

# **TRANSEND REVENUE CAP 2009/10-2013/14**

## **SUBMISSION BY RIO TINTO ALCAN (BELL BAY) IN RESPONSE TO THE DRAFT DECISION OF THE AER**

### **A. INTRODUCTION**

Rio Tinto Alcan Bell Bay (**RTA Bell Bay**) welcomes the opportunity to lodge this submission in response to:

- (a) the AER's draft decision on Transend's revenue proposal for the 2009/10-2013/14 regulatory control period; and
- (b) Transend's revised revenue proposal dated 13 January 2009.

In its first submission, RTA Bell Bay expressed its interest in this matter and the direct and material financial impact that the AER's decision will have on its Tasmanian aluminium smelter.

RTA Bell Bay is pleased that the AER has acted on several of the points made in its first submission on Transend's proposal. However, RTA Bell Bay believes that several issues still need to be addressed by the AER if its final decision is to conform to the requirements of the *National Electricity Rules (NER)*. Many of these issues are addressed in the submission by the Major Employer Group, which RTA Bell Bay supports.

In particular, RTA Bell Bay wishes to highlight the impact of the current global economic crisis. Since the second half of 2008 the aluminium price has fallen by 70%, making it necessary for RTA Bell Bay to reduce operating and capital expenditure. In the past week RTA Bell Bay has announced 48 redundancies from its smelter workforce, with a majority of those made redundant in engineering and operations support staff. Other industries in Tasmania have also announced workforce reductions in recent months as commodity prices plummet.

The suggestion that Transend will continue to operate in a tight market for skilled labour is clearly no longer tenable and should not be accepted by the AER. When the current economic climate is considered, it is clear that the demand forecasts used by Transend exceed the likely load on the transmission network over the next five years. This will be exacerbated by the impact of the proposed Carbon Pollution Reduction Scheme, which is designed to reduce demand for electricity. RTA Bell Bay supports the submission of the Major Employer Group, which recommended that the AER remove from Transend's forecast, capex projects which are of marginal net benefit. At the very least, where the need for further augmentation of the network is not absolutely clear, anticipated projects should be reclassified as contingent projects and excluded from the forecast capex for this decision (subject to compliance with clause 6A.8.1).

RTA Bell Bay's further submissions are set out below.

### **B. FORECAST CAPEX RELATING TO NEGOTIATED SERVICES**

#### **1. The AER's draft decision**

1.1 In section 1 of its first submission, RTA Bell Bay identified several of Transend's proposed contingent projects that relate to negotiated transmission services, and cannot therefore be approved by the AER as contingent projects under clause 6A.8.1. These projects are:

- Sheffield-George Town new transmission line

- Burnie-Smithton new transmission line
- Sheffield-Farrell new transmission line
- Sheffield-Burnie new transmission line
- Palmerston-Sheffield 220kV transmission line augmentation.

Each of these projects is described in greater detail in Annexure A to this submission.

- 1.2 RTA Bell Bay also urged the AER to examine Transend's proposed capex generally to satisfy itself that the proposed expenditure is properly allocated to prescribed transmission services.
- 1.3 At page 142 of its draft decision, the AER stated:

*'Under chapter 6A of the NER Transend is only entitled to an allowance for future capital expenditure in relation to assets providing prescribed services. However, for the purposes of the next regulatory control period, it is relevant to consider clause 11.6.11 which details the arrangements for the grandfathering of existing customer connections. The AER notes that the proposed redevelopment of certain substations as proposed by Transend may, under clause 11.6.11, result in some assets no longer being eligible for inclusion in the Transend capital expenditure allowance.'*

*Transend has not advised the AER of any specific assets which are affected by this provision. The AER also notes that a rule change currently under consideration by the AEMC will, if adopted, result in a change to the eligibility of particular assets to be included in the regulatory asset base of a TNSP.'*

*The AER notes that were a project such as the Tungatinah substation redevelopment to proceed in the next regulatory control period, then the possibility exists of some assets providing connection services to generators colocated at that site being inappropriately included in the Transend capital expenditure allowance if the proposed rule change does not proceed.'*

- 1.4 Subject to changes to the trigger events and estimated costs, the AER approved nine contingent projects identified by Transend, including each of the contingent projects listed in paragraph 1.1 above.
- 1.5 Transend's revised revenue proposal simply repeats the assertion that its proposed contingent projects comply with the requirements of the NER.<sup>1</sup> There is no detailed discussion of the issues raised by RTA Bell Bay in its first submission on the AER's draft decision.

## **2. RTA Bell Bay's response to the AER's draft decision**

- 2.1 The brevity of the AER's discussion of this issue in the draft decision suggests that the AER does not fully appreciate its significance to users such as RTA Bell Bay. In its revised revenue proposal, Transend seeks the approval of \$710.8 million in forecast capex.<sup>2</sup> While RTA Bell Bay considers this figure to be excessive, an even greater concern is that Transend has sought the AER's approval for a suite of contingent projects

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<sup>1</sup> Transend revised revenue proposal, page 8.

<sup>2</sup> Transend revised revenue proposal, page 41.

that are estimated by Transend to cost a further \$509 million. The five contingent projects identified in paragraph 1.1 above are estimated by the AER to cost \$311 million. If each of these five projects is triggered and rolled into Transend's RAB during the next regulatory control period, Transend's forecast capex will increase from \$710.8 million to \$1,021.8 million (\$2008-09). Given that the return on capital will account for well over half of Transend's maximum allowed revenue in the next period, an increase in Transend's forecast capex of over \$300 million will have a significant and direct financial impact on transmission charges paid by major industrial users such as RTA Bell Bay.

- 2.2 The AER is mistaken if it believes that Transend's contingent projects will be affected by clause 11.6.11. This is a transitional provision designed to 'grandfather' the status of certain existing connection services supplied using existing or replacement assets. It will have little, if any, effect on the construction of new assets as a result of new generation developments.
- 2.3 In RTA Bell Bay's submission, the AER has no power under the NER to approve the five contingent projects listed in paragraph 1.1 above. Clause 11.6.11 of the NER does not affect this outcome. There are four points that lead to this result:
- (a) the AER can only approve forecast capex that will be undertaken to provide prescribed transmission services;
  - (b) the AER can only approve contingent projects that will be undertaken to provide prescribed transmission services;
  - (c) the five contingent projects identified by RTA Bell Bay will be undertaken to provide negotiated transmission services, not prescribed transmission services;
  - (d) clause 11.6.11 is a 'grandfathering' provision that will not affect the status of Transend's proposed contingent projects.
- 2.4 RTA Bell Bay elaborates on each of these points in the paragraphs below. Because of the importance of this issue, RTA Bell Bay has set out in detail the reasons why the AER has no power to approve the specific contingent projects identified in Annexure A.
- 2.5 If the AER does not accept RTA Bell Bay's submission in relation to these contingent projects, it is imperative that the AER sets out its reasons in its final decision:
- (a) to comply with clause 6A.14.2 of the NER; and
  - (b) to enable RTA Bell Bay to consider its rights in terms of review of the AER's decision.

### **3. The AER can only approve forecast capex that will be undertaken to provide prescribed transmission services**

- 3.1 Under clause 6A.6.7(c)(1), the AER must approve a TNSP's capex forecast if it reasonably reflects *'the efficient costs of achieving the capital expenditure objectives'*. The 'capital expenditure objectives' are set out in clause 6A.6.7(a) in the following terms:

- '(1) meet the expected demand for **prescribed transmission services** over that period;*
- (2) comply with all applicable regulatory obligations associated with the provision of **prescribed transmission services**;*

(3) *maintain the quality, reliability and security of supply of **prescribed transmission services**; and*

(4) *maintain the reliability, safety and security of the transmission system through the supply of **prescribed transmission services**.' (emphasis added)*

3.2 Under clause 6A.6.7(d)(1), the AER cannot approve a TNSP's capex forecast if the AER is not satisfied that it reasonably reflects the efficient costs of achieving these objectives.

3.3 Each of the capital expenditure objectives is concerned with the provision of *prescribed transmission services*. Capital expenditure relating to a service that is not a prescribed transmission service cannot, by definition, achieve any of the capital expenditure objectives. There can be no rational basis upon which the AER could be satisfied that capital expenditure relating to a service that is not a prescribed transmission service is reasonably required to achieve any of the capital expenditure objectives. It follows that the AER cannot approve forecast capex that is not undertaken to provide a prescribed transmission service.

#### **4. The AER can only approve contingent projects that will be undertaken to provide prescribed transmission services**

4.1 Clause 6A.8.1(b) provides that:

*'The AER must determine that a proposed contingent project is a contingent project if the AER is satisfied that:*

*(1) the proposed contingent project is reasonably required to be undertaken in order to achieve any of the **capital expenditure objectives**' (emphasis added)*

4.2 Under clause 6A.14.1(4)(ii), the AER must determine, in this transmission determination, *'the capital expenditure that it is satisfied reasonably reflects the capital expenditure criteria'*.

4.3 As noted in paragraph 3.1 above, the capital expenditure objectives relate only to the provision of prescribed transmission services. There can be no rational basis upon which the AER can be satisfied that a contingent project undertaken to provide a service other than a prescribed transmission service is reasonably required to achieve any of the capital expenditure objectives. It follows that such a project cannot be approved by the AER as a contingent project under clause 6A.8.1(b).

#### **5. The five contingent projects identified by RTA Bell Bay will be undertaken to provide negotiated transmission services, not prescribed transmission services**

5.1 A 'negotiated transmission service' is defined in Chapter 10 of the NER in the following terms:

*'Any of the following services:*

*(a) a shared transmission service that:*

*(1) exceeds the network performance requirements (whether as to quality or quantity) (if any) as that shared transmission service is required to meet under any jurisdictional electricity legislation; or*

*(2) except to the extent that the network performance requirements which that shared transmission service is required to meet are prescribed under any*

*jurisdictional electricity legislation, exceeds or does not meet the network performance requirements (whether as to quality or quantity) as are set out in schedule 5.1a or 5.1;*

- (b) **connection services** that are provided to serve a Transmission Network User, or group of Transmission Network Users, at a single transmission network connection point, other than connection services that are provided by one Network Service Provider to another Network Service Provider to connect their networks where neither of the Network Service Providers is a Market Network Service Provider; or
- (c) **use of system services** provided to a Transmission Network User and referred to in rule 5.4A(f)(3) in relation to augmentations or extensions required to be undertaken on a transmission network as described in rule 5.4A,

*but does not include an above-standard system shared transmission service or a market network service.'* (**emphasis added**)

- 5.2 Paragraph (b) of this definition refers to 'connection services'. A 'connection service' is defined in Chapter 10 as:

*'An entry service (being a service provided to serve a Generator or a group of Generators, or a Network Service Provider or a group of Network Service Providers, at a single connection point) or an exit service (being a service provided to serve a Transmission Customer or Distribution Customer or a group of Transmission Customers or Distribution Customers, or a Network Service Provider or a group of Network Service Providers, at a single connection point).'*

- 5.3 Paragraph (c) of the definition of a negotiated transmission service refers to 'use of system services' referred to in clause 5.4A(f)(3). Clause 5.4A relates to access arrangements for transmission networks. Each TNSP is bound to comply with this provision in making an offer to connect to the network.<sup>3</sup> In so far as it is relevant, clause 5.4A(f)(3) provides that:

*'The Transmission Network Service Provider and the Connection Applicant must negotiate in good faith to reach agreement as appropriate on:*

...

(3) *the use of system services charge to be paid:*

- (i) *by the Connection Applicant in relation to any augmentations or extensions required to be undertaken on all affected transmission networks and distribution networks'. (emphasis added)*

- 5.4 A 'Connection Applicant' is defined in Chapter 10 as:

*'A person who wants to **establish or modify** connection to a transmission network or distribution network and/or who wishes to receive network services and who makes a connection enquiry as described in clause 5.3.2.'* (**emphasis added**)

- 5.5 In summary, this means that a 'negotiated transmission service' includes:

- (a) a 'connection service' supplied to:
  - (i) a new generator; or
  - (ii) an existing generator that wishes to modify an existing connection; and

<sup>3</sup> clauses 6A.9.2(b); 5.3.6(i).

- (b) a 'use of system service' relating to augmentations or extensions required to be undertaken as a result of a connection application by:
- (i) a new generator; or
  - (ii) an existing generator that wishes to modify an existing connection.

5.6 A 'prescribed transmission service' is defined in Chapter 10 of the NER as:

*'Any of the following services:*

*(a) a shared transmission service that:*

*(1) does not exceed such network performance requirements (whether as to quality or quantity) as that shared transmission service is required to meet under any jurisdictional electricity legislation;*

*(2) except to the extent that the network performance requirements which that shared transmission service is required to meet are prescribed under any jurisdictional electricity legislation, does not exceed such network performance requirements (whether as to quality or quantity) as are set out in schedule 5.1a or 5.1; or*

*(3) is an above-standard system shared transmission service;*

*(b) services that are required to be provided by a Transmission Network Service Provider under the Rules, or in accordance with jurisdictional electricity legislation, to the extent such services relate to the provision of the services referred to in paragraph (a), including such of those services as are:*

*(1) required by NEMMCO to be provided under the Rules; and*

*(2) necessary to ensure the integrity of a transmission network, including through the maintenance of power system security and assisting in the planning of the power system; or*

*(c) connection services that are provided by a Transmission Network Service Provider to another Network Service Provider to connect their networks where neither of the Network Service Providers is a Market Network Service Provider;*

*but does not include a negotiated transmission service or a market network service.'*  
*(emphasis added)*

5.7 Put simply, a 'negotiated transmission service' is not a 'prescribed transmission service'.

5.8 RTA Bell Bay has identified five proposed contingent projects which, according to Transend's own revenue proposal, will be driven by new generation. This is confirmed by the AER's draft decision. Annexure A to this submission identifies the passages from Transend's revenue proposal and the AER's draft decision that support these findings.

5.9 As Transend has stated, these augmentations are physically removed from any generator connection. This means they will not be undertaken for the purpose of providing 'connection services'. However, it is clear that each project will be required as a result of a connection application by one or more generators (see the definition of 'Connection Applicant' in paragraph 5.4 above). Accordingly, these projects, if triggered, will relate to a use of system service that falls within paragraph (c) of the definition of 'negotiated transmission service' (see paragraph 5.3 above).

- 5.10 This means that each of these five proposed contingent projects will relate to 'negotiated transmission services'. Accordingly, none of these contingent projects will relate to 'prescribed transmission services' and therefore cannot be approved by the AER as part of Transend's forecast capex or as a contingent project under clause 6A.8.1.
- 5.11 RTA Bell Bay has focussed on five proposed contingent projects because it is clear from Transend's revenue proposal and the AER's draft decision that these projects are driven by new generation. However, in order to approve Transend's capex forecast and its proposed contingent projects, the AER must be affirmatively satisfied of the matters specified in clause 6A.6.7(c) and 6A.8.1(b) with respect to the whole of Transend's forecast capex allowance and each proposed contingent project.<sup>4</sup> In this context, RTA Bell Bay is concerned by the AER's statement that '*Transend has not advised the AER of any specific assets which are affected by this provision*'. This language appears to suggest that the AER is relying on Transend to inform it whether part of its forecast capex may not relate to prescribed services, or may relate to prescribed services only because of clause 11.6.11.
- 5.12 The AER has no power to approve forecast capex or contingent projects that do not reasonably reflect the capital expenditure objectives. The fact that Transend has not informed the AER of circumstances that may suggest that a project should not be approved will not validate a decision by the AER that exceeds its power under the NER.
- 5.13 While the AER must certainly have regard to any information provided by Transend in relation to its forecast capex, it must also consider submissions received in the course of consulting on the proposal.<sup>5</sup> Proper consideration of RTA Bell Bay's submission requires the AER to make its own inquiries into whether Transend's forecast capex and contingent projects relate to prescribed transmission services. The AER cannot satisfy itself that Transend's proposed forecast capex and contingent projects are properly allocated to prescribed transmission services based solely on the advice that Transend provides (or does not provide) to the AER.

**6. Clause 11.6.11 is a 'grandfathering' provision that will not affect the status of Transend's proposed contingent projects**

- 6.1 In its draft decision, the ACCC referred to clause 11.6.11 of the NER. At the time of the draft decision, this clause provided as follows:

*'(a) References to prescribed transmission services in the new Chapter 6A include a service provided by an asset used in connection with, or committed to be constructed for use in connection with, a transmission system as at 9 February 2006:*

*(1) to the extent that the value of the asset is included in the regulatory asset base for that transmission system under an existing revenue determination in force at that time; or*

*(2) if the price for that service has not been negotiated under a negotiating framework established pursuant to old clause 6.5.9,*

*and, but for this clause, that service would not otherwise be a prescribed transmission service.*

<sup>4</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 at [9]; *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 at [46].

<sup>5</sup> NER – clauses 6A.12.1(a), 6A.13.1(a).

- (b) *Where a service is a prescribed transmission service by virtue of the operation of this clause, that service is taken not to be a negotiated transmission service.*
- (c) *For the purposes of this clause 11.6.11, an asset is, and is only, to be taken to be committed to be constructed if it satisfies the criteria which a project needs to satisfy to be a 'committed project' for the purposes of the regulatory test.'*

6.2 On 29 January 2009, the AEMC released the *National Electricity Amendment (Cost Allocation Arrangements for Transmission Services) Rule 2009*. This determination inserted a new clause 11.6.11, which will come into effect on 13 February 2009, and will therefore apply to the Transend revenue cap determination.

6.3 Clause 11.6.11 now provides as follows:

***'Definitions***

(a) *In this clause 11.6.11:*

***existing asset*** means an asset that as at 9 February 2006:

- (1) *was used in connection with a transmission system where the value, or a portion of the value, of that asset was included in the regulatory asset base; or*
- (2) *was committed to be constructed for use in connection with a transmission system where the forecast value or a portion of the forecast value was included in the forecast capital expenditure,*

*for that transmission system under a revenue determination in force as at 9 February 2006.*

*For the purpose of this definition, an asset is, and is only, to be taken to be committed to be constructed if it satisfied the criteria which a project needed to satisfy to be a 'committed project' for the purpose of the regulatory test in force as at 9 February 2006.*

***replacement asset*** means:

- (1) *an asset which replaces an existing asset after 9 February 2006; or*
- (2) *an asset which replaces an asset referred to in this clause 11.6.11(a) after 9 February 2006.*

*For the purpose of this definition, an asset will be treated as replacing another asset even if it provides an increased or different functionality to the asset it replaces, provided that the increased or different functionality was not requested by the relevant Transmission Network User.*

***eligible asset*** means:

- (1) *an existing asset which was, immediately before the commencement date, or was or is, when first commissioned after the commencement date, wholly and exclusively used by a Transmission Network Service Provider to provide connection services to a Transmission Network User or a group of Transmission Network Users at a transmission network connection point; and*
- (2) *a replacement asset which is wholly and exclusively used after the commencement date by a Transmission Network Service Provider to continue providing connection services to a Transmission Network User or a group of Transmission Network Users at a transmission network connection point,*



and excludes:

- (3) *an existing asset or a replacement asset to the extent that it ceases to be used after the commencement date to provide a connection service to a Transmission Network User or a group of Transmission Network Users at a transmission network connection point; and*
- (4) *an existing asset or replacement asset that, as at the 2009 commencement date, was wholly and exclusively used by a Transmission Network Service Provider to provide connection services to a Transmission Network User or a group of Transmission Network Users at a transmission network connection point but had all of its costs treated as directly attributable to, or incurred in providing, transmission use of system services at that date.*

**prescribed connection service** means a connection service provided by a Transmission Network Service Provider to a Transmission Network User at a transmission network connection point on or after the 2009 commencement date in respect of which the following criteria are satisfied:

- (1) *the relevant service is provided using assets that include eligible assets;*
- (2) *the relevant service is being provided under a connection agreement which was first entered into before the commencement date (as extended or novated from time to time);*
- (3) *the connection agreement has not at any time after the 2009 commencement date been amended at the request of the Transmission Network User for the purposes of altering the relevant service; and*
- (4) *the relevant service would not otherwise be a prescribed transmission service for the purposes of new Chapter 6A but for this clause 11.6.11.*

**2009 commencement date** means the date on which the National Electricity Amendment (Cost Allocation Arrangements for Transmission Services) Rule 2009 commences operation.

#### **Prescribed transmission services**

- (b) *References to prescribed transmission services in new Chapter 6A include prescribed connection services and, where a service is a prescribed transmission service by virtue of the operation of this clause 11.6.11, that service is taken not to be a negotiated transmission service.*

#### **Interaction with new Chapter 6A**

- (c) *For the purposes of new Chapter 6A:*
  - (1) *the costs of the transmission system assets that, from time to time, may be treated as:*
    - (i) *directly attributable to the provision of a prescribed connection service; or*
    - (ii) *incurred in providing a prescribed connection service,*  
  
*to a Transmission Network User or a group of Transmission Network Users at a transmission network connection point are limited to the costs of the eligible assets which, from time to time, provide that prescribed connection service;*
  - (2) *any costs of an existing eligible asset or a replacement asset (or of any portion of an existing asset or a replacement asset) that:*

- (i) *is not an eligible asset (other than as a result of clause 11.6.11(d)); and*
- (ii) *is used by a Transmission Network Service Provider to provide connection services to a Transmission Network User or a group of Transmission Network Users at a transmission network connection point,*

*must be treated as costs that are directly attributable to the provision of, or are incurred in providing, prescribed TUOS services and, to avoid doubt, the services provided by those assets which would otherwise be connection services are taken to be prescribed TUOS services; and*

- (3) *the stand-alone amount for prescribed TUOS services is taken to include any portion of the costs referred to in clause 11.6.11(c)(2) that has not been allocated under clause 6A.23.2(d)(1).*

#### ***Cessation of prescribed connection services***

- (d) *If a connection service ceases to be a prescribed connection service at the start of a regulatory control period for the relevant Transmission Network Service Provider:*
  - (1) *the connection service is taken to be a negotiated transmission service;*
  - (2) *despite clause 6A.19.2(7), the costs which were allocated to the prescribed connection service may be reallocated to negotiated transmission services;*
  - (3) *the eligible assets that previously provided the prescribed connection service cease to be eligible assets; and*
  - (4) *despite clause 6A.2.3, the value of the eligible assets which previously provided the prescribed connection service may be removed from the regulatory asset base of the Transmission Network Service Provider.'*

- 6.4 The purpose of this rule is to 'grandfather' the status of certain services which, under previous regulatory determinations, were treated as prescribed services. The effect of the rule is to deem certain *existing* connection services to be prescribed transmission services, thereby allowing the assets used to provide those services to remain in the TNSP's RAB. However, clause 11.6.11 will only operate where certain specific criteria are satisfied.
- 6.5 Clause 11.6.11(b) grandfathers certain existing connection services by providing that references in Chapter 6A to a 'prescribed transmission service' include a 'prescribed connection service'. A 'prescribed connection service' is a new concept created by clause 11.6.11.
- 6.6 In order to qualify as a 'prescribed connection service', the following conditions must be satisfied:
- (a) the service must be a connection service provided by the TNSP at a transmission connection point after the commencement of the new rule (ie. 13 February 2009);
  - (b) the service must be supplied using assets that include 'eligible assets', namely:
    - (i) existing or committed assets that were, at 9 February 2006, used in connection with a transmission system and was wholly or partly included in the TNSP's RAB (an 'existing asset'); or
    - (ii) an asset that replaces such an asset (even if it provides increased or different functionality) (a 'replacement asset');

- (c) the service must be provided under an existing connection agreement. This connection agreement must not have been amended after 13 February 2009, at the request of the user, to alter the relevant service; and
  - (d) the service must not otherwise be a prescribed transmission service.
- 6.7 Only if each of these conditions is satisfied will a service be deemed to be a 'prescribed transmission service' under clause 11.6.11(b).
- 6.8 The AER cannot determine that forecast capex should be included in Transend's RAB under clause 11.6.11 without first satisfying itself that each of the requirements of this clause are satisfied. Given that clause 11.6.11 is concerned with grandfathering the status of existing connection services, clause 11.6.11 is likely to have limited application to those capex projects that augment (as opposed to replace) existing network assets. Even then, the AER must be satisfied of the other matters required by 11.6.11, including the requirements that the assets are used to supply connection services under existing connection agreements.
- 6.9 It is clear that none of the five contingent projects described in Annexure A to this submission relate to existing assets or replacement assets. These are projects to augment the transmission network by developing new transmission lines and related assets as a result of new generation. There is nothing to 'grandfather' under clause 11.6.11. Further, these projects will not, by Transend's own admission, be used to supply connection services at a transmission network connection point. Finally, Transend has not demonstrated that any of these projects relate to services supplied under existing connection agreements. In short, clause 11.6.11 has no application to any of the five contingent projects described in Annexure A to this submission.

### **C. RATE OF RETURN**

#### **7. Forecast inflation**

- 7.1 RTA Bell Bay stands by its arguments in section 13 of its submission in response to Transend's revenue proposal.
- 7.2 In its revised revenue proposal, Transend has proposed yet another methodology for forecasting inflation. In the submission attached to Transend's revenue proposal in May 2008, CEG stated:
- 'The evidence that indexed government bond yields are downward biased is compelling ...'*<sup>6</sup>
- 7.3 In the submission, CEG agreed with the AER's decision to cease forecasting inflation by comparing forecast yields on nominal and real Commonwealth Government Securities using the Fisher equation.
- 7.4 Transend now argues that the rationale for ceasing to use the Fisher equation is no longer valid. This is a remarkable reversal in Transend's position which, in RTA Bell Bay's submission, simply underscores the point made in RTA Bell Bay's first submission. The difficulties in forecasting inflation are well documented and have been canvassed at length in previous decisions. The AER should utilise a method of forecasting inflation that produces consistent and predictable outcomes over time. The alternative is a

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<sup>6</sup> Transend revenue proposal, Appendix 14, page 4.

situation where TNSPs develop distinct methodologies that are designed to produce the most favourable outcome for that TNSP at any given time, even if this means changing methodologies *during the decision making process*.

7.5 This is underscored by Transend's proposal that the AER should develop two approaches, and use whichever produces the *lowest* result. Transend is arguing, in effect, that the AER should not use its *best* estimate of inflation, but the figure that produces the outcome most favourable to Transend. This is not the outcome required by clause 6A.5.3(b)(1) of the NER.

7.6 The AER's draft decision is correct and should be reflected in the AER's transmission determination.

## **8. Debt margin**

8.1 In its revised revenue proposal, Transend has proposed a new methodology for the calculation of its debt margin. Clause 6A.12.3(b) does not permit Transend to revise its revenue proposal in this way.

8.2 In its original revenue proposal, Transend proposed that the debt margin should be calculated according to the methodology set out by CEG in Appendix 19 to the original revenue proposal.<sup>7</sup>

8.3 In Appendix 19, CEG proposed that the debt margin should be determined in accordance with the methodology used in the 2008 SP AusNet decision.<sup>8</sup> This methodology used data published by Bloomberg to derive a proxy yield for a 10 year BBB+ bond. In its draft decision, the AER decided to use this same approach to determine Transend's debt margin.<sup>9</sup>

8.4 In its revised revenue proposal, Transend now proposes to establish the debt margin by taking the mid point between estimates produced using data from Bloomberg and CBASpectrum.

8.5 While clause 6A.12.3(a) permits a TNSP to revise its revenue proposal, clause 6A.12.3(b) provides that:

*'A Transmission Network Service Provider may only make the revisions referred to in paragraph (a) so as to incorporate the substance of any changes required by, or to address matters raised in, the draft decision.'*

8.6 The AER's draft decision raised no issue with Transend's proposed use of Bloomberg data to determine its debt margin. The use of Bloomberg data, and the methodology proposed by Transend, was accepted by the AER. The only issue raised by the AER was the averaging period nominated by Transend. Accordingly, Transend is not now permitted to modify this part of its revenue proposal.

8.7 Even if Transend was permitted to modify its revenue proposal in this way, the AER should stand by its draft decision. The use of CBASpectrum data to determine the debt margin has resulted in the re-opening of revenue caps for both Transgrid and

<sup>7</sup> Transend revenue proposal, page 159.

<sup>8</sup> Transend revenue proposal, Appendix 19, pages 7, 9.

<sup>9</sup> AER Draft Decision, page 151.

EnergyAustralia, and has been the subject of extensive study by the AER, leading to the conclusion that Bloomberg data should be used instead of CBASpectrum. Transend should not now be permitted to re-open this issue simply because it believes it can achieve a more favourable outcome using data produced by CBASpectrum.

- 8.8 The AER's draft decision is correct and should be reflected in the AER's transmission determination.

### **C. FORECAST OPEX**

#### **9. Equity raising costs associated with the opening RAB**

- 9.1 Transend has produced a lengthy response to the AER's draft decision to preclude from Transend's forecast opex allowance equity raising costs associated with Transend's opening RAB. This includes a detailed paper prepared by Harding Katz which includes, among other things, an extensive survey of the history of the regulatory treatment of equity raising costs in relation to the opening RAB.

- 9.2 In RTA Bell Bay's submission, the issue is far more straightforward than Transend contends. When the AEMC promulgated the new Chapter 6A of the NER in 2006, it made a deliberate and unambiguous decision to lock in the opening RAB for each TNSP. In its original rule proposal, the AEMC stated:

*The potential for periodic optimisation of assets raises uncertainty, which in turn is likely to dampen incentives to invest. The periodic optimisation approach is also information intensive and subjective. Arguments in favour of periodic optimisation of the RAB typically focus on the incentives for efficient investment provided under such an approach. However, the strength of incentives for efficiency depends on the extent of clarity around when/if assets will be optimised.*

*The Commission does not support periodic optimisation of the RAB, for the reasons given above. The Draft Rule therefore codifies the current lock-in approach in the SRP to determining the RAB, with additional guidance on the criteria to be adopted in undertaking any prudence review of actual expenditure.*

*The starting point for the lock-in of the RAB is the opening asset base as already determined in the current regulatory determinations applying to the TNSPs. The dollar values of these initial RABs are set out in the Draft Rule for clarity (Appendix 4). The Commission has taken these values from the values set out in the existing determinations, and has not made its own assessment of the RABs for each TNSP. The Draft Rule requires these RAB values to be adopted for the purposes of the roll-forward.<sup>10</sup>*

- 9.3 This principle was reflected in the final version of Chapter 6A promulgated by the AEMC in November 2006.
- 9.4 In its 2008 decision relating to SP AusNet's revenue cap, the AER recognised that changing the regulatory treatment of equity raising costs for the opening RAB equated, in effect, to a selective re-valuation of the opening RAB. The relevant passage from the AER's decision is reproduced in paragraph 8.8 of RTA Bell Bay's original submission. The AER rightly rejected an approach that allowed for 'cherry picking' of the opening RAB, that is, selectively re-valuing those components of the opening RAB that favour the TNSP, while leaving untouched the remainder of the opening RAB.

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<sup>10</sup> Draft National Electricity Amendment (Economic Regulation Of Transmission Services) Rule 2006, Rule Proposal Report, AEMC, February 2006, pages 57-58.

- 9.5 Harding Katz devote considerable effort to showing that the ACCC did not 'lock in' Transend's RAB.<sup>11</sup> This argument is misconceived. Under Part B of Chapter 6 of the former *National Electricity Code* the ACCC had no power to lock in the opening RAB. Clause 6.2.3(d)(4)(iv) empowered the ACCC to revalue sunk assets. This means that the ACCC could not commit to lock in each TNSP's RAB, even though it expressed a clear preference to do so in its 2004 Statement of Regulatory Principles.
- 9.6 The Transend's RAB was not locked in by the ACCC. It was locked in by the AEMC for the reasons outlined in its determinations relating to Chapter 6A of the NER. In relation to SP AusNet, ElectraNet and the Transend draft decision, the AER has adopted a principled approach to equity raising costs that is consistent with the lock in of the opening RAB:
- (a) in the case of SP AusNet and ElectraNet, the AER recognised that each TNSP's 2003 opex included an allowance for equity raising costs for the opening RAB, which was analogous to recognising those costs in the opening RAB itself. On this basis the AER continued to recognise those costs;
  - (b) in the case of Transend, the AER recognised that no allowance for equity raising costs for the opening RAB was included either in the RAB itself or Transend's 2004 opex allowance. Accordingly, the AER preserved the integrity of the opening RAB and refused an allowance for Transend in its draft decision.
- 9.7 Consistency with previous decisions is important, but in the case of each TNSP's opening RAB, consistency demands that the opening RAB is not re-visited each time there is a change in regulatory thinking. To allow a TNSP to selectively adjust its opening RAB as a result of subsequent regulatory decisions undermines the objectives that motivated the AEMC to lock in the opening RAB under Chapter 6A.
- 9.8 In the present case, Transend seeks to re-visit its opening RAB through its opex allowance rather than the value of the RAB itself. The AER has recognised that what Transend has proposed is, in effect, a modification to its opening RAB which should not be permitted simply because it has been characterised as opex by Transend.
- 9.9 The AER's draft decision is correct and should be reflected in the AER's transmission determination.

## **10. Debt and equity raising costs generally**

- 10.1 RTA Bell Bay strongly supports the AER's draft decision in relation to debt and equity raising costs generally. RTA Bell Bay notes that Transend's response to the AER's draft decision is set out in Appendix 6 to its revised revenue proposal, being a submission prepared for Transend by CEG. As at the date of this submission by RTA Bell Bay, Appendix 6 has not been published on the AER's web site. The AER's web site states that a '*number of the appendices to the revised revenue proposal have not been published pending resolution of confidentiality issues.*' Transend has already submitted lengthy arguments in relation to debt and equity raising costs as part of its original revenue proposal. These arguments have been rejected by the AER. If Transend is not willing to allow the AER to publish its further submission on these issues, in sufficient time to give affected parties a reasonable opportunity to respond, the AER should, pursuant to clause

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<sup>11</sup> Transend revised revenue proposal, Appendix 8, pages 17 to 19.

6A.16(e), give these further arguments no weight in its transmission determination and affirm its draft decision in relation to these issues.

#### **D. OTHER MATTERS**

##### **11. Service Target Performance Incentive Scheme**

- 11.1 In its response to the AER's draft decision, Transend has stated that it wishes to have the option to introduce the 'market impact parameter' during the forthcoming period if it is practical to do so.<sup>12</sup> This is not permitted by clause 6A.7.4 of the NER.
- 11.2 Clause 6A.7.4(b) requires the performance incentive scheme parameters to be published at the same time as the Service Target Performance Incentive Scheme is published. These parameters can vary as between TNSP's and over time. The parameters approved for Transend did not include the market impact parameter.
- 11.3 While clause 6A.7.4(f) permits the AER to amend or replace the scheme, it also states that '*no such amendment or replacement may change the application of the scheme to a Transmission Network Service Provider in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement coming into operation*'.
- 11.4 Transend is proposing an amendment to the scheme by adding a parameter to come into effect during the next regulatory control period. This is not permitted by the NER.

**23 February 2009**

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<sup>12</sup> Transend revised revenue proposal, page 68.

## ANNEXURE A – REVIEW OF SPECIFIC CONTINGENT PROJECTS

### 1. Sheffield-George Town new transmission line

Transend had proposed that this project would cost \$147 million. In the AER's draft decision, this project was approved as a contingent project with an estimated value of \$70 million.

In Appendix 18 to its revenue proposal, Transend describes the scope of this project in the following terms:

*The project comprises the establishment of a third transmission line between Sheffield and George Town substations, including the construction of switch bays at Sheffield and George Town substations to cater for the new transmission line.*

*The scope of work for this project is wholly within the shared transmission network and is physically removed from any generator connection.'*

The need for this project is described in the following terms:

*The analysis undertaken by ROAM Consulting identified potential significant generation developments in the north-western and western regions of Tasmania. If these generation developments occur, it is likely that increased power transfer capacity between Sheffield and George Town substations will be required.*

*Transfer capacity between the north-western and western regions and the remainder of the transmission system is currently limited to the rating of the 220 kV transmission lines that connect Sheffield Substation to George Town and Palmerston substations. If generation developments in the north-western and western regions occur, the proposed contingent project could deliver market benefits by removing a transmission system constraint that would occur on the existing transmission network between Sheffield and George Town substations.'*

At page 326 of its draft decision, the AER described this project in the following terms:

*The driver for this project is to provide adequate network capacity to allow for the connection of new generation in the north-western and/or western regions.*

*The scope of the project involves the establishment of a third 220 kV transmission line between Sheffield and George Town substations, including the construction of switch bays at Sheffield and George Town substations to cater for a new transmission line. The indicative cost of this project is \$70m (June 09, \$).*

*The trigger for this project will be committed and/or advanced generation in the northwestern and/or western regions in excess of 50MW resulting in the successful application of the regulatory test for augmentation of the Sheffield-George Town transmission corridor.'*

### 2. Sheffield-Farrell new transmission line

Transend had proposed that this project would cost \$80 million. In the AER's draft decision, this project was approved as a contingent project with an estimated value of \$79 million.

The scope and driver for this project is described by Transend in Appendix 18 to its revenue proposal in similar terms to the scope and driver of the Sheffield-George Town new transmission line.

At page 326 of its draft decision, the AER described this project in the following terms:



*The driver for this project is to provide adequate network capacity to allow for the connection of new generation in the north western and western regions of Tasmania.*

*The scope of the project involves the construction of a new transmission line between Sheffield and Farrell substations. The project may also involve the construction of a new switching station in the Staverton area near Cethana power station that would consolidate the three incoming circuits from the Farrell substation and the four incoming circuits from Cethana, Wilmot, Lemonthyme and Fisher power stations into the six circuits that would connect to Sheffield substation. The indicative cost of this project is \$79 (June 09,\$).*

*The trigger for this project will be if at least 50MW of committed and/or advanced generation projects in the west coast area resulting in the successful application of the regulatory test for augmentation of the Sheffield-Farrell transmission corridor.'*

### **3. Burnie-Smithton new transmission line**

Transend had proposed that this project would cost \$85 million. In the AER's draft decision, this project was approved as a contingent project with an estimated value of \$88 million.

The scope and driver for this project is described by Transend in Appendix 18 to its revenue proposal in similar terms to the scope and driver of the Sheffield-George Town new transmission line.

At page 325 of its draft decision, the AER described this project in the following terms:

*The driver for this project is to allow for adequate network capacity in north-western Tasmania if new generation is connected to the network.*

*The scope of the project involves the construction of a new double circuit transmission line between Burnie and Smithton substations and an augmentation of the existing Burnie-Smithton transmission line. The indicative cost of this project is \$88m (June 09, \$).*

*The trigger for this project will operate if there are committed and/or advanced generation projects in the north-western region in excess of 50MW resulting in the successful application of the regulatory test for augmentation of the Burnie-Smithton transmission corridor.'*

### **4. Sheffield-Burnie new transmission line**

Transend had proposed that this project would cost \$77 million. In the AER's draft decision, this project was approved as a contingent project with an estimated value of \$52 million.

The driver for this project is described by Transend in Appendix 18 to its revenue proposal in the following terms:

*'Burnie Substation supplies Tasmania's north-western region. Burnie Substation is supplied via the Sheffield-Burnie No 1 220 kV transmission line and two Sheffield-Burnie 110 kV transmission lines, one of which also supplies Emu Bay and Ulverstone substations and connects generation from Hydro Tasmania's Paloona Power Station.*

*Augmentation of the Sheffield-Burnie 110 kV transmission lines from a design operating temperature of 49°C to 75°C is included in the capital expenditure forecast for the forthcoming regulatory control period. Based on the 2008 demand forecast, this augmentation should provide adequate capacity to Burnie Substation to meet demand in the north western region of Tasmania.*

*The analysis undertaken by ROAM Consulting identified potential significant generation developments in north-western region. If these generation developments occur, the proposed contingent project could deliver market benefits by removing a transmission system constraint that would occur on the existing transmission network between Sheffield and Burnie substations.*

*Transend's capital expenditure forecast includes the acquisition of an easement for an additional Sheffield–Burnie transmission line. The estimate for this proposed contingent project does not include any easement acquisition costs.'*

At page 326 of its draft decision, the AER described this project in the following terms:

*'The driver for this project is to provide adequate network capacity to allow the connection of new generation in the north-western and western regions and/or to cater for load growth in the region.*

*The scope of the project involves the establishment of a new double-circuit 220kV transmission line between Sheffield and Burnie substations, including the construction of switch bays and Sheffield and Burnie substations to cater for new circuits. The existing 220 kV Sheffield-Burnie transmission line will be decommissioned. The indicative cost of this project is \$52m (June 09, \$).*

*The trigger for this project is demand in Tasmania's north-western region exceeding 310MW and/or in excess of 50MW committed and/or advanced generation projects in the north-western region resulting in the successful application of the regulatory test for augmentation of the Sheffield-Burnie transmission corridor.'*

Notwithstanding the AER's description of the driver for this project, to the extent that the cost of this project is not already included in Transend's forecast capex, it appears to be driven by new generation. To the extent that this expenditure is a contingent project, it does not relate to an existing asset or a replacement asset.

## **5. Palmerston-Sheffield new transmission line**

Transend had proposed that this project would cost \$22 million. In the AER's draft decision, this project was approved as a contingent project with an estimated value of \$22 million.

The scope and driver for this project is described by Transend in Appendix 18 to its revenue proposal in similar terms to the scope and driver of the Sheffield-George Town new transmission line.

At page 327 of its draft decision, the AER described this project in the following terms:

*'The drivers for this project are to provide adequate network capacity to allow for the connection of new generation in the north-western and western regions.*

*The scope of the project involves the augmentation of the Palmerston-Sheffield 220 kV transmission line and the associated switch bays at Palmerston and Sheffield substations. The technical parameters for the augmented transmission line have not yet been determined in detail; however the indicative cost is based upon re-tensioning the Palmerston-Sheffield 220kV line to a design temperature of 80 degrees Celsius.*

*The indicative cost of this project is \$22m (June 09, \$).*

*The trigger for this project is at least 50MW of actual, committed and/or advanced generation projects in the north-western and/or western regions resulting in the successful application of the regulatory test for augmentation of the transmission system to the Palmerston-Sheffield transmission corridor.'*