Ref. Obj. ID A538079

18 February, 2009

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

Dear Chris,

Draft Decision
Transend Transmission Determination 2009-10 to 2013-14

Powerlink appreciates the opportunity to provide comment on the AER's Draft Decision. The submission focuses on a number of specific issues, which are discussed below.

Asset Renewals

The AER has decided that the deferral of a number of renewals projects to the next regulatory period would not materially affect the performance of the assets or Transend's ability to meet its objectives.

Powerlink considers that the AER's proposed reduction to renewals on the basis of the average asset age decrease (from 23 to 15 years) is not reasonable. In particular, the AER has applied a 40 per cent reduction to the 110kV substation redevelopment projects. Among other things, these projects are designed to address the replacement of the Reyrolle OS10 and other circuit breakers.

The work by the AER's consultant (Nuttall Consulting) highlights that the primary drivers for these renewals are the significant maintenance costs (4 times higher than a new breaker), safety hazards and possible future failure modes associated with keeping these 56/57-year old assets operational.

For information, Powerlink's experience with Reyrolle OS10 circuit breakers has been very similar to Transend's. Due to fault levels and condition issues (eg. leaking oil, air system defects), Powerlink has had to replace these breakers.

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Labour Cost Escalators

In relation to labour costs, the AER appears to have generally adopted the forecasts of its advisers, Econtech. The Econtech forecasts tend to be lower than those put forward by CEG to support Transend's revenue proposal, and materially so in relation to general wages (ie. on average, Econtech forecasts are 60 per cent lower than CEG). In a number of areas, the AER explains that the reason for Econtech's lower forecasts is due to the change in the economic climate since similar forecasts were provided to the AER in 2007. The AER also flagged its intention to apply the updated Econtech construction cost forecasts to Transend's capex proposal.

In light of the material difference in the forecasts between the two sets of consultants, and in the interests of achieving a mutually robust outcome on this issue, Powerlink recommends that the AER consult more widely on the escalators prior to finalising its review.

Equity Raising Costs

In its Draft Decision, the AER determined that Transend would be able to fund its capex program over the next regulatory period with retained cash flows, and therefore did not require additional equity finance. The AER also determined that compensation for the indirect costs of raising equity under the benchmark regulatory framework was not appropriate.

As noted in its response to the TransGrid Draft Decision, Powerlink questions whether the AER has given due and appropriate consideration to the expert advice from CEG in support of Transend's proposed equity raising cost allowance. This is particularly concerning given the AER's acceptance that underpricing can occur for both initial public offerings and seasoned equity offerings on the one hand (consistent with CEG), then its seemingly contradictory position that allowance for such costs would be inconsistent with the benchmark regulatory framework on the other. To the extent that the regulatory framework necessitates that service providers be able to recover the reasonable costs for providing prescribed transmission services, including costs in relation to raising equity (and debt), this should logically apply to both direct and indirect costs.

Initial RAB

Powerlink also notes that the AER has refused to include any allowance for equity raising costs in Transend's initial RAB. The AER considers that Transend's valuation was made inclusive of equity raising costs, citing the Allen Consulting Group's 2004 advice to the ACCC in support of its position, namely:

> ACG concluded that where the initial asset base has already been established and has been used to determine revenue based on the building block approach, equity raising costs must be considered to be included[1].

[1] AER (2009), Transend Transmission Determination 2009-10 to 2013-14, p199.

However, the AER has failed to recognise that where the RAB has already been established, ACG also considered that the regulator would need to consider the issue on its merits. In particular, ACG referred to situations where the RAB had been established:

> … and a clear signal was provided that the starting value would just be rolled-forward ….[2]

It is understood that no such signal was provided to Transend at the time of its 2003 revenue determination. The decision to lock-in and roll-forward the RAB was not made until December 2004, with the finalisation of the *Statement of Principles for the Regulation of Electricity Transmission Revenues*. In light of the timing of these events, it would therefore be appropriate to now compensate Transend in the Final Decision for the costs of raising equity associated with its 2003 opening asset base.

Should you have any queries in relation to these matters, please contact me directly or Jennifer Harris on (07) 3860-2667.

Yours sincerely,

Gordon Jardine
CHIEF EXECUTIVE

[2] Allen Consulting Group (2004), Debt and Equity Raising Transaction Costs, Final Report, Report to the Australian Competition and Consumer Commission, December, pix.