Hydro Tasmania
the renewable energy business

30 April 2003

Mr Sebastian Roberts
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Dear Mr Roberts,

Transend Networks' Revenue Cap Application
Hydro Tasmania's Submission

Thank you for the opportunity to submit Hydro Tasmania's response to Transend Networks' Revenue Cap Application ("Application"), which was lodged with the Australian Competition and Consumer Commission ("Commission") on 14 March 2003. Hydro Tasmania has provided a submission in response to the Application as it has an interest both as a generator and because it is exposed to transmission charges through its Major Industrial Vesting Contracts[1]. I also appreciate the extension to the submission date agreed with your staff.

As you are aware, Hydro Tasmania has promoted the Tasmanian Government's energy policy by developing Basslink and wind generation, upgrading existing hydro facilities and Bell Bay, and pursuing Tasmania's entry to the National Electricity Market. Above all, these initiatives seek a level playing field across Tasmania through efficient electricity pricing.

In stark contrast, the Application, as it stands, would deliver unjustified and unacceptable price shocks to transmission customers – with increases of up to 72%[2]! The move to the Commission's jurisdiction must not enable opportunistic increases in transmission revenues, with the attendant risk of bringing the whole energy reform process into disrepute. ***As such, the Commission must reject this ambit claim.***

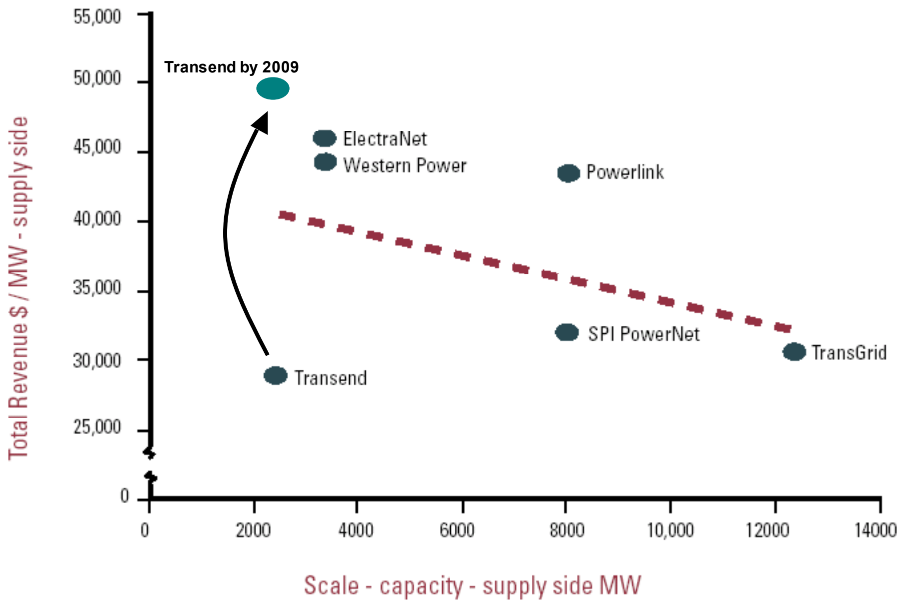
[1] Contracts entered into to support the Tasmanian Government's disaggregation of the Hydro Electric Corporation in 1998.
[2] Approximate percentage increases based on 2003 AARR and 2004-05 (a 40% overall increase in forecast revenue) and 2008-09 (a 72% overall increase in forecast revenue) ($ 2002-03).

A detailed submission is attached containing our concerns with the Application and the main areas where we consider that the Commission has scope to redress the balance. The primary deficiencies in the Application are:

- **The operating and capital expenditure forecasts are overstated**

  In its Application, Transend relies on benchmarking to demonstrate that its overall level of costs are efficient. However, Transend dismisses the more widely accepted ITOMS benchmarking approach on the basis of a Pacific Economics Group report which is not provided. ITOMS found Transend to be higher cost than other Australian and New Zealand transmission utilities, using a methodology which has been developed over many years.

  However, even Transend's preferred approach demonstrates that allowing the Application would result in it becoming one of the worst cost performers in Australia, and even when discounting economies of scale (as illustrated below).



Source: Transend Application Page 11 and Page 97
(Changing Total Revenue – other quantities assumed constant)

  Transend has consistently underspent the capital forecast provided at the time of the last OTTER determination, as demonstrated by Graph 1 in the attached Submission. While there is generally insufficient detail in the Application to adequately evaluate the current capital expenditure forecast, there is little to indicate that the current forecasts are any more reliable. On one of the few projects amenable to review, there are questions both about the need for the project and the forecast timing of the expenditure, due to the potential for procedural delays. We also question Transend's overall ability to progress such a high level of expenditure.

- **The proposed service standards are inadequate**

  Transend has proposed a limited range of service standards which are broadly based on existing performance levels, yet Transend itself acknowledges that current performance is inadequate. The targets and incentives need to be sharpened, and other areas of underperformance subject to suitable targets.

- **The WACC is too high**

  Transend has calculated a WACC that is higher than that in recent decisions for transmission companies, particularly in respect of the cost of debt. The Commission has established sound precedent in this area and will no doubt amend the Application accordingly.

- **Even with substantial reductions in the areas above, the Application would result in unacceptable price shocks**

  The Commission is constrained by the Ministerial Valuation of the regulated asset base (which is a significant increase over the original valuation), and so even if there are substantial reductions in capital expenditure, operating expenditure and WACC, the new revenue control would result in unacceptable price rises. The Commission must take strong action to avoid price shocks that, otherwise, could undermine the progress being made in the State through the major infrastructure developments of Basslink, natural gas and wind. The attached Submission sets out a glide path approach, which is demonstrated to be within the Commission's gift to adopt.

Thank you again for providing Hydro Tasmania with this opportunity to furnish our response to the Application. As you would expect, we will continue to actively engage in this process, and would welcome an opportunity to discuss these issues further with the Commission's representatives. In this regard, our Manager Power Delivery, Greg Jones, is the nominated contact for Hydro Tasmania's submission on 03 6230 5485.

Yours sincerely,

[Electronic Version]

G.L. Willis
Chief Executive Officer

Hydro Tasmania
the renewable energy business

Hydro Tasmania's Submission –
Transend Networks' Revenue Cap Application

April 2003

1 Introduction

In responding to Transend's Revenue Cap Application ("the Application"), Hydro Tasmania's objectives, consistent with the objectives for network regulation in the Tasmanian Electricity Code ("TEC"), are to ensure that the Application:

- promotes "efficient and cost effective"[1] outcomes;
- fosters "efficient investment…operation and maintenance…[and]…use of network assets"[2]; and
- has regard to the public interest, and the interests of people who use the service.

Hydro Tasmania has provided this submission in response to the Application as it has an interest both as a generator and because it is exposed to transmission charges through its Major Industrial Vesting Contracts[3].

This submission has been developed with consideration of the impacts of many of the unique features of the Tasmanian transmission network. Some of these features, as outlined in the Application, include:

- the wide geographical dispersion of generation;
- the relatively small generator size compared with other networks;
- relatively low generator load factors; and
- seasonality of generator operation.

This unique structure also gives rise to a particular concern about transmission charges. Whereas the Commission can broadly assume on the mainland that there will be no material impact on any individual customer, this is not true of Tasmania. The top five customers, including Hydro Tasmania, pay almost half of total transmission charges[4].

We consider that the Commission, having regard to the public interest in the exercise of its discretion, must take account of the impact of steep increases

[1] TEC Clause 6.2.1 (a)
[2] TEC Clauses 6.2.1 (d), (e) and (f).
[3] Contracts entered into to support the Tasmanian Government's disaggregation of the Hydro Electric Corporation in 1998.
[4] Our high level modelling indicates that these customers are liable for 45% of existing charges.

in transmission prices on these parties and should note that avoiding price shocks is one of the Government's stated objectives for this determination.

Section 2 lists the main deficiencies in the Application, namely in the areas of capital expenditure ("capex"), operating and maintenance expenditure ("opex"), service standards and the price shocks that would result from the Application. Section 3 lists Hydro Tasmania's further specific concerns with the Application. While detailed, these concerns often have material impacts. Section 4 submits our recommended actions to the Commission.

2 Primary Deficiencies

Hydro Tasmania has identified four primary deficiencies with the Application as it stands:

- the level of capex and opex, based on the level of support in the Application and past performance, appears significantly overstated both in terms of the requirement and in terms of Transend's ability to carry out the expenditure;
- the proposed service standards are inadequate as they are skewed to reward unimproved performance, they do not address the significant and acknowledged current underperformance. Even if these items were addressed, the proposed service standards would not meet the needs of Tasmanian market participants;
- the Weighted Average Cost of Capital ("WACC") is overstated; and
- even if the level of capex, opex and WACC were acceptable and the service levels were satisfactory, the resulting revenues would lead to significant price shocks for customers in general and for the largest customers in particular.

2.1 Capex and opex forecasts are overstated in a number of respects

In the Application, Transend has forecast significant increases in both capex and opex. Hydro Tasmania recognises that the Commission's consultants will consider and report on the extent to which these forecasts are justified. At that point, we will examine their reports to provide further comment to the Commission. Even so, Hydro Tasmania is already concerned that these forecasts are potentially overstated in a number of major regards.

2.1.1 Transend's fixed projects are not fully justified

Transend has argued for a process that recognises 'fixed' and 'variable' projects. Whilst this approach has some merit[5], in Section 3, we deal with our detailed concerns. More importantly, Hydro Tasmania considers that even the forecast costs for 'fixed' projects could well be overstated.

The Application does not provide sufficient information to analyse the case for and timing of each capex project. Even without sufficient

[5] Given the potential for projects to have a disproportionate impact on the Tasmanian transmission system.

detailed information in the Application, the Southern Augmentation Project[6] provides a useful case study of the potential to overstate forecast costs more generally.

Transend notes that "the project was submitted to the Reliability Network Planning Panel ("Panel") in December 2002; the Panel endorsed it at its meeting on 30 January 2003."[7] However, we understand that the Panel also noted that the project would need re-submission if certain circumstances eventuated before the development of the 220kV line. At first glance[8], this would reduce Transend's forecast capex for this project from $55.4m to $25.2m.

Even aside from this uncertainty, the need case for the project depends crucially on the ongoing operation of the Pasminco zinc smelter at Risdon, which has a significant demand. This load is subject to a Special Protection Scheme, which allows the immediate tripping of the smelter load under fault conditions and which Pasminco has expressed a preference to decommission. Nevertheless, the increase in transmission charges that results from the Southern Augmentation may well influence Pasminco's view of the longer term operation of the Special Protection Scheme, particularly given its recent period in voluntary administration[9].

Hydro Tasmania's concerns over the justification and timing of capex projects is further heightened by Transend's apparent intentions in respect of constraint equation formulation for National Electricity Market ("NEM") entry. As we understand it, Transend does not intend to consult on the formulation of limit equations[10]. It would be extremely disappointing if the benefits of any capital expenditure were squandered by conservative constraint equation formulation. Transend's lack of consultation on this matter has, we understand, been driven by concerns about complying with the Trade Practices Act ("TPA") by demonstrating even-handed dealings with all existing and potential market participants. While not the primary focus of this submission, we would be grateful if the Commission were able to clarify that, notwithstanding the existing industry structure in Tasmania, Transend could consult on these matters without contravening the Act.

2.1.2 Historically, Transend has not demonstrated its ability to accurately forecast capex

Even if the 'fixed' projects had solid need cases within the Application period, Transend has not demonstrated its ability to accurately forecast actual levels of capex. Graph 1 illustrates Transend's recent performance at forecasting capex for the 1999 Office of the Tasmanian

[6] As an aside, this project is a useful example of procedural delays in the capex process, with Transend's original consultation on non-network options taking place in November 2000. The interaction with the Reliability Network Planning Panel has already delayed many projects.

[7] Application, page 54.

[8] There is insufficient detail in the Application to be certain.

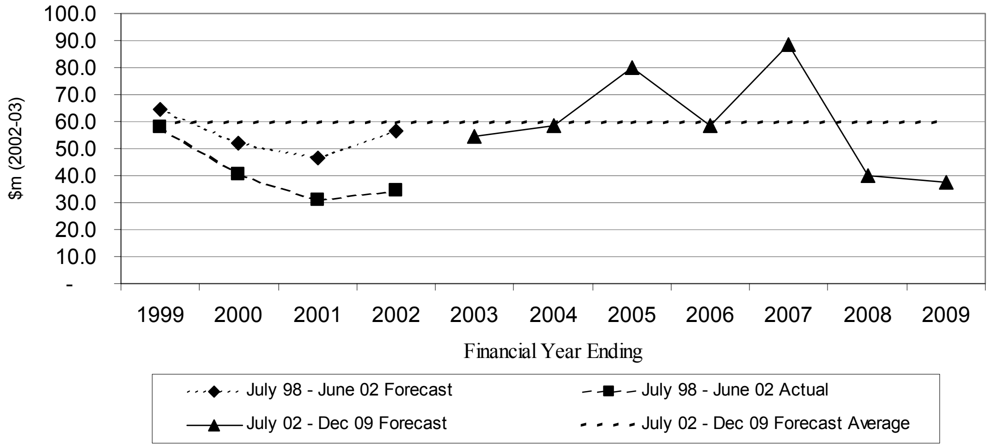
[9] Source: www.pasminco.com.au

[10] NEMMCO's practice is to consult widely on these matters.

Energy Regulator ("OTTER") Pricing Determination. It can be seen that:

- Transcend forecast substantially more capex than was actually delivered;
- the forecast levels of capex for 2000, 2001 and 2002 are lower than the average forecast capex from 1 July 2002 to 30 June 2009, and the actual level of capex is lower still; and
- in 2005 and 2007, Transend forecasts that it will spend more than double its current actual expenditure.

Graph 1 - Forecast & Actual Capital Expenditure
(Financial Years ending June 1999 to June 2009)



2.1.3 In the Application, Transend has not demonstrated its capability to deliver its currently forecast capex

In its recent determination on the South Australian Transmission Network Revenue Cap, the Commission reprised Meritec's conclusion that there was a risk that Electranet would be unable to deliver its proposed capex programme. The chief foundations for this conclusion was the doubling of Electranet's capex programme from its existing level, and the likely "increased competition for limited resources, particularly in the areas of experienced service providers, major plant items and project management personnel."[11]

Transend has not demonstrated that similar risks have been accounted for in its forecasts.

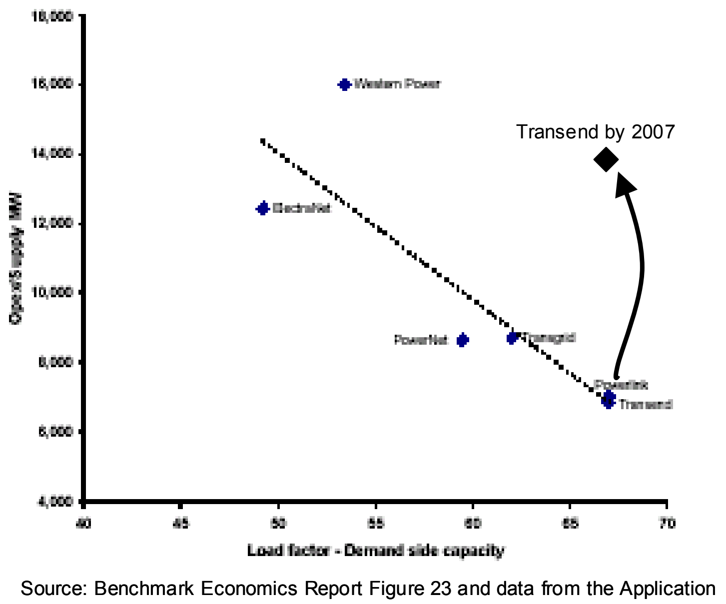
[11] "South Australian Revenue Cap Determination", ACCC, 11 December 2002

2.1.4 *Transend has not demonstrated that its opex forecast is efficient*

The Application argues that Transend's current level of opex is unsustainably low, and that there are a number of drivers for change that impact on its department opex forecasts. However, neither of these arguments are substantiated in sufficient detail.

Transend relies on the report by Benchmark Economics[12] to argue that it is currently a low-cost performer, given its size. However, these findings are not substantiated by the ITOMS benchmarking report, which finds Transend to be higher cost than other Australian and New Zealand transmission utilities. Unfortunately, Transend has not provided the Pacific Economics Group report that explores the differences between the two methodologies. We note, however, that the Pacific Economics Group conclusions consider that the methodological differences only explain 'in part' this discrepancy.

Furthermore, the Benchmark Economics' report is based on the 2003 jurisdictional allowance, which includes roughly half the average level of Transend's forecast opex in the Application. Even if Figure 23 in the Benchmark Economics' report is taken at face value, the effect of allowing the Application would be to make them among the worst performers in the comparison group (other things being equal) ***even when accounting for economies of scale,*** as illustrated in the modified figure below*.*



Source: Benchmark Economics Report Figure 23 and data from the Application

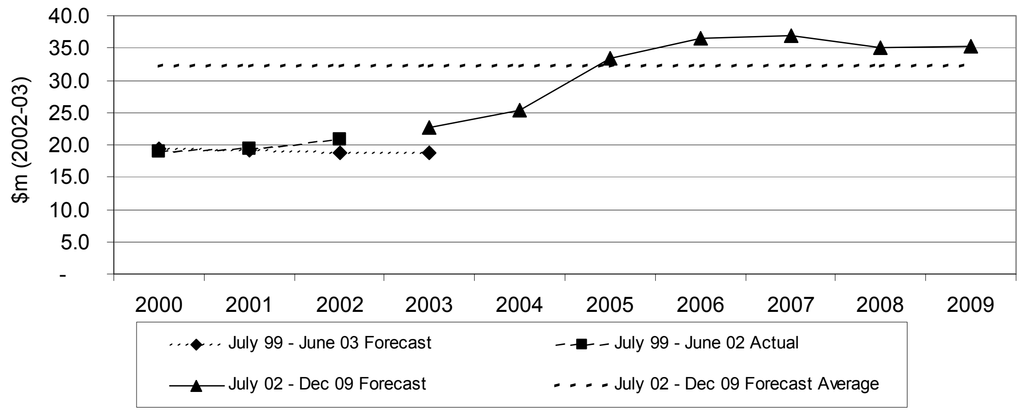
2.1.5 *Transend has not demonstrated its capability to deliver its forecast opex*

Even if the proposed level of opex were efficient, it represents a significant increase in opex for Transend, as can be seen from Graph 2. This suggests that there are risks, similar to those discussed above

[12] Appendix 2 in the Application.

in respect of capex, around Transend's ability to disburse these monies effectively, and with an eye to improved service performance.

Graph 2 - Forecast & Actual Operating Expenditure
(Financial Years ending June 2000 to June 2009)



2.2 Proposed Service Standards are inadequate

Transend has proposed service standards roughly based on the recent Sinclair Knight Merz ("SKM") report[13] to the Commission. There appear to be four main problems with Transend's approach, as discussed below.

2.2.1 Targets are skewed to reward unimproved performance

The targets adopted by Transend, and the skewing of the incentive payments mean that Transend could in all cases be rewarded for outcomes consistent with past performance. Given that Transend acknowledges that its current performance is inadequate, this seems highly inappropriate. Instead a longer 'deadband' should be used to ensure that Transend is only rewarded when a reasonable level of performance is achieved, but that the targets are still revenue neutral overall.

2.2.2 Aggregated service standards are less effective on a 'stringy' system

Aggregated service standards are far less effective when applied to a 'stringy' electricity transmission network as compared to a more meshed network. Given Tasmania's stringy network and Transend's acknowledged significant problems with service quality, Hydro Tasmania considers that the national approach combined with more customer-focussed service standards would provide a more appropriate base service level for generators and consumers alike. For example, a programme that targets the worst performing connection sites may be appropriate to the Tasmanian transmission system.

[13] "Transmission Network Service Provider (TNSP) Service Standards", Report to the Australian Competition and Consumer Commission by SKM, November 2002.

2.2.3 *More indicators are required*

In its Application, Transend notes that "the designed indicators must align with outcomes that customers and generators value"[14]. Transend's current proposal fails this test as, for example, it provides no incentive to reduce the volume of constraints, nor the value of such constraints. Hydro Tasmania acknowledges that a further data collection period will be necessary before there is sufficient information to establish a service standard for the volume of intra-regional constraints. Equally, at the same time, Transend should also be gathering information on the value of intra-regional constraints. This will mean that by the time of the next revenue reset application, the Commission will have sufficient information to develop incentives based on the value of constraints, rather than just their volume. It would be an unfortunate delay in the development of the market if it were a further five years before this information were available. We also note the approach taken in the England and Wales market, where performance targets have been set in the absence of historical performance, but with 'softer' incentives[15]. This ensures that the transmission company's risk profile is maintained, but transmission customers benefit as early as possible from the incentive arrangements.

This process should also involve the collection and recording of additional service standard parameters including, for example, the time taken to respond to connection enquiries and applications. This is an area where Hydro Tasmania has found Transend's performance particularly disappointing. For example, we note that Powerlink Queensland's Negotiating Framework undertakes to negotiate a new agreement within 120 days (subject to certain conditions being met) [16]. SPI Powernet's Licence requires it to make a Connection Offer within 65 business days. As an example of Transend's performance in this area, Hydro Tasmania has been seeking an acceptable Offer to Connect from Transend since August 2001, on a relatively straightforward connection.

Hydro Tasmania has briefly touched on two of the indicators that would be incorporated into a service standard regime that would meet the needs of market participants. We would welcome the opportunity to furnish a more detailed proposal for the Application period to the Commission by say, 31 May 2003. We envisage that the proposal would include the following indicators, as a minimum:

- intra-regional constraints generally;
- constraints on specific connections;

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[14] Application, Page 39

[15] For example, when establishing the Balancing Mechanism Incentive Scheme following the introduction of the New Electricity Trading Arrangements, the effects of which could simply not be forecast. In contrast, the market mechanisms in the NEM are relatively well understood.

[16] In fact, we note that Transend has no such targets in its negotiating framework.

- operation of the System Protection System; and
- connection enquiries and applications.

A further concern is that inter-regional constraints have been dismissed as not applicable. While Basslink will operate as an Market Network Service Provider, the local Tasmanian system will still have the scope to constrain the interconnector, and we consider that this should be the subject of an incentive arrangement, to the extent it is not picked up in other measures.

2.2.4 The Commission could clarify the scope to negotiate enhanced tailored packages

The NEC envisages that market participants should be able to negotiate tailored, enhanced service arrangements over and above the base standards. To date, Hydro Tasmania has been unable to effectively engage Transend in such negotiations on either existing or new connection agreements due to Transend's perceived concerns about:

- the interaction with its revenue cap setting and the Commission's service standards;
- whether such a process would have implications under the TPA;
- diverting resources away from its preparation of the Application;
- entering into contracts that have not fully considered the implications of NEM entry;
- the potential for those contracts to be impacted by subsequent regulatory changes; and
- offering an 'unregulated' performance agreement which relates to a regulated asset.

The Application does not provide any commentary on this issue, and we look to the Commission to provide some clarity. Hydro Tasmania understands that these potential roadblocks should not, in fact, inhibit Transend's ability to offer enhanced service arrangements. The Commission could provide some assurances on these matters to Transend[17].

2.3 WACC is overstated

Transend has calculated a WACC that is higher than that in recent decisions for transmission companies, particularly in respect of the cost of debt. The Commission has established sound precedent in this area and will no doubt amend the Application accordingly.

[17] To illustrate the importance of these agreements, we refer the Commission to Hydro Tasmania's experience in seeking to develop windfarms. The commercial arrangements around these developments hinge on adequate network capability and performance. Inadequate commercial arrangements with the network provider undermines the ability of any developer to deliver these important environmental projects.

2.4 Price shocks must be avoided

Hydro Tasmania notes that, even if its concerns in 2.1, 2.2 and 2.3 were addressed, there would still be a considerable price shock in moving to the new allowed revenue, primarily due to the application of the Ministerial Valuation. The need to avoid this price shock is particularly important given the potential impact on wider community support for the reforms in the Tasmanian electricity sector. For example, in the application for derogations to the NEC, the Tasmanian Government stated "a transitional period provides certainty, by continuing the pricing arrangements and undertakings established as part of the reform and restructuring of the Tasmanian electricity supply industry. Any uncertainty could also undermine industry and public acceptance of the reforms"[18].

The Commission has considered the use of "competition depreciation" to ensure that lumpy investment profiles do not result in unmanageable price shocks. However, in the Application's case, the level and timing of the price shock is such that using a 'competitive depreciation' approach would have little impact. It is too late for this approach to have a substantive effect.

Instead, an approach should be found to mitigate the impact of the increase in prices on individual customers while ensuring that Transend's legitimate business interests are considered.

One approach to manage these price shocks, which Hydro Tasmania considers to have merit, would be to impose a, say, 2% cap[19] on increases in total transmission charges to individual transmission customers in any year during the Application period. Income that Transend was unable to recover due to this constraint would not be recovered from other transmission customers in that period, but rolled forward to the following year in the K factor, adjusted for the time value of money[20]. At the start of the next regulatory period, the Commission would consider the need for an extra allowance to allow Transend to recover any outstanding amounts, but also in light of its actual performance over the period, taking into account the Commission's glide path arrangements, actual expenditure and so on.

Hydro Tasmania further notes that the Commission is constrained by the Ministerial Valuation of 30 June 2001. We also understand that part of the purpose of the revaluation was to provide price certainty and minimise long-term price shocks. Given this principle, another approach would be to use a glide path for the increase from the original valuation (1999) and the Ministers 30 June 2001 valuation. In addition, given Transend's acknowledged problems with service quality, this glide path should be linked to service performance.

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[18] "Tasmanian Derogations and Vesting Contracts – Final Determination", ACCC, November 2001

[19] The actual percentage would be a compromise between avoiding price shocks on customers and Transend's ability to recoup the monies in a reasonable time. Clearly, it would be necessary to have some arrangements for customers whose circumstances change materially.

[20] Further comments on the time value of money are set out in Section 3.

Hydro Tasmania considers that the Commission has sufficient scope to exercise discretion in this matter. TEC Clause 6.2.1 (k) requires that the regulatory regime seek outcomes including "reasonable and well defined regulatory discretion which permits an acceptable balancing of the interests of Transmission Network Service Providers, Transmission Network Users and the public interest."[21]

While a complete list depends on the precise clause, Part IIIA of the TPA generally requires that the Commission have regard to the following matters:

- the legitimate business interests of providers;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of persons who might want access to the service; and
- any other matters that the Commission thinks are relevant.

The Commission has noted on many occasions that "public benefits recognised in the past include:

- fostering business efficiency;
- industry rationalisation;
- promotion of industry cost savings;
- promotion of competition in industry;
- promotion of equitable dealings in the market;
- expansion of employment;
- development of import replacements;
- growth in export markets; and
- arrangements which facilitate the smooth transition to deregulation."[22]

While this is clearly a matter that the Commission will reach its own conclusions on, we consider that the TEC provides sufficient discretion for the Commission to develop an approach to the untenable price shocks that would result from the Application as its stands, without setting a precedent and having consideration to Transend's legitimate business interests[23].

A further complication will be the move from Transend's existing Pricing Policy to that which applies following on from the Commission's Determination. OTTER's 1999 Determination provided a considerable level of guidance to Transend on the principles to underpin its pricing policy. As this detailed guidance falls away, and as Transend aligns its transmission prices with those applied under the NEC, there is considerable scope for severe price shocks to

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[21] For completeness, NEC Clause 6.2.2 (k) requires that the regulatory regime seek outcomes including "reasonable and well defined regulatory discretion which permits an acceptable balancing of the interests of Transmission Network Owners and/or Transmission Network Service Providers (as appropriate), Transmission Network Users and the public interest as required of the ACCC under the provisions of Part IIIA of the Trade Practices Act."
[22] Various ACCC Determinations
[23] For completeness, we consider that the NEC offers the same discretion.

individual customers. In light of the scope for these price shocks, the Commission should provide guidance on the process to establish a new pricing policy, and the content of that policy, to the greatest extent possible.

3 Detailed Issues

The following briefly lists further specific issues that Hydro Tasmania has with the Revenue Reset Application as it stands:

- **Service Standards**

  In Section 5.3.3, Transend notes that it will wish to align its reporting requirements with those set out in the connection agreements. As we understand it, Transend is not currently reporting against the Hydro Tasmania's contracts, and so this should not inhibit the development of a worthwhile reporting framework.

- **Capital Expenditure**

  In the last paragraph on page 44, Transend asserts that the security criteria approach to forecasting capex should give a similar result to applying a market benefits test as "the criteria should reflect the underlying costs and benefits to customers of providing a particular level of system security". While this may be true in principle, Transend and SKM do not make this case, and rely instead on an analysis of the approaches taken in other jurisdictions. This is despite having elsewhere made the case that the Tasmanian network is unique in its design. Furthermore, Transend commissioned TransGrid to review its security criteria, but TransGrid's report is not reproduced.

  There has also been no effective consultation with Tasmanian stakeholders on the use of these security criteria in the development of capex plans. This has denied transmission customers the opportunity to ensure that the capex forecasts proposed in the Application actually meet their needs and expectations.

  The level of renewal capex is insufficiently justified in the Application. The drivers are not linked to detailed projects.

  We noted earlier that the 'fixed' and 'variable' approach proposed by Transend has some merit in the Tasmanian context. However, it would be a departure from national practice. More importantly, the treatment of 'variable' capex provides very poor incentives, as there is no driver for Transend to improve its forecasting techniques nor to drive down the cost of capital investment through innovative design or best practice tendering. The alternative is to make an appropriate allowance for these projects (and given our comments in Section 2, probably even lower than the level for 'fixed' projects currently proposed by Transend), and recognise that the revenue control could be re-opened in 3 or 4 years if the forecasts are materially inaccurate. This approach still enables Transend to deliver the actual level of capex required as the market in Tasmania develops. This would also allow the Commission to consider the price impacts of any large increases in capex. As proposed in the Application, Transend would, at best, simply report actual capex, and then charge it to customers.

- **Asset Valuation**

  The roll forward of the Ministerial Valuation to 1 January 2004 does not provide any assurance that the capex undertaken was prudent.

  We recognise that the Commission is constrained to use the Ministerial Valuation. We note that it is one of the biggest contributors to the increases in transmission charges and would look to the Commission to verify that the asset value has not exceeded the deprival value, and to also consider the extent to which the full valuation should be applied from Day 1.

- **Efficiency Bonus**

  The efficiency bonus seems overstated given that Transend could and should have forecast these costs in 1999, and particularly given the uncertainty discussed above about the implication of ITOMS report.

- **NEM Entry**

  Transend's shareholder instructed Transend to provide all necessary resources to facilitate NEM entry. Hydro Tasmania is fully supportive of this project. However, we would question whether these costs should be borne by customers or the shareholder.

- **Time value of money**

  In the detailed application of the revenue control, Transend has used its WACC to address the time value of money in the calculation of the K, S, P and VC factors. This is similar to the approach used in Victoria, but only since the price of the previously used reference bond was no longer available as a surrogate for the cost of debt. Instead, we consider that the Transend cost of debt should be used for these factors so as to provide appropriate incentives to forecast accurately.

- **Contestable and Non-Contestable Services**

  The Application makes some reference to contestable services. Transend should be properly remunerated for those assets which are non-contestable. Equally, the Commission must ensure that all possible contestable items are so defined. Currently, Transend considers embedded assets (that is, assets located on Transend sites) to be non-contestable. There appears to be some inconsistency in Transend's approach at the moment, and we look to the Commission for clarity on this matter.

4 Recommended Actions

In light of the concerns detailed in the remainder of this submission, Hydro Tasmania submits that the Commission should take the following actions in arriving at its Determination.

- Reduce significantly the level of forecast operating expenditure in the Application.
- Reduce significantly the level of forecast capital expenditure in the Application.
- Support wider consultation on the formulation of constraint equations and system security criteria to ensure that as capex proceeds the actual network capacity is enhanced.
- Reject Transend's proposed 'fixed' and 'variable' approach, and require it to rely, more properly, on its ability to reopen its revenue control.
- Reduce the WACC applied to be consistent with the approach taken in other jurisdictions.
- Tighten the incentives and targets under the proposed Performance Incentive scheme.
- Require Transend to gather information that would support future development of the Performance Incentive Scheme.
- Recognise that some specific issues with Transend's performance require the application of additional Performance Incentive schemes in the Application period;
- Endorse the Code principles that pertain to the negotiation of enhanced service levels.
- Most importantly, apply a mechanism to ensure that price shocks are avoided.

We consider that these actions are well within the Commission's gift. In fact, they are arguably required by the Commission's various obligations.