

4 March 2009

Dr John Tamblyn
Chair
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Dr Tamblyn

Request for Supplementary Changes to the National Electricity Rules

and

Conditional objection to the section 95 and 96 Notice dated 19 February 2009

This letter encloses an amendment to the AER's proposed WACC review extension Rule change and a consequential request for a Rule change which is required if the AER's proposed Rule change is adopted. The letter outlines our response to the section 95 and 96 Notice issued by the AEMC on 19 February 2009.

I discuss each in turn but before doing so, I note the following:

- ETSA Utilities appreciates the importance of the proposed Rule change for the AER. At the same time, the Rule change will deprive ETSA Utilities of its entitlement to develop a robust Regulatory Proposal, which may involve adopting alternative parameters to those proposed by the AER. Further, it is within this truncated period that executive and board approval must be obtained, including certification of the assumptions used as required by the Rules.
- With this in mind, on 27 February 2009 ETSA Utilities, together with Energex and Ergon Energy (whose Regulatory Proposals are to be submitted at the same time as ETSA Utilities), met with the AER to outline the issues raised by its proposed Rule change and consider ways of addressing our concerns. However, we have been unable to reach a practical solution with the AER.
- ETSA Utilities therefore wishes to lodge a conditional objection to the AER's proposed Rule change. If the AEMC makes the Rule changes proposed by the AER and ETSA Utilities concurrently, our conditional objection will be withdrawn.
- Given the tight timeframes involved in the first review, and the desirability of a robust and well-developed Statement of Regulatory Intent followed by an equally well-developed Regulatory Proposal, ETSA Utilities is open to considering a process for achieving the proposed Rule changes.

1. Request for Supplementary Changes to the National Electricity Rules

On 19 February 2009, the AEMC published a section 95 and 96 Notice concerning a Rule change proposed by the AER, namely that the date for release of its final decision on the WACC parameters be extended to 1 May 2009.

In its application for the Rule change the AER stated that:

“The AER expects that a one-month extension will not materially affect the ability of the Queensland and South Australian electricity businesses to prepare building block proposals to be lodged by 31 May 2009.”

“Allowing a one-month extension for the release of the AER’s final decision will not affect the first businesses to which the outcomes of the review will apply. Accordingly the AER considers that the proposed Rule change is unlikely to have a significant effect on the national electricity market and proposes that it be treated as non-controversial in nature.”

ETSA Utilities has its 5 year regulatory proposal due on 29 May 2009 and it was not consulted on the AER’s proposed rule change.

ETSA Utilities appreciates the AER’s desire to have an additional month to consider fully the submissions and materials provided to it and reach a robust outcome. As noted in the AER’s Rule change proposal, there is a great deal of complexity surrounding these issues. Equally, for the reasons set out below, the WACC parameters are an essential input to many detailed aspects of our Regulatory Proposal. As such, ETSA Utilities requires reasonable and adequate time to determine whether to adjust our own parameters in response to the AER’s final Statement of Regulatory Intent. It is likely that ETSA Utilities would need to seek expert opinion on the question of whether it proposes alternative parameters: see 6.5.4(g). In the event that ETSA Utilities relies on alternative parameters, the Rules require persuasive evidence justifying the departure. This would require ETSA Utilities to prepare substantial supporting materials. All this is to be done within the framework of the oversight and approval by the executive and board prior to lodgment of the Regulatory Proposal.

- (a) ETSA Utilities is entitled, where there is persuasive evidence, to adopt WACC parameter values that differ from those in the Statement of Regulatory Intent

In the AER’s Explanatory Statement accompanying the proposed Statement of Regulatory Intent the AER considered whether it should adjust the WACC parameters in response to the global financial crisis but declined to do so on the basis that the WACC parameters must last for a period of 10 years by which time it would have abated. That cannot be said of the WACC decision applying to a business such as ETSA Utilities, which is required to lodge its Revenue Proposal in the midst of the crisis. Given the severity of the global financial crisis, ETSA Utilities may, in the circumstances, need to request WACC parameters that differ from those in the Statement of Regulatory Intent. If so, detailed expert input must be sought, the material must be considered internally and finally approved by the Board. This is neither a short nor an easily accomplished task.

- (b) ETSA Utilities is required to apply the WACC parameters in establishing numeric values used in the Post Tax Revenue Model, *building block proposal* and the *annual revenue requirement* with directors' sign-off.

After all the detailed inputs to the proposal are settled, the business must then calculate the Post Tax Revenue Model, the building block proposal and the annual revenue requirement. These are compulsory elements of the proposal. The over-all package must then be taken to the directors for certification, which is a process involving a close internal review and may include testing, verification and internal accountability measures. These compulsory mechanical and procedural steps themselves can take up a significant portion of the month or indeed more than a month, given the need for overseas-based Directors to participate..

- (c) The Revenue Proposals already require an onerous quantity of other inputs that must be established in the same timeframe

In any normal revenue reset proposal a wealth of inputs must be assembled in the short period before lodgment using the latest demand forecasts, energy flow patterns, project information and input costs. If in addition ETSA Utilities is required, in a short timeframe, to adopt and develop persuasive evidence supporting adjusted parameters, the timeframe within which this is to be accomplished is very short. Thus, in circumstances where AER has proposed that ETSA Utilities lose 30 days from the original timeframe for submission of its proposal, there is a very serious risk that our proposal will be detrimentally affected.

In addition to the above, I note the following.

First, if the timeframe between the AER's release of its final decision and the ETSA Utilities' preparation and submission of its revenue proposal is cut in half from 60 days to 30 days, it will be difficult or impossible to lodge a robust revenue proposal.

Secondly, the AER's Rule change allowing itself an extension of time suggests that it considers the circumstances warrant such an extension. Likewise, ETSA Utilities considers that the circumstances warrant an extension of time to submit its Regulatory Proposal which would merely preserve the original allowed time from release of the SORI to ETSA Utilities' submission of its Regulatory Proposal.

Thirdly, ETSA Utilities' Regulatory Proposal is of crucial importance to the business and therefore requires executive and Board oversight to finally approve the Regulatory Proposal. Relevantly:

- The NER requires Directors to certify the key assumptions which underlie the capital and operating expenditure forecasts: see S6.1.1(6) and S6.1.2(6).
- As you are aware, the Draft Regulatory Information Notice specifies the nature of that certification, including that the certification must be in accordance with a resolution of the Directors. Accordingly, prior to submitting its proposal, ETSA Utilities must gain the required approval and resolutions. Gaining this approval and the necessary directors' resolutions can only occur once the total proposal has been finalised and presented to the Board. In turn, the actual proposal document has to be finalised and produced, once Board approval has been received.

- Given the level of engagement with directors, which is required to gain their approval for the proposal, a minimum period of three weeks from the point at which the analysis (including obtaining expert opinion) has been completed is required. This timeframe takes into account the fact that all Non-executive Directors are based interstate or in Hong Kong. This would be a tighter timeframe than the schedule of Board, Board committee and executive meetings which were planned, taking into account that the final Statement of Regulatory Intent was to be released on 31 March 2009.

ETSA Utilities also notes that the AER's proposed Rule change is unclear as to its effect on subsequent reviews. ETSA Utilities is concerned to ensure that there is no doubt the AER's proposed Rule change does not effect a permanent change to the timing contained in the Rules. For this reason, ETSA Utilities proposes an amendment to the AER's Rule change proposal.

Please find attached a supplementary Rule change proposal to address the issues arising from the AER's Rule change. Specifically, ETSA Utilities requests:

- an amendment to the AER's proposed Rule change to ensure the extension does not effect a permanent change to the timing and process of the second review; and
- a consequential Rule change to ensure that, in light of the AER's extension of time, ETSA Utilities receives an attendant extension of time to enable it to deal with the complex analysis required and to work through the internal approval process to lodge its revenue proposal.

The attached Rule change proposal is prepared in accordance with Clause 8(1) of the NEL Regulations, and includes the text of the proposed amendments. ETSA Utilities requests that the attached Rule change proposal be treated as non-controversial and expedited under section 96 of the NEL.

2. Conditional objection to section 95 and 96 Notice of 19 February 2009

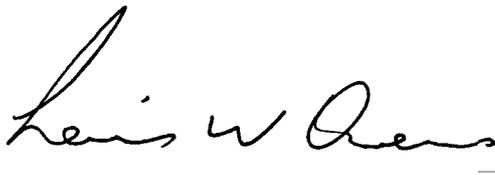
The AER's proposed Rule change and ETSA Utilities' proposed Rule change must be determined as a single integrated package. That is, each Rule change is contingent on the other. For this reason, I request that the Rule change proposals follow the same timetable with both final Rule determinations to be made at the same time.

If there was any prospect that this would not occur, ETSA Utilities would have no option but to object to, and make submissions in respect of, the AER's proposed Rule change. For that reason, this letter is a conditional objection to the AER's Rule change. This objection would cease if, and when, the AEMC decides that ETSA Utilities' Rule change can be determined, on a non-controversial basis, together with the AER's proposed Rule change.

As noted above, I appreciate the importance of the Rule change proposed by the AER and to enable a satisfactory outcome for all parties I propose that we meet with the AEMC to discuss a process for ensuring the Rule changes take effect. In addition, we commit to work with AER to minimise the impact of the one month delay on their decision making process.

Should you have any questions or queries regarding any of the issues discussed in this proposal please contact me.

Yours sincerely,

A handwritten signature in black ink that reads "Lewis Owens". The signature is written in a cursive style with a horizontal line underneath the name.

Lewis Owens
Chief Executive Officer

ATTACHMENT A

NATIONAL ELECTRICITY LA W

REQUEST FOR A NON-CONTROVERSIAL RULE CHANGE

RELATING TO

EXTENSION OF TIME FOR THE AER TO CONCLUDE ITS REVIEW OF THE WACC PARAMETERS FOR ELECTRICITY TRANSMISSION AND DISTRIBUTION

A. NAME AND ADDRESS OF PERSON MAKING THE REQUEST

ETSA Utilities Partnership
1 Anzac Highway
Keswick
South Australia 5041

B. INTRODUCTION

In accordance with Chapter 6 of the National Electricity Rules (NER) the AER is currently conducting its review of the Weighted Average Cost of Capital (WACC) parameters to apply to electricity transmission and distribution network service providers (WACC review). Under the NER, for electricity distribution, the AER is required to conclude its WACC review with the release of a final decision by 31 March 2009.

Given the large volume of submissions to the AER's Explanatory Statement and the complexity of the issues raised therein, particularly in light of current economic conditions, the AER has requested an extension to the date for the release of the final decision to 1 May 2009.

If that occurs, ETSA Utilities must, in only 30 days, undertake a complex analysis to understand any changes made between the draft and final decisions, potentially prepare persuasive and complex evidence that would justify a departure from the AER's parameters, and progress its revenue proposal through ETSA Utilities' internal approval process. A process which, in accordance with the Rules, includes a requirement that the Directors certify certain key assumptions.

Accordingly, this Rule change proposal seeks:

- (1) to clarify that the AER's proposed Rule change only applies in respect of the 2009 review and does not effect a change in the timing and process of the second review; and
- (2) a consequential Rule change arising from the AER's Rule change proposal, namely that ETSA Utilities receives an extension of time within which to lodge its revenue proposal.

ETSA Utilities requests that each Rule change be determined concurrently with both final Rule determinations commencing at the same time.

C. REQUEST FOR EXPEDITED PROCESS

ETSA Utilities proposes that its Rule change proposal be consulted and determined under an expedited process in accordance with section 96 of the NEL. The Rule change proposed merely addresses the issues that arise out of the AER's WACC review and its request for a Rule change for additional time.

Accordingly, the proposed Rule change is unlikely to have a significant effect on the national electricity market and therefore is non-controversial in nature.

D. STATEMENT OF ISSUES

i Current Rules

The current rules require that ETSA Utilities' revenue proposals be formulated applying the Statement of Regulatory Intent, if the statement is published prior to the revenue proposal (see clause 6.5.4(f)).

ii The problem

First, the AER did not consult with ETSA Utilities prior to lodging its proposed rule change.

Secondly, it is not possible for ETSA Utilities to lodge a revenue proposal applying the Statement of Regulatory Intent in only 30 days because:

- (1) ETSA Utilities is entitled to adopt WACC parameter values that differ from those in the Statement of Regulatory Intent;
- (2) ETSA Utilities is required to apply the WACC parameters in establishing numeric values used in the Post Tax Revenue Model, *building block proposal* and the *annual revenue requirement* and which require directors sign-off; and
- (3) the revenue proposals already require complex analysis of significant inputs that must be established in the same timeframe.

As noted above, the issues raised in the WACC review are numerous and complex. In particular, the current financial market conditions need to be considered and assessed in setting robust WACC parameters. The Network Industry Submission, dated February 2009, and submitted to the WACC review, comprehensively outlines the importance of considering the current financial conditions in setting the parameters. For these reasons, ETSA Utilities' request simply reflects the complexity of responding to the AER decision in the current environment where it may need to adopt parameters which differ from those contained in the draft Statement.

Finally, ETSA Utilities' Regulatory Proposal is of crucial importance to the business, therefore requires that the proposal be reviewed, agreed and approved by the Board. The key steps involved in this process include:

- (1) The Directors to certify the key assumptions.

- (2) Certification of ETSA Utilities' Regulatory Proposal by a resolution of the Directors. This requires that prior to making its submission, ETSA Utilities gain the required approval and resolutions of its directors. Gaining this approval and the necessary directors' resolutions can only occur once the total proposal has been finalised and presented to the Board.

With the level of engagement required of directors a minimum period of three weeks is needed from the finalisation of all aspects of the Regulatory Proposal for executive and Board approval, particularly given that all non-executive directors are interstate or in Hong Kong. This would be a tighter timeframe than the schedule of Board, Board committee and executive meetings which were planned, taking into account that the final Statement of Regulatory Intent was to be released on 31 March 2009.

- (1) A reduction in the timeframe by which ETSA Utilities has to consider and manage the Statement of Regulatory Intent will be contrary to provisions in the Rules which encourage a DNSP to operate in an efficient and prudent manner.

In our submission the proposed Rule change should not prejudice the Directors of ETSA Utilities in their endeavor to operate in a prudent and efficient manner when considering the impact to ETSA Utilities of the AER's final Statement of Regulatory Intent.

iii Proposed solution

ETSA Utilities requests that the AER's Rule change proposal for an extension of time for the AER, be clarified to ensure that the Rule change does not have the effect of altering the process and timing for the second review, and consequently that it has 60 days within which to submit its first Regulatory Proposal.

iv How the proposed solution will contribute to the achievement of the National Electricity Objective

The National Electricity Objective (NEO) as stated in section 7 of the NEL is:

... to promote the efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.

In our view, the proposed Rule change is non-controversial in nature and the businesses consider that the proposed Rule change contributes to the NEO by promoting efficient investment in electricity networks in the states concerned. In particular, if accepted, ETSA Utilities' proposal will allow robust revenue proposals with respect to: forecast capital expenditure; forecast operational expenditure; the cost of corporate income tax; the return on capital; and all the other aspects of the proposal that must be prepared between now and lodgment.

Without the proposed Rule change, which arises because of the AER's Rule change proposal, our ability to lodge a robust proposal is unfairly and detrimentally impaired. In contrast, ETSA Utilities' proposed Rule change assists to ensure efficient investment in its electricity networks as the extension of time for the AER coupled with our proposed Rule changes enables the promotion of investment that the AER's Rule change seeks.

v Benefits and costs and potential impact on those likely to be affected by Rule change

The significant benefits of this supplementary Rule change proposal are that it will:

- (1) complement and enable the AER's rule change proposal. In this way, the AER's submission suggests all issues raised in submissions to it in the WACC review may be properly considered in its final decision. In the AER's view this will contribute to the robustness of the outcome and ensure that it properly takes into account recent developments in global financial markets; and
- (2) enable ETSA Utilities to formulate robust revenue proposals in servicing their populations.

APPENDIX A.1 - PROPOSED AMENDMENTS

SUPPLEMENTARY RULE CHANGE REQUEST TO ACCOMPANY THE PROPOSED EXTENSION OF TIME FOR THE AER TO CONCLUDE ITS REVIEW OF THE WACC PARAMETERS FOR ELECTRICITY TRANSMISSION AND DISTRIBUTION

TEXT OF PROPOSED AMENDMENTS

Clause 6A.6.2(g) to be amended to read:

- (g) The AER must conclude the first review by 1 May 2009. The AER must conclude the second review by 31 March 2014 and conclude subsequent reviews at intervals of five years thereafter.

Clause 6A.6.4(c) to be amended to read:

- (g) The AER must conclude the first review by 1 May 2009. The AER must conclude the second review by 31 March 2014 and conclude subsequent reviews at intervals of five years thereafter.

Clause 6.5.4(b) to be amended to read:

- (c) The AER must conclude the first review by 1 May 2009. The second review must be concluded by 31 March 2014 and further reviews are to follow at intervals not exceeding, in any case, 5 years.

11.X ETSA Utilities [*insert details*]Distribution Network Service Providers

11.X.X Definitions

ETSA Utilities means [*insert details*].

11.X.X Application of Part E to ETSA Utilities 2010-2015 distribution determination

- (a) In relation to the regulatory proposal required to be submitted, pursuant to clause 6.8.2, by ETSA Utilities for the regulatory control period 2010-2015:
 - (i) ETSA Utilities is not required to submit its revenue proposal at least 13 months before the expiry of its distribution determination, as provided in clause 6.8.2(b); and
 - (ii) ETSA Utilities must submit its revenue proposal within 60 days of the AER publishing its Statement of Regulatory Intent.