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# **AER Draft Determination – Debt Raising Costs**

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**BY EMAIL  
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Nicola Tully  
Manager Revenue Reset  
TransGrid  
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Dear Nicola

**AER draft determination - Debt raising costs**

You have asked us to consider the Australian Energy Regulator's (**AER**) approach to determining the debt raising costs of TransGrid in its draft determination dated 27 November 2014. In the draft determination the AER has not accepted TransGrid's proposed debt raising costs for liquidity and three month ahead financing (**Relevant Debt Raising Costs**) because:

- (a) the timing assumptions in the post tax revenue model already provides adequate compensation meaning that additional allowances are unnecessary; and
- (b) the AER does not consider that a prudent operator requires an allowance for the Relevant Debt Raising Costs because:
  - (i) some of the other network service providers that submitted revenue proposals in May 2014 (Ausgrid, Endeavour Energy, Essential Energy, Transend and Directlink) have not sought to include the Relevant Debt Raising Costs in their proposals; and
  - (ii) the inclusion of the Relevant Debt Raising Costs result in a more complex regulatory approach to estimate debt raising costs.

The Relevant Debt Raising Costs are operating expenditure under the National Electricity Rules (**NER**). Accordingly, the assessment of whether they should be allowed by the AER must be done in accordance with clause 6A.6.6 of the NER. Clause 6A.6.6 requires the AER to assess whether the forecast operating expenditure reasonably reflects the efficient costs of achieving the operating expenditure objectives, the costs that a prudent operator would require to achieve the operating expenditure objectives and a reasonable expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives (**Operating Expenditure Criteria**). In undertaking this assessment the AER must consider the operating expenditure factors set out in clause 6A.6.6(e) of the NER.

While the AER appears to have considered the prudence of the Relevant Debt Raising Costs claimed by TransGrid, its reasons for not accepting that they are prudent are not, in our view, consistent with the requirements of the NER. In particular, it is not clear from the AER's draft decision or the NER why what has been proposed by other network service providers or the increased complexity of the approach to estimation is relevant under clause 6A.6.6. Such factors are not contemplated by either the operating expenditure objectives, operating expenditure criteria or operating expenditure factors and cannot be relied on by the AER without notice to TransGrid prior to submitting its revised revenue proposal in accordance with clause 6A.6.6(e)(14) of the NER. Any factor notified by the AER in accordance with this clause must assist the AER with assessing

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whether the Relevant Debt Raising Costs proposed by TransGrid reasonably reflects the Operating Expenditure Criteria. In our view, what has been proposed by other network service providers and the increased complexity of the estimation are not relevant to this assessment and the AER has provided no reason to suggest that it is.

Our understanding of the Incenta report relied on by TransGrid is that the Relevant Debt Raising Costs cannot be avoided by a prudent operator. The AER has not provided any evidence that contradicts Incenta's statement of expert opinion. Whether other network service providers have claimed these costs or any increase in the complexity of the estimation do not address the issue of whether a prudent operator would have incurred them as the AER is required to consider under the NER.

The other reason given by the AER for not including the Relevant Debt Raising Costs is that the timing assumptions in the post tax revenue model already over-compensate TransGrid. Again, it is not clear why this is relevant to the assessment under the NER given that the claimed overcompensation from the post tax revenue model is not considered in clause 6A.6.6 of the NER. As such, the AER cannot rely on this claimed overcompensation when determining TransGrid's allowed operating expenditure when applying clause 6A.6.6 of the NER as it is required to do.

In addition, the AER has not presented any evidence as to why it considers that the post tax revenue model will in fact over-compensate TransGrid in the forthcoming regulatory control period. It is therefore difficult for TransGrid or any third party to assess the veracity of this claim by the AER or respond to it. The assertion should not be relied on without evidence to support it in our view and should not be used by the AER to determine TransGrid's allowed operating costs.

Please contact us if you would like to discuss this letter.

Yours faithfully



**Liza Carver**  
Practice Head

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