliminary position**

### **8.1 AER draft decision on the offer of 31 July 2009**

After consideration of the circumstances, the AER's draft decision is that the terms and conditions in United Energy's offer of 31 July 2009 are neither fair nor reasonable. Specifically, the 30 year lease term with a 30 year option is not fair and reasonable. The AER makes this draft decision in accordance with United Energy's EDL having regard to Guideline No. 1 to assist the AER in forming its opinion of the fairness and reasonableness of the terms and conditions.

### **8.2 AER draft view on the revised lease of 22 October 2010**

The AER's draft view of United Energy's revised lease of 22 October 2010 is that the terms and conditions (specifically those pertaining to the 30 year lease with a 30 year option) are neither fair nor reasonable. The AER has come to this view because, although Sietel can request the transformer to be removed from the Land, which will result in the termination of the lease, the removal of the transformer is still at the discretion of United Energy. This term is not sufficient to offset the AER's concerns with the length of the lease. Therefore the AER considers that an offer with this term will not be fair nor reasonable

### **8.3 Preliminary position on what the AER might consider fair and reasonable**

Whilst the AER can determine whether an offer is fair and reasonable, it cannot compel a DNSP to make specific offers. Therefore, the AER will outline its preliminary position on what it may consider to be fair and reasonable in this circumstance. The AER's preliminary position is that United Energy has at least two options available to make the terms and conditions of the lease provided to Sietel on 31 July 2009 fair and reasonable:

1. Provide an offer with a lease of shorter duration that is reflective of the operational needs of Sietel.
2. Provide a lease with a guaranteed right of termination by Sietel.

The AER accepts that United Energy should be granted a lease over this land before installing the transformer. The AER considers that a lease of 5 years with a 5 year extension option available at Sietel's request (should it still have the need for the transformer) will more closely suit Sietel's needs as indicated by Sietel.<sup>15</sup> The AER considers that the length of this term is fair and reasonable having regard to Sietel's needs and United Energy's administration costs. Therefore, the AER's preliminary position is that, in this case, a lease of no more than 5 years (with a 5 year extension option available at Sietel's request should it still have the need for the transformer) would be fair and reasonable.

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<sup>15</sup> Sietel, *email*, 17 February 2011.

An alternate option is that United Energy provides Sietel with a lease that grants Sietel a unilateral right to terminate the lease. The AER considers it fair and reasonable that as a condition of this right to terminate the lease, Sietel must provide a reasonable period of notice of its intention to terminate the lease. The AER's preliminary position is that six months notice is likely to be fair and reasonable in this case.

## 9 Submissions

The AER requests submissions on its draft decision paper. In particular, the AER seeks submissions on:

- the AER's draft decision is that the terms and conditions of United Energy's 31 July 2009 offer to Sietel are neither fair nor reasonable. Specifically that the term of the 30 year lease with a 30 year option at United Energy's discretion is not fair and reasonable in the circumstances of this case.
- the AER's draft view that the terms and conditions of United Energy's revised lease of 22 October 2010 are neither fair nor reasonable. Specifically that the option for early termination of the lease at United Energy's discretion is not sufficient for the AER to consider the remaining terms and conditions to be fair and reasonable
- whether a lease of 5 years with a 5 year option available at Sietel's request, should it still have the need for the transformer, is fair and reasonable for both Sietel and United Energy
- whether providing Sietel with a unilateral right to terminate the lease, after a notice period of six months, is fair and reasonable for both Sietel and United Energy