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Mr Sebastian Roberts  
A/g General Manager  
Regulatory Affairs – Electricity  
Australian Competition and Consumer Commission  
PO Box 1199  
DICKSON ACT 2606

Dear Sebastian

**ACCC Preliminary View of Murraylink**

The Electricity Consumers Coalition Of SA and the Energy Consumers Coalition of Victoria would like to provide views with regard to the ACCC Preliminary View of Murraylink. Accordingly, they have combined to present their views resulting from the ACCC Preliminary View of Murraylink application for regulated status and the ensuing public forum. We apologise for the late submission, but we required more time to address the issues raised at the forum and in subsequent discussions, and to prepare additional analysis.

We would add that comments made below are in addition to the views espoused at the Murraylink forum by ECCSA and EUCV.

**The automatic right to “safe harbour”**

We strongly support the views put so forcefully by Minister Conlon at the forum regarding the automatic right to “safe harbour”. The issue as to the right of a market network service provider to rely on the “safe harbour” provisions was not clearly addressed in the Preliminary View, and the issue as to whether an MNSP can be granted an automatic right to conversion to regulated status in the absence of any defining change in the electricity market, was also not addressed in the Preliminary View.

As we pointed out in our presentation we are unaware of any substantive changes in the NEM that would warrant the right to exercise “safe harbour” provisions, and we commented that our assessment of the application by Murraylink is purely an economic one – Murraylink would appear to be earning insufficient revenue to satisfy its investors and perhaps its bankers. If this is the case, as any business operating in the commercial environment knows, the fact that financial losses are being incurred should not automatically engender the right to rely on guaranteed contributions from the public. A number of our members have been exposed to changes in government policies (eg the removal of tariff barriers) which have placed many businesses in Australia at risk. There has been no automatic right to recompense from government which results in a guaranteed ongoing revenue because the business made inappropriate investment.

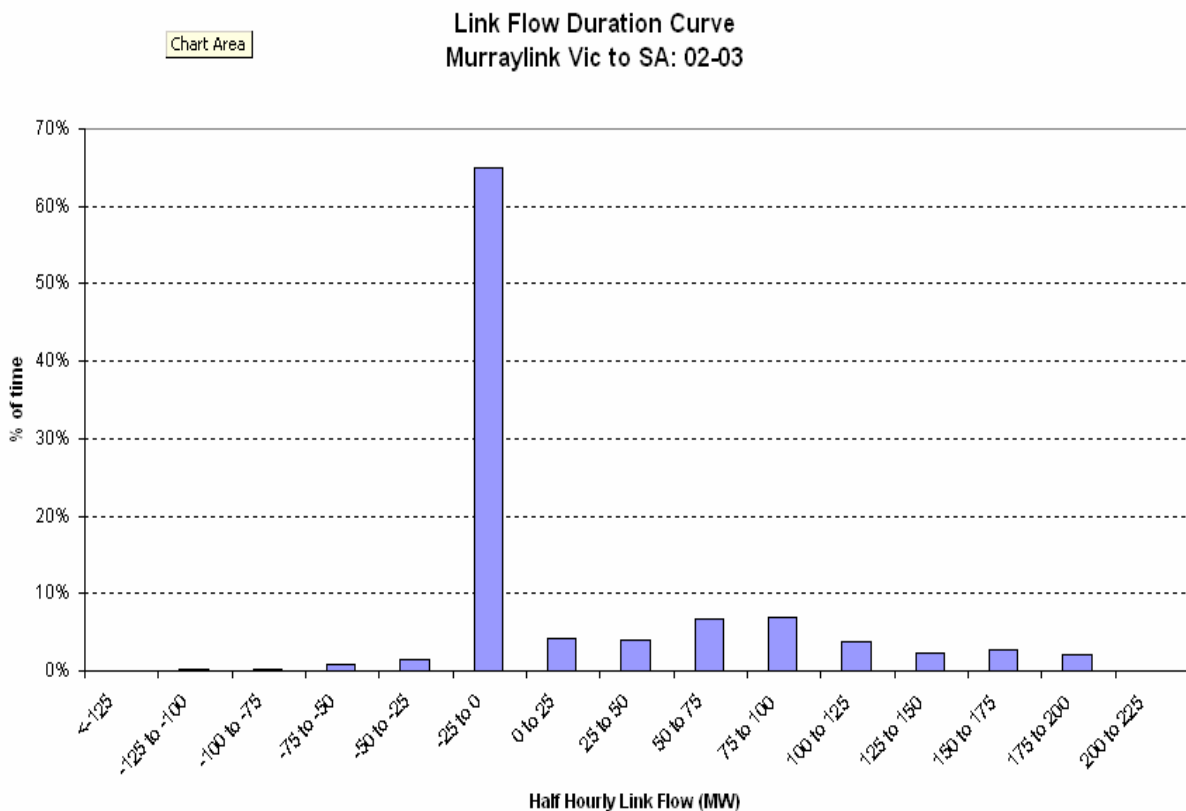
As was put by Minister Conlon so succinctly, there must be a hurdle required before the ACCC should allow the exercise of its discretion as to whether conversion should be permitted. No party to the debate has delineated such a hurdle as yet, except that Murraylink, as would be expected, believes that no such hurdle is necessary.

We are therefore very strongly of the view that the ACCC should examine the right to “safe harbour” for Murraylink, as a market based network insert, to be permitted the right of conversion to regulated status in the absence of any externality initiating the exercise of ACCC regulatory discretion.

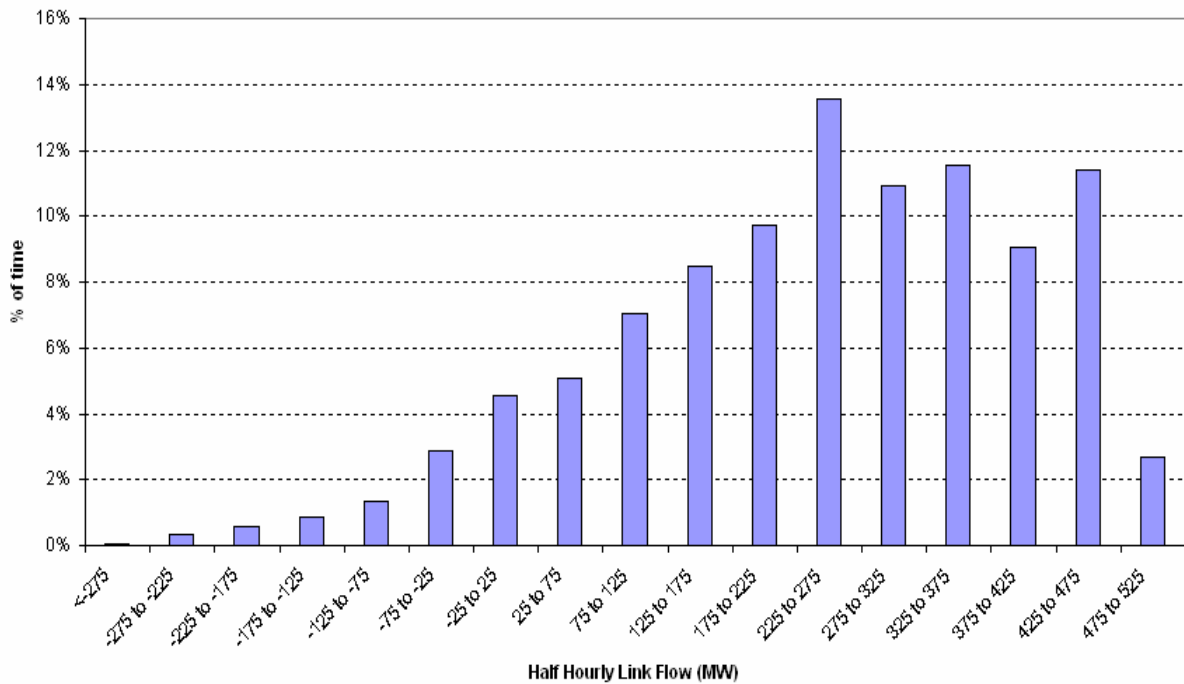
### The Murraylink benefit

During the forum and later in further submissions, there has been considerable debate as to what the system needs are that a “regulated Murraylink” will be assumed to fulfil.

So far neither the ACCC nor Murraylink has established that there is a need for the full 220 MW transfer capacity from Victoria to SA that Murraylink is assumed to provide. In fact a review of the actual transfers on Heywood and Murraylink since Murraylink commenced operation is quite intriguing.



Link Flow Duration Curve  
Heywood Interconnector: 02-03



The usage of Murraylink is quite modest compared the that of the free flowing Heywood interconnector which for 2002/03 operated in a pattern indicating that for much of the time the SA region requires considerably less power from Victoria than the notional additional capacity of Murraylink offers. In a like way the Victorian power needs from the SA region appear much less than Murraylink has the capacity to provide. This supports the view that the real needs for transfer between the two states could well be satisfied by the low cost “overlay” augmentation of Heywood (“Southernlink”) which provides an increase in transfer capacity of 140 -160 MW, and which avoids the challenges faced in building new assets through national parks, with the attendant environmental problems.

As it currently stands, no party has yet defined what the system needs are for a transfer of power between SA and Victoria. This is an activity normally undertaken by the IRPC with assistance of the IOWG. There has been no independent study undertaken to assess the needs of the SA, NSW and Victorian regions (such as when SNI was being examined).

The need for such studies was built into the National Electricity Code to ensure that there is a careful review of the needs of the national network before approval is granted for any regulated interconnection. Murraylink has neatly avoided such inquiry and there is now an assumption, prevalent but unproven, that Murraylink comprises the optimum sizing and power route, and all alternatives should be based on the Murraylink design. There has been no independent confirmation to deny or prove this assumption.

The approach taken by the ACCC has placed the owners of Murraylink (a private company) in a unique position to decide from an effectively unsupervised viewpoint what

the parameters and needs should be for regulated assets in the NEM. This is being permitted without any of the discipline imposed on government agencies or the owners of regulated assets who are required to have responsibility for the adequacy of the network.

As a stop gap measure ESIPC of SA has undertaken some preliminary work as to the needs of the SA region and from this it can be assumed that ESIPC has identified that there is doubt as to whether the full capacity of Murraylink is needed in the short term for the whole of the SA market, whether there is any short term value (ie prior to the latter part of this decade) provided by Murraylink in deferring investment to the Riverland region, and what will be the value of Murraylink when SNI is operating. As a result of this work there is considerable doubt as to when and whether the full benefit of Murraylink will ever be delivered.

There is no doubt that the approach taken by Murraylink has allowed it to bypass the normal inquiry that a new regulated link must undergo to ensure the optimum solution is achieved. The ACCC must address this major shortcoming in its assessment of Murraylink and indeed any other market interconnector that seeks to access the safe harbour provisions when it appears that the investment will not return the revenue anticipated.

### **The regulated capital cost to be allowed for Murraylink**

The forum raised a number of issues regarding the value which might be assigned to Murraylink if an alternative design and route between Red Cliffs and Monash was to be used as the valuation basis – most of the work was concentrated on alternative three.

In addition to the work carried out by TransGrid, valuation of the alternative three by ElectraNet, ESIPC and the NSW Government (via an SKM report) indicates that after allowing for adjustments, at most the capital value of alternative three would be of the order of \$70,000. This is in stark contrast to the value of \$114,000 assigned by the ACCC to Murraylink in its Preliminary View.

The ACCC has released for comment a letter dated 31 July 2003, from the Victorian Department of Sustainability and Environment (DSE) which gives a view that not only will parts of an interconnector between Red Cliffs and the SA border have to transit some national parks, but that as Murraylink has demonstrated that their technology minimises an implied negative environmental impact of overhead power lines, the DSE evinces a preference for the Murraylink technology to be used. Thus any application for power line construction made now will be influenced by the Murraylink approach to construction, even though at the time of its construction, an alternative design and route may have been acceptable. Thus to apply the standards of today is inappropriate when assessing the value of alternative designs.

If the ACCC is of a view that the cost of the Murraylink proposed alternatives may be affected by the views expressed in the DSE letter, then this decision reinforces the need to assess the capital cost of other (remote) alternatives to Murraylink which may equally satisfy the needs of the two regions.

Because of its failure to obtain and consider detailed analysis of the needs of the SA and Victorian regions through an assessment such as would be carried out by the IRPC and the IOWG, the ACCC has failed to consider that there are more alternative solutions to

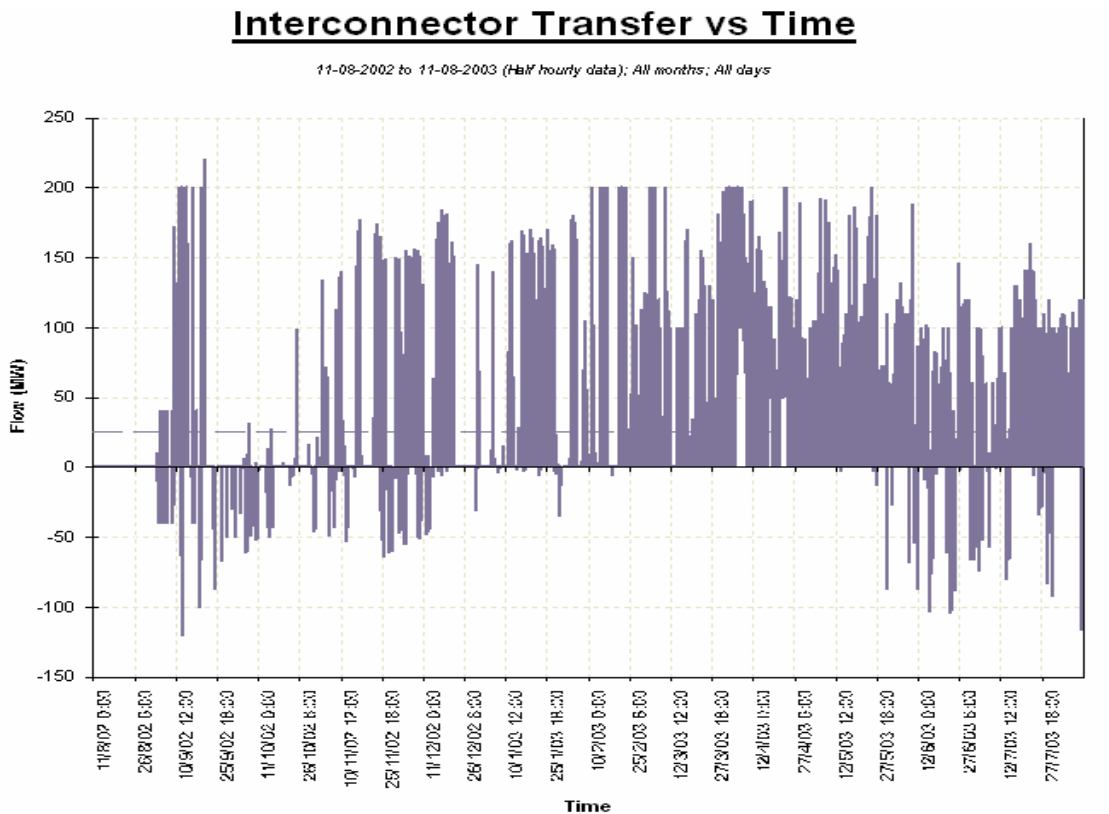
providing the service that Murraylink provides other than those advised by Murraylink and implicitly accepted by the ACCC as the only alternatives to be considered. A number of these other alternatives were suggested to the ACCC at the forum by ECCSA, ESIPC, ElectraNet and others.

The ACCC must consider other alternatives to those suggested by Murraylink, and ECCSA would strongly recommend that the ACCC seek the assistance of the IOWG and the IRPC to assess the needs of the regions and the optimum solution for servicing these needs as an independent review. We accept that these groups include representatives from organisations which may have competing interests to those of Murraylink, but there is no doubt that independent and competent analysis of the national network system needs, must be a primary driver to identifying the optimum solution.

To permit Murraylink to use a “backdoor” approach to have its apparently failed entrepreneurial link converted to regulated status without the rigour of independent analysis which applies to other proposed regulated assets, will be a failure by the ACCC in its role as the national electricity network regulator.

### Capacity and future capex

There is considerable debate as to what capacity value should be placed on Murraylink. Currently Murraylink can only safely transfer on a continuous basis 180 MW from Victoria to SA and perhaps 120 MW as a reverse flow. This is shown in the following figure.



The limits on Murraylink transfer capacity are predominantly related to the capacity of the despatching and receiving regions to accommodate these power flows. The ACCC has

assumed that investments will be made in the two regions to permit Murraylink to operate at its full capacity and so has calculated values for alternative designs on this basis. As such augmentation is beyond the capacity of Murraylink to carryout, this assumption is clearly invalid, and the ACCC must assess Murraylink at the capacity constrained by the other networks.

Further the ACCC has proposed inclusion in the Murraylink revenue, capex for investment in networks owned by other parties to achieve the rated capacity of Murraylink. This is also invalid, effectively becoming a “double dip” on consumers and does not necessarily mean that the capex will be spent.

There is no doubt that the ACCC must only assess the capacity of Murraylink based on the system ability to manage the needed transfers. By failing to involve the IRPC and the IOWG in the assessment of the system needs, the ACCC has failed to incorporate this major shortcoming in its review of the Murraylink application.

## **The WACC**

Murraylink maintains that the views of its consultants must be granted more credibility than those of end users, and the ACCC has tended to support the views of Murraylink in setting the values of the key elements of CAPM formulae. Neither the ACCC nor Murraylink have provided any reasons why the end user views are incorrect!

Some recent work on WACC element benchmarks and further research by end users into MRP and equity beta is in the process of being carried out, but the preliminary results of investigations can be summarised as follows.

- a. The ASX accumulation index is a reasonable surrogate for the equity held in all publicly listed companies. The annual change in the ASX accumulation index over the past 30 years has averaged 13.1%, whilst at the same time the 5 and 10 year bond rates have averaged 9.36% and 9.54% respectively. Annual inflation as measured by the CPI was 6.5%. Thus, the reward for “risk free” investment over the past 30 years was about 3% real, and for investment in equities, 6.6% real. The risk premium for investment in a range of equities (notionally at an equity beta of 1.0) has therefore averaged 3.6%.
- b. The ECCSA has just received funding to examine MRP and equity beta covering the larger public and private businesses. This work is to analyse the past ten years of returns of the 300+ largest (by sales) Australian public and private companies with the source data provided by IBISWorld. The initial findings are that the weighted average gearing (debt to total company assets) of all these companies is 77% and after “re-levering to 60% gearing”, the MRP is 4%. Further analysis is proceeding to identify the equity beta for the cash stable enterprises included in the sample, so that an equity beta can be measured for businesses similar to a regulated transmission company. The preliminary findings are available to be discussed with ACCC staff.
- c. Other work carried out in identifying what is an appropriate MRP includes
  - NERA (2001) for the ACCC found that equity returns granted by Australian regulators are significantly higher than those of overseas regulators;

- Pareto Associates (2002) for BHP Billiton (GasNet) and EUAA (PowerNet) confirmed this trend, identifying MRP and equity beta's in Australia as the prime cause of an overly high Australian WACC, and that overseas regulators set MRP at about 3%; and
  - Mercer Consulting (2002) for ESCoV opined that MRP should be ~3% points.
- d. Fund managers commonly state they can out perform “the index” by 1-2% points and for this receive a fee. Research recently performed shows that on average, fund managers have not exceeded the benchmark even to the extent of returning their fees, let alone the benchmark out performance. Thus forward looking benchmarks can be seen as regularly overstating the real performance, throwing doubt as to whether forward looking benchmarks should be used at full value, or discounted.
- e. An underlying view stated by most regulators in past decisions is that MRP at 6% is “at the high end of the range” but they then use this figure due to the lack of new data on which to vary the consensus view, commenting that to change increases regulatory risk and the impact of price shock if the number is reduced. Consumers would respond to these observations on the basis that to overly reward regulated businesses is not part the regulatory bargain.
- f. Work continues to identify an appropriate equity beta. The ACCC has previously used an equity beta of 1.0, but this implies that the regulated business has an investment risk profile the same as the average of all risk taking enterprises. This would appear to be incorrect as a guaranteed revenue with a five year known forward income must be considered as having a lower risk than the average.
- g. Further work with relation to equity beta includes the results of the Allen Consulting Group analysis for the ACCC (2002), where ACG found that for local and international gas transmission companies equity beta ranges from -0.3 to 1.04, averaging 0.3 to 0.4. Gas transmission companies have perhaps a higher risk profile than electricity companies, as the Gas Code places some of the risk for usage volume with the gas company, whereas the electricity code insulates the business from volume risk.

The data provided above is relatively recent and regulators should recognize that continuing with inflated elements for the CAPM formulae, only continues to provide an incentive to regulated businesses to maximize their asset values and planned capex.

On balance there is an increasing body of evidence that MRP and equity beta suggested by regulated businesses and used in the CAPM formulae by regulators, are too high.

As a result we recommend that the ACCC reduce the allowed market risk premium to 4%, and the equity beta to 0.4-0.5.

We also note that the ACCC has allowed a debt margin of 1.45. We recommend that the debt margin be the same levels as those awarded recently to ElectraNet and PowerNet, at 1.2

## The allocation of cost between regions

The ACCC was silent in its Preliminary View as the acceptability of the proposed allocation of Murraylink revenue between ElectraNet and PowerNet. As we understand, the proposed allocation is for each regional regulated business to pay Murraylink half of the regulated revenue. The ACCC has made no comment as to the appropriateness of the proposed allocation.

In the absence of any analysis to demonstrate that an equal sharing of costs, we would accept this allocation as reasonable.

However it is a failing of the ACCC not to have had greater involvement of the IRPC and the IOWG in this entire review process, as one of the outworkings of their investigations would be a recommendation for cost allocation based on the relative values each region receives from the integration of the a new regulated asset into the national network.

## Conclusions

What is now to be provided to consumers is an asset which has apparently failed as a market driven investment and will now be “given” to the national market as a regulated asset which consumers must pay for. The ACCC must not allow business risks to be transferred to consumers in such a way.

The implication of the Preliminary View is that the ACCC has accepted in principle integration of Murraylink into the national network at consumers expense, despite the fact that a regulated Murraylink

- has dubious credentials for automatic integration into the national network
- has a useable capacity for which the quantum is hotly debated and requires further investment by other parties to achieve its claimed rating
- still has an inflated asset value, based on dubious criteria
- has an overstated WACC, and
- does not provide a reasoned direction as to cost allocation

With such a history, it is apparent that the ACCC has not fully addressed the issues which will ultimately have a heavy cost impact on electricity consumers.

Yours sincerely

John Pike Chairman, EUCV	Rod Davidson Chairman, ECCSA
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