Transend Revenue Proposal

AER Public Forum – Hobart

Contents

General comments

- The Australian economy is at close to full employment
  - Electricity industry labour is in short supply
  - Commodity prices – feeding into capital prices are at unprecedented levels
- Extra caution should be applied in making long dated capital investments
  - Recent history indicates projects likely to suffer upwards price pressure
  - Only investments that have obvious returns should go ahead
  - Marginal investments should be deferred

Current regulatory period

Contingent capital expenditure

- $451.5 million (forecast) Capital expended
  - 25% more than approved
  - Waddamana-Lindisfarne line delayed
  - $309.9 million on renewal – 50% above approval – difficult to understand increased need after 2003 approval
- Recommend AER
  - Closely assess delay in Waddamana-Lindisfarne
    - Was GEIP standard met in terms of project and cost management?
    - Unavoidable costs claimed were prudent?
    - No diversion of capital top other projects?
  - Renewal projects
    - What changed requiring very large increase in renewal?
    - Prudency test?

Regulated asset base

- Proposed RAB increase $603.6 M to $987.3 M
  - Delayed Waddamana-Lindisfarne line
    - ~ $120 M in next regulatory period
  - Includes $309.9 M renewal
    - Redeveloped six substations, replaced various large transformers, replaced high voltage switchgear, replaced Norwood-Scottsdale-Derby line and Creek Road-Risdon conductor.
  - Economic depreciation - $83.5 M
- Recommend AER
  - Consider writing down renewal projects where benefits not clear
  - closely review renewal program to ensure replaced assets written off

Controllable operating costs

- Proposed increases in revenue
  - compensating uplift of 9.1% in revenue to cover current losses
  - Another proposed 5.5% to cover increased activity – some operating
  - Argue for 7.5% compound increase over 5.5 years (after inflation)
- Renewal program should be reducing operating cost pressures
- Applying GEIP and prudent operator test to scope increase
  - Transend expected to be doing these things
- Recommend AER
  - Carefully review claimed scope changes
  - Seek operating cost efficiency dividend from renewal program
  - Reject operating cost uplift

Next Regulatory Period

Load forecast

- Load forecast – 147 MW over period 2008-2014
    - 2.09% compound increase
- Grid Vision 2030 various scenarios
    - BAU (no carbon) – > 300 MW (2010-2020)
    - Carbon constraint – < 130 MW (2010-2020)
- Transend median forecast appears not to include carbon constraint
- Recent ACIL Tasman general equilibrium analysis
    - Carbon price of $45/tonne – 12% reduction in energy usage
- Base case should include significant carbon constraint
- Carbon is already in forward prices
- Tasmania faces specific TEI risk
- Recommend AER
    - Require Transend to replace load forecast with carbon constrained forecast

Regulated asset base

- Propose to spend $680.7 M in next period
  - Increase in RAB at end of period (63.5%)
  - Includes $226.6 M in asset renewal
  - Includes $121.8 M for connections
    - Seven new connection points??
  - Economic depreciation - $132.5 M
  - Most asset life in excess of 40 years
- Asset renewal over 10.5 years is 85% of 2004 RAB.
  - Aversch-Johnson effect?
  - Questionable scope for renewal and augmentation
- Recommend AER
  - Closely review capital expenditure and remove unwarranted proposals and marginal proposals

Controllable operating costs

- Seeking real increase by 2013-14 of $7.4 M pa
  - 3.7% real increase per annum over period
  - 11% real increase per annum when factor in claim to recover efficient costs
- Unitised labour and material costs are increasing
- Claims for scope increases are unconvincing
- Benefits from recent and planned renewal?
- Recommend AER
  - Carefully review claimed scope changes
  - Seek operating cost efficiency dividend from renewal program

Land and easements

- $20.9 M proposed for land and easements
  - Unclear as to the purpose
- Alternative acquisition strategies should be considered
  - Defer land acquisition through use of options
  - Dual use arrangements to reduce acquisition costs
- Recommend AER
  - Require use of option strategies to defer acquisition
  - Require use of dual use arrangements to lower costs

Financing costs

- Claim for equity and debt financing costs
- These costs would normally be part of WACC consideration
- Locked in equity beta of 1 and BBB+ debt risk premiums
- Transend does not raise equity through the market
  - Equity raising costs not warranted – looks like a tax
- Debt raising costs should be closely looked at
  - Possibly cover reasonable actual outlays
- Recommend AER
  - Disallow equity raising costs
  - Only allow debt raising costs where demonstrated cost occurs

Other issues

Attribution of benefits

- Transend attribute shaping of transmission system to Tasmanian hydro generation
  - Hydro plant have substantial influence on configuration and operating conditions
- Implication that significant portion of transmission system for benefit of hydro plant
  - Should be reflected in prescribed transmission system
  - Should be reflected in pricing methodology
- AER recommended to
  - Review prescribed transmission system
  - Review pricing methodology

Scope of services

- Transend claim unique operating environment
  - Transmission assets
  - Sub-transmission assets down to 6.6kV
- Rationale not clear for operating sub-transmission
  - Not part of meshed network
  - Benefit only to local transmission customer
- Recommend AER ensure
  - Sub-transmission costs not included in general TUOS charges
  - Revenues associated with sub-transmission charged to localised transmission customer