countryenergy

Ref: JC:JC:B593304

16 February 2009

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
CANBERRA ACT 2601

Dear Mr Buckley

Draft NSW distribution determination – Draft decision

Country Energy appreciates the opportunity to respond to the Australian Energy Regulator's (AER's) draft decision on the NSW distribution determination. Country Energy submitted a revised regulatory proposal on 16 January 2009 in response to the draft decision, and this submission should be read in conjunction with that revised proposal. Country Energy's submission further discusses some of the issues raised in its revised proposal and examines some issues not fully covered in the revised proposal.

Demand Forecasts

In its draft decision, the AER requested that Country Energy use the audited energy and customer data for 2007-08 as the starting point when projecting the demand forecasts over the next regulatory control period. Country Energy supplied updated demand forecasts for the next regulatory control period in its revised proposal, but did not have the 2007-08 audited actual quantities for energy and customers available for inclusion at that time.

The audit of 2007-08 actual quantities has now occurred, and Country Energy will provide this data as part of an updated version of the Forecast Sales Quantities table within the Input sheet of the AER's post tax revenue model (PTRM) by 20 February 2009, in accordance with the AER's draft decision.

TUOS Recovery Treatment

Country Energy seeks clarification from the AER on its proposed treatment of TUOS recovery as part of the annual pricing proposal. The AER's draft decision seems to indicate a departure from the current methodology employed by the Independent Pricing and Regulatory Tribunal (IPART) and Country Energy's understanding of the transitional Rules in relation to distribution pricing.

Country Energy has made significant progress in managing its TUOS recovery balance in the current regulatory control period. Under the methodology proposed by the AER in the draft decision, it appears to Country Energy that the TUOS recovery treatment will be set back one year by using the actual audited balance of year (t-2) rather than the forecast balance of year (t-1). This lag of one year may result in greater fluctuations in TUOS prices between years, an undesirable outcome for customers who seek stability and predictability in prices to the greatest extent possible. Country Energy would be happy to discuss this matter further with the AER prior to confirmation of the methodology in the final decision.

The PTRM lodged with Country Energy's revised proposal contained the audited balance of the TUOS overs and unders account as at 30 June 2007. The audited balance for the year ended 30 June 2008 and estimated balance for the year ended 30 June 2009 were not available for inclusion at that time. Country Energy is now able to provide these balances on a commercial in confidence basis, and will do so at the same time the actual energy and customer quantities are updated in the PTRM and submitted to the AER by 20 February 2009.

Network Maintenance Costs

Country Energy would like to reaffirm the position presented on this matter in the revised proposal. It is paramount for the AER in an ex-ante framework that includes an efficiency benefit sharing scheme (EBSS) to set the regulatory allowances at a level whereby Country Energy is provided with the opportunity to recover at least the efficient costs incurred in providing direct control services and complying with all regulatory obligations, consistent with clause 7A(2) of the National Electricity Law (NEL).

Country Energy believes it is not appropriate to impose an EBSS, when both the AER and its consultant, Wilson Cook, concluded that the efficient level of operating expenditure required during the next regulatory control period is well above the amounts included in the AER's own draft decision. Country Energy's regulatory allowances during the current regulatory period were set too low, a point highlighted by Wilson Cook, and the AER's draft decision only prolongs this problem for a further three years.

Country Energy believes that the AER have inappropriately applied the provisions of the NEL and National Electricity Rules (NER) in its reasoning for reducing the approved level of forecast network maintenance expenditure. The AER appear to have applied only one aspect of one clause of the NER. This was done at the expense of the overriding NEL objective and all other provisions of the NER relating to assessment of forecast operating expenditure. Please refer to Country Energy's revised proposal for a detailed discussion of Country Energy's position on the AER's draft decision in this respect.

Growth Capital Expenditure

It was difficult to quantify the likely impact of the revised demand forecasts on capital expenditure when developing Country Energy's revised regulatory proposal, due to the constrained time period available. Country Energy has completed further analysis and modelling based on the revised demand forecasts since submission of the revised proposal.

The majority of work associated with the connection of new customers is related to the connection of new subdivisions. The revised forecast for new customer connections has reduced from 1.46 per cent to 1.29 per cent , representing a small reduction in expected new connections. As a result, Country Energy has identified a deferral of capital expenditure for forecast commercial and domestic subdivisions, due primarily to the global financial crisis and the resulting loss of investor confidence.

The table below details the proposed decrease for each year of the next regulatory control period.

$M (2008-09)	2009-10	2010-11	2011-12	2012-13	2013-14
Annual Decrease in Growth Capital Expenditure	9.96	11.17	11.88	12.22	12.55

EBSS Exclusions

Country Energy did not propose any additional EBSS exclusions in its revised proposal. However, Country Energy believes the AER should consider extending the exclusion for changes in capitalisation policies to cover events where the legal form of a transaction results in costs moving between operating expenditure and capital expenditure during the next regulatory control period.

For example, Country Energy currently purchases all of its assets, with the resulting costs accounted for in capital expenditure. However, it is possible for a business to lease some or all assets that Country Energy currently purchases. In this instance, costs would move from capital expenditure to operating expenditure. Country Energy therefore believes that the EBSS should include an exclusion to cover such an event if it occurs during the regulatory control period.

Equity Raising Costs in the PTRM

During the course of finalising the inputs to the AER's PTRM, Country Energy identified what it believed to be an anomaly in the equity raising costs calculation used in the building blocks. Consequently, Country Energy amended the PTRM to correct this anomaly and submitted this modified PTRM as part of the revised proposal.

The anomaly occurs due to the AER's PTRM cash flow calculation not recognising the requirement to make debt repayments each year. This requirement needs to be accounted for in order to maintain the assumed benchmark gearing level of 60 per cent. Please refer to the CEG report on debt and equity raising costs attached to Country Energy's revised proposal for further detailed information and discussion on this issue.

Gamma

Country Energy believes the AER's PTRM may also contain an anomaly in relation to the assumed gamma of 0.5. The PTRM does not appear to provide a sufficient level of cash

PO Box 718 Queanbeyan NSW 2620 Telephone: (02) 6589 8998 Facsimile: (02) 6589 8680 www.countryenergy.com.au

flows to enable Country Energy to pay the required level of dividends and associated imputation credits. Country Energy did not amend the PTRM to correct for this anomaly, but considers that the AER needs to examine this issue further before making its final decision.

Country Energy would be pleased to discuss the matters raised in this submission with the AER. Should you require further information or clarification please feel free to contact Natalie Lindsay on 02 6589 8419 or Jason Cooke on 02 6338 3685.

Yours sincerely

Bill Frewen
Group General Manager External Relations