Boyer

8th August 2014

Mr Chris Pattas
General Manager - Networks Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

TasNetworks (Transend) Revenue Proposal: 2014 –2019 Regulatory Period

Dear Mr Pattas,

Thank you for the opportunity for Norske Skog to outline our transmission pricing concerns with the Australian Energy Regulator.

Norske Skog Paper Mills Australia Limited is the only manufacturer of newsprint grades of paper in Australia operating the Albury Mill in NSW and the Boyer Mill in Tasmania. The company is part of Norske Skogindustrier ASA, a Norwegian based company, which manufactures newsprint and publication grade paper from 8 mills in 6 countries.

The Boyer Mill commenced operations in 1941, has over 300 employees onsite at its facility at Boyer, Tasmania and supports an estimated further 900 indirect jobs. The Mill contributes over $140 million directly to the Tasmanian economy each year. Following the recent capital investment of $85 million to convert one of our two paper machines to produce catalogue grades, the Mill has an annual production capacity of 290,000 tonnes.

The Boyer Mill is directly connected to the TasNetworks 110kV transmission network and has operated under a Prescribed Connection Agreement since late 2008. The Boyer Mill's historical nominated maximum demand of 85MW was raised to 110MW in November 2009 following a conversion of a pulping plant from hardwood to softwood fibre supply. The actual maximum demand since then has been 98-100MW and peaked at 103MW due to a capacity "slowback" associated with a dramatic decline in the Newsprint Market.

Please find below a discussion of the Boyer Mill's view of some of the key points in the current Revenue Proposal.

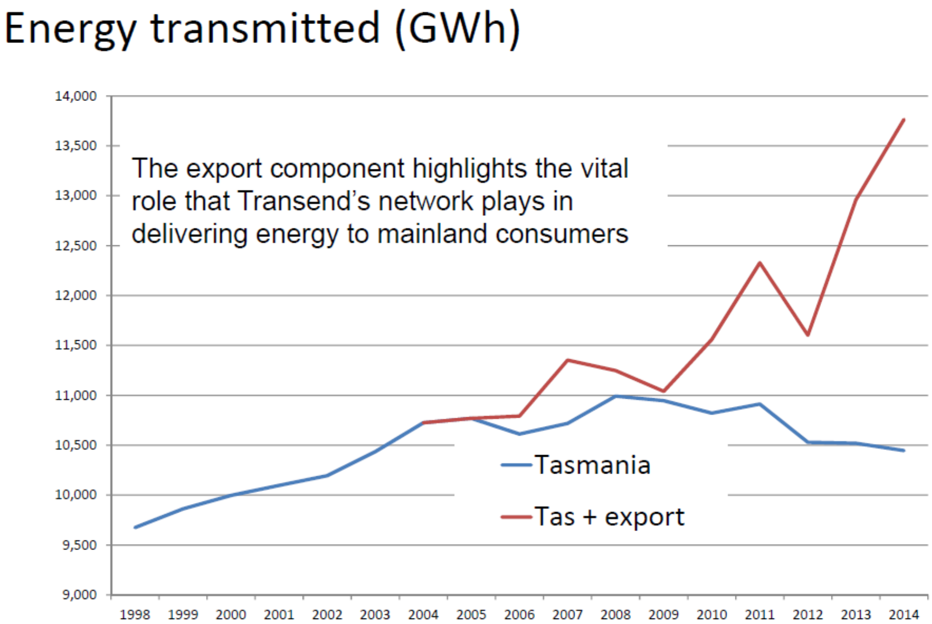
Norske Skog Paper Mills (Australia) Limited
Boyer

Boyer	ABN:	84 009 477 137
Tasmania 7140	Phone:	+ 61 3 6261 0111
Australia	Fax:	+ 61 3 6261 3247

2014-19 Revenue Proposal

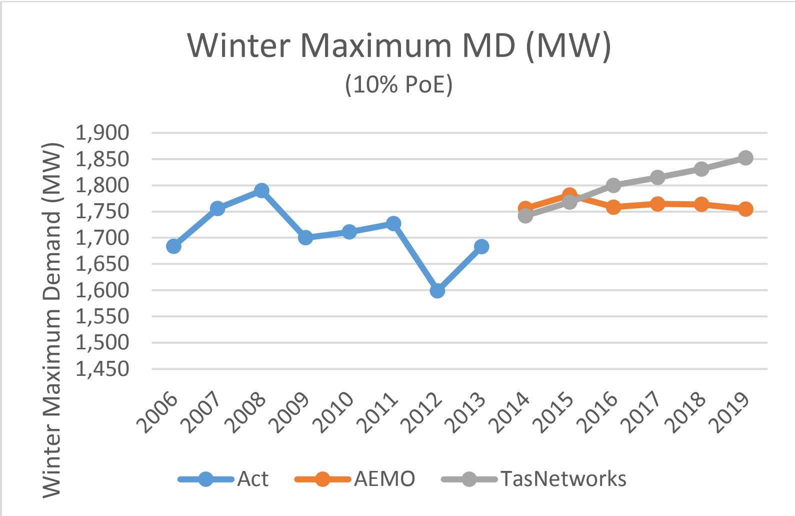
Capex

Over the last few years the National network has seen slower growth in peak demand and ongoing falls in total electricity consumption. Whilst TasNetworks highlights the increases in their total transmission, their own data indicate that transmission in Tasmania has fallen to levels not seen in over a decade. Moreover, it is clear that Hydro Tasmania's export of renewable electricity via BassLink was influenced by the introduction of the Carbon Pricing Mechanism and it remains to be seen if they will maintain the flow towards the North without the current Victorian price signal for export. As a result, any justification for Capex that includes the ongoing supply of electricity to mainland customers at recent levels would include a large element of risk.



Source: TasNetworks Proposal July AER public Forum - 2014

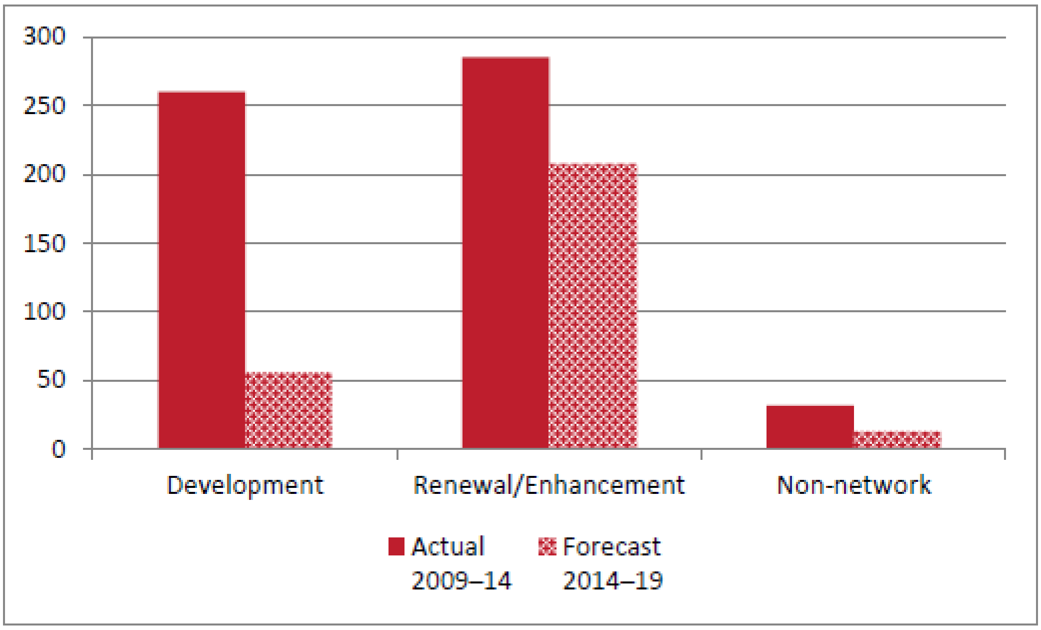
Despite expectations that softening in demand and consumption will continue, TasNetworks has maintained a forecast against the trend and well above AEMO's recent NEFR forecast. In fact, the two forecasts diverge by approximately 100MW by the end of the regulatory period and Transend has received approval in previous regulatory periods to invest over $600 Million and develop a Regulated Asset Base capable of servicing a Maximum Demand of 2100MW, over 10% above the most bullish forecast for the next Regulatory Period.



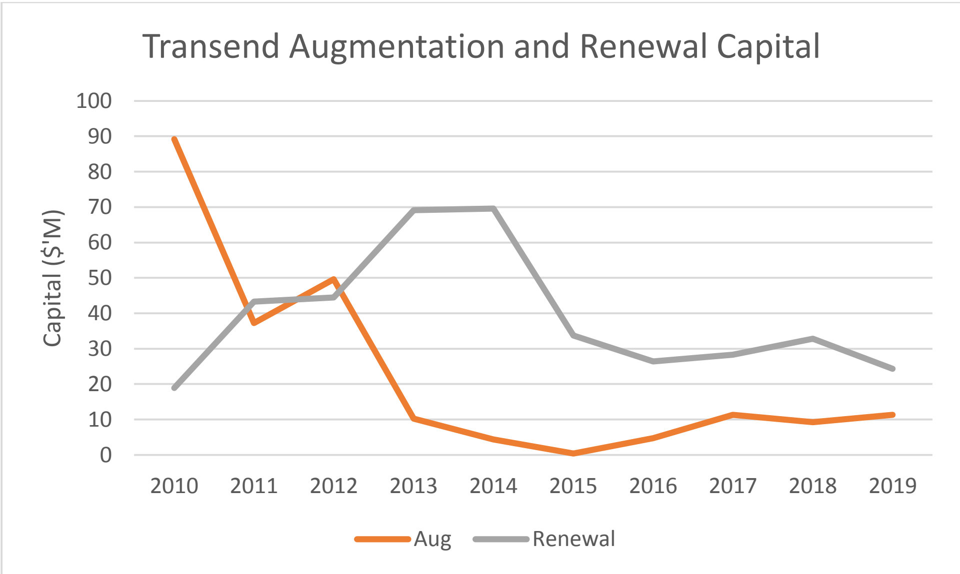
Source: Transend's Full Revenue Proposal May 2014 & AEMO NEFR_2014_TAS_forecasts template values

The use of an appropriate forecast for this regulatory period will be particularly important. Despite the occurrence and impact of the Global Financial Crisis as Transend prepared and presented their last proposal, and despite reductions in domestic demand through the latter stages of 2008 and into 2009, massive increases in charges were approved in the 2009-2014 proposal on the back of clearly unrealistic and flawed forecast demand increases. The ongoing trend in demand reduction we continue to see should translate to lower overall Capex requirements for the next regulatory control period particularly given the huge investments made to date. The extreme levels of Development capital employed in the previous regulatory period versus the ongoing reduction in demand has created the situation where assets are both stranded and have had their lives significantly extended.

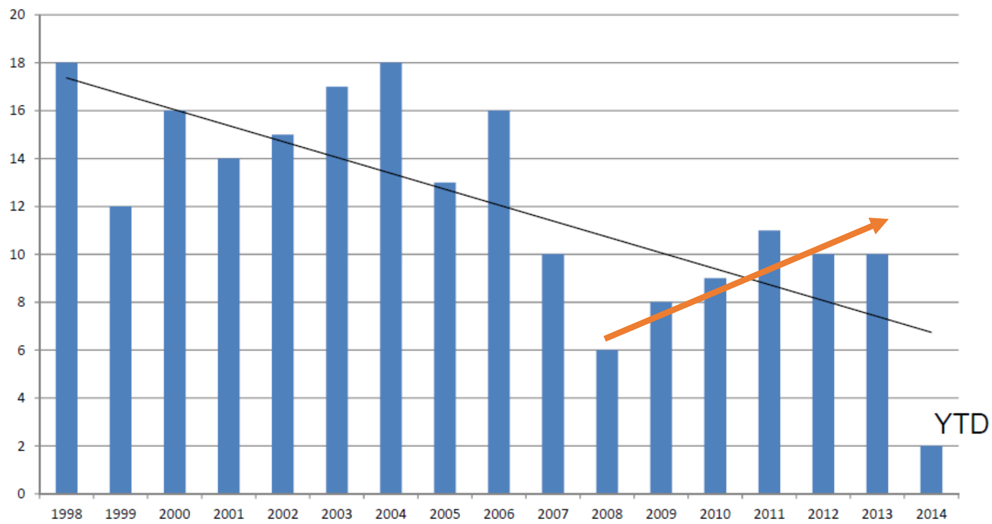
In fact, despite overspending Renewal Capex by over $40M in the previous period (which could be interpreted as pre-installation) TasNetworks have shifted their emphasis from Development to Renewal/Enhancement activities which will further exacerbate the situation.



Source: Transend's Full Revenue Proposal May 2014



It is worth noting that TasNetworks believes that despite the overspend in renewal projects they are taking on additional risk to "reduce customer charges now" perhaps indicating that the wrong projects were identified and undertaken in the previous regulatory period. TasNetworks proudly presented the following chart indicating to the unobservant that there has been a significant reduction in interruptions since the late 90's (seen by the black "trend" line). However, it is clear that through the last regulatory period supply interruptions have in fact increased (seen as the orange line) despite massive increases in charges to customers. One might ask if their capital has been efficiently spent.

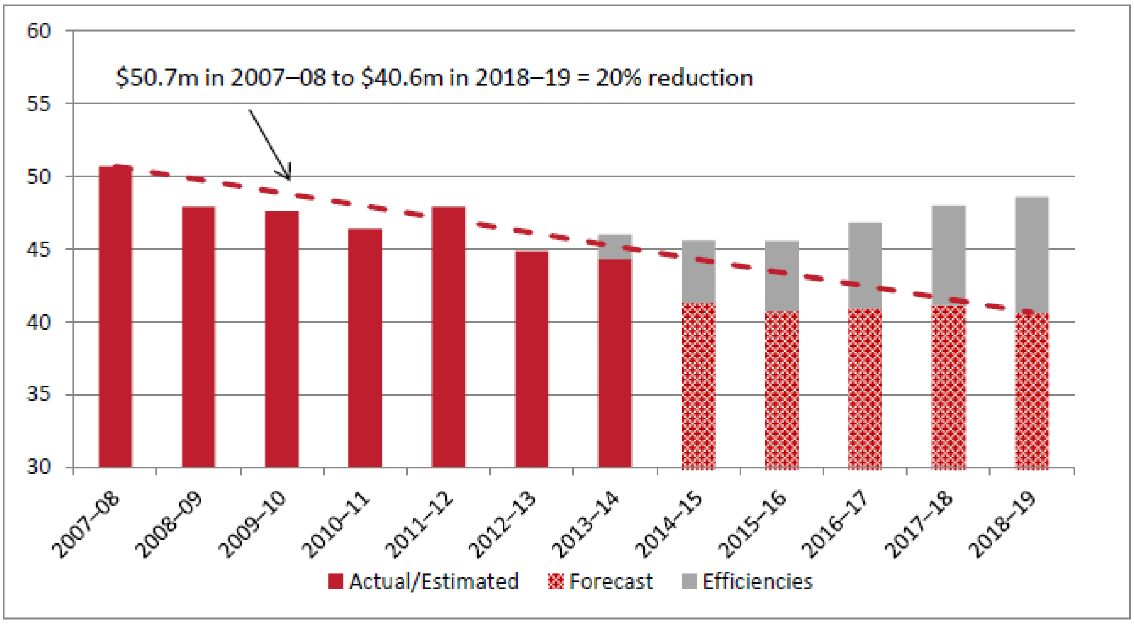


Loss of Supply events, Transmission > 0.1 system minutes

Source: TasNetworks Proposal July AER public Forum - 2014

Opex

Through the last regulatory period TasNetworks had one of the highest levels of Opex/MWh of any TNSP in Australia. Whilst the current proposal forecasts a reduction in OPEX over the next 5 years, much (if not all) of the improvements are driven by synergies associated with the merger with Aurora Energy's distribution business.

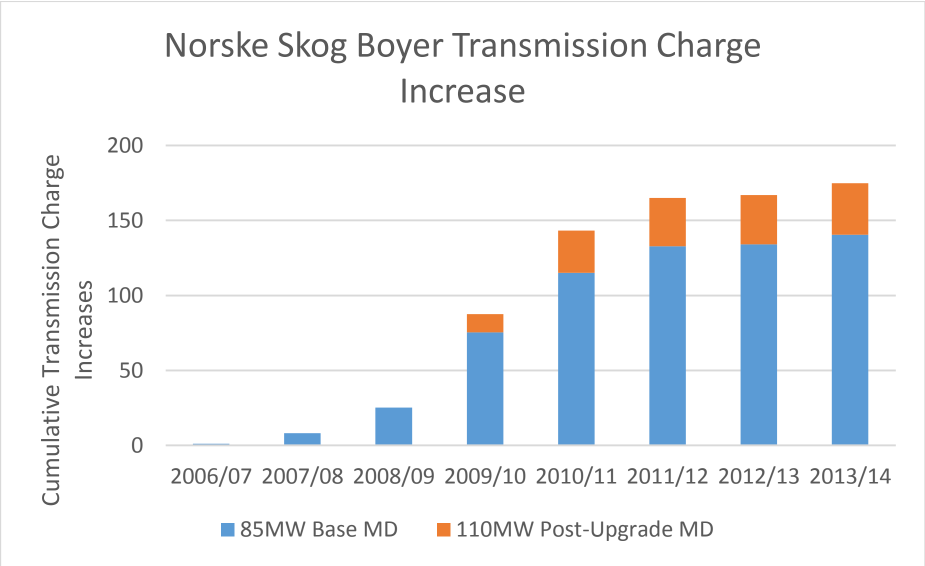


Source: Transend's Full Revenue Proposal May 2014

There is no stretch or aspirational target for OPEX improvement that one would see in a modern cost-focussed organisation and this does not fit with the CEO's stated goal at the recent Hobart Public forum of TasNetworks "driving efficiency and cost saving".

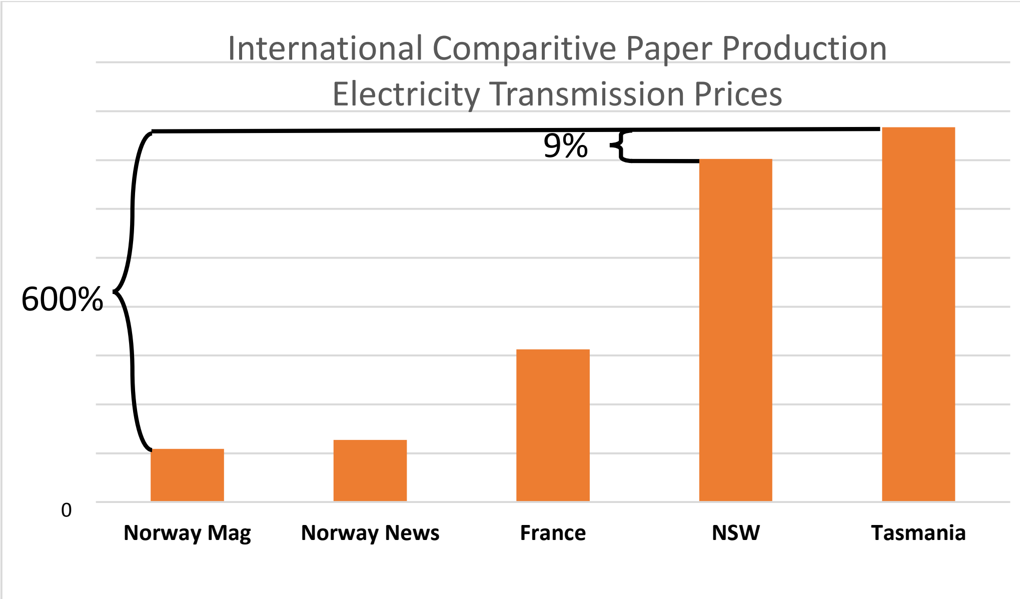
TasNetworks and Transmission Pricing Effects on Boyer

The Boyer Mill has experienced significant increases to its Transmission costs both prior to and during the previous regulatory period. We have seen a 175% increase since 2006/7 including a 47% increase during the previous regulatory period. Imposed on our operation have been cumulative year-on-year increases, some 74% higher than CPI over the last 6 years. The full CPI equivalent 2006/07 charges in 2013/14 would be 43% below where they currently are.



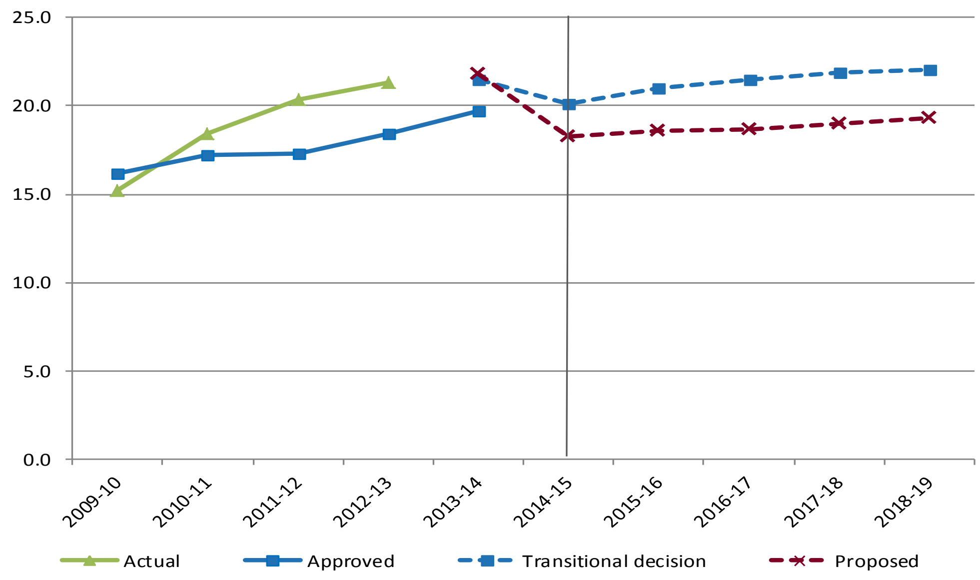
Since late 2011 we have initiated a number of formal and informal discussions between our operations management and Transend and openly described the considerable pressure the Mill is under from a cost and revenue perspective (in stark contrast to that of Transend).

Internal benchmarking indicates that the Boyer Mill suffers under the highest transmission charges of any mill in the global Norske Skog organisation. Combined with revenue reductions of over 30% during the same period, it should be clear that our business is significantly challenged.



Whilst it may be argued that the extremely low transmission costs at the Norwegian sites may be due to generation sites located close to their operations, Hydro power stations in the Derwent Valley have generation capacity 5 times greater than Boyer Mill demand - within 1 hr of our site. It is worth noting that our Norske Skog Mill in Albury, NSW supplied by Transgrid is also significantly disadvantaged by transmission prices compared to our international sites.

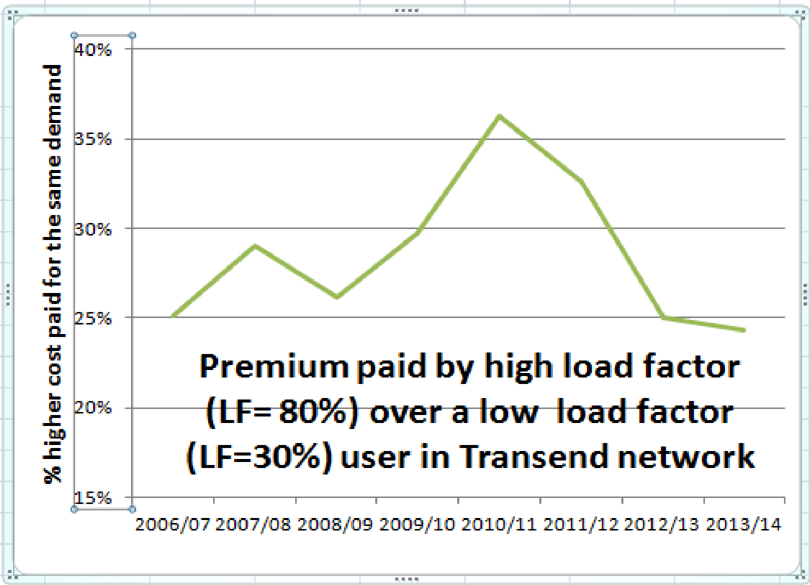
We have maintained the position that TNSP's should have the capacity to provide some relief from ongoing increases in charges to a high load factor user like the Boyer Mill. Management at Transend express understanding but have maintained the position (also promoted publically) that we, as consumers, should recognise that they have not passed on all of the increases they were allowed under the regulation (such as the $37M under-recovery amount). This position has been maintained by TasNetworks in the current proposal and the under-recovery forms a large proportion of the initial reduction in price path going forward.



Source: TransGrid, TasNetworks and Directlink - electricity transmission determination | Issues Paper, July 2014

In early 2013 after a meeting held to reiterate the critical cost and business pressures on the Boyer Mills operation, and the subsequent risks of permanent closure of capacity, Transend visited the site and indicated they would be holding back revenue increases to less than CPI. Whilst no firm commitment was given on the day, indications were given that this would be in the order of CPI <u>minus</u> 0.5%. At that time, the Boyer Mill management made it clear that this did not represent the level of reduction needed to return the businesses transmission costs to acceptable/sustainable levels, particularly given the significant increases through the regulatory period to date. In April 2013, the Boyer Mill received a letter notifying management that our charges for 2013-14 would actually be CPI <u>plus</u> 0.5%. It also included a final paragraph outlining how grateful Norske Skog should be that Transend had taken this action, as without this *"… the 2013-14 charges for Norske Skog would be approximately $13.4 million (excluding GST), or CPI plus 18%. Therefore, the action taken by Transend will provide Norske Skog with a material reduction in charges for 2013-14 from what they otherwise would have been.*" In further discussions with Transend since that time they seemed unable to understand why we felt dissatisfied by their position.

We note that following the AER's determination concerning Transend's 2014 Transitional proposal we have received the first reduction in charges in 8 years. However, the reduction is small compared to the year-on-year increases we have seen through the last regulatory period. It is clear that the efficiencies of scale that high load factor users such as the Boyer Mill provide to the transmission network is not reflected in the current Pricing Methodology. For example, an analysis by the Major Energy Users for the New Norfolk exit point indicates that for two users with the same demand but different load factors (80% and 30%), the high load factor user pays a considerable premium for transmission services.



Source: The Major Energy Users Inc, Transend pricing and MEU calculations

Customer Engagement

In its proposal, TasNetworks focussed heavily on their "Straight Talk" engagement activities, however for the entirety of the last regulatory period Transend had very few customers with 57% of transmission and over 40% of their income coming from 4 large industrial users. Despite the importance of large users such as the Boyer Mill, there was limited high-level contact initiated by Transend towards our operation. The Boyer Mill re-initiated regular lower level, operational contact due to significant issues concerning the transformers in the main yard. Annual surveys have been completed by Mill personnel that encompass both operational and management level interactions, but there is no follow-up on the responses we provide (which have typically outlined the poor response to our concerns and business challenges).

Transend has a demonstrated history of poor/no feedback to the Boyer Mill. Documentation such as the new Pricing Methodology is sent out with no briefing or follow-up and is generic to all users. When we do formally respond and request clarification of some details (such as in the case of changes to Transend's Negotiating Framework for Negotiated Services sent to us on 23rd December 2013) we receive no response. A major concern going forward would be the dilution of already poor customer engagement activities given the addition of Aurora's distribution network to their portfolio.

It is worth noting at the outset that TasNetworks did provide the Boyer Mill with an overview of the price impact of the new proposal and forecast going forward and we are hopeful that the new organisation continues to improve its communication and engagement with large consumers. As already described, there is some way to go as typified in the NCIPAP process employed for the current regulatory period. Project 18 is for work specifically related to the assets that solely supply the Boyer Mill. Despite this, Norske Skog was not consulted or even informed that the project, subsequently supported by AEMO, was being proposed by Transend until after it had been submitted in the Transitionary Proposal for 2014/15. This is not poor engagement – it is the absence of engagement.

This submission outlines concerns we have regarding the current Revenue Proposal and the continuation of cost increases to our operation. Both Norske Skog Australian sites are affected by the current TasNetworks and Transgrid Revenue Proposals and our organisation requests the opportunity to meet with the AER directly to provide further detailed information surrounding the proposals, their effects on our business and how an Emissions Intensive – Trade Exposed organisation deals with Opex, Capex and Return on our investments. We are available to meet at a mutually convenient time and location.

Please contact John Meehan for further information (contact details below).

Yours faithfully

John Meehan

Energy and Continuous Improvement Leader

Boyer Mill

Norske Skog Paper Mills (Australia) Ltd.

John.meehan@norskeskog.com

Ph: 03 6261 0301 or Mob: 0417 399 295

cc:

Rod Bender

General Manager, Norske Skog Boyer Mill