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2 February 2009

Mr Chris Pattas
General Manager
Network Regulation South Branch
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Dear Chris

PROPOSED WEIGHTED AVERAGE COST OF CAPITAL PARAMETERS

ETSA Utilities, Powercor and CitiPower (the businesses) welcome the opportunity to provide a submission to the Australian Energy Regulator (AER) on its proposed weighted average cost of capital (WACC) parameters applicable to electricity transmission and distribution businesses.

ETSA Utilities operates and maintains the only significant electricity distribution network in South Australia, supplying safe and reliable energy to about 800,000 customers throughout South Australia including major metropolitan areas and the capital city of Adelaide. With more than 60 years' experience, ETSA Utilities is one of the State's largest organisations employing approximately 1800 people, with operations spanning 178,000 square kilometres and 28 depots around the State. The ETSA Utilities network is among the most reliable in Australia, with a network availability rating of 99.97%.

Powercor Australia is the largest distributor of electricity in Victoria, owning and operating a network that serves over 680,000 customers in central and western regional Victoria and the Western suburbs of Melbourne. CitiPower owns and operates the distribution network that

supplies electricity to over 300,000 customers in Melbourne's CBD and inner suburbs. Powercor and CitiPower's operations span approximately 150,000 square kilometres, employing around 1700 people. The Powercor and CitiPower networks operate at network availabilities of 99.96% and 99.99% respectively.

ETSA Utilities, Powercor and CitiPower are 51 percent owned by Cheung Kong Infrastructure Holdings Limited and Hongkong Electric Holdings Limited, which form part of the Cheung Kong Group of companies. The remaining 49 percent is owned by Spark Infrastructure Group, which began trading on the Australian Stock Exchange in December 2005.

The businesses fully support the conclusions contained within the ENA, APIA and Grid Australia joint industry association's (JIA) submission. The JIA submission contains the most comprehensive and up to date analysis and evidence on each of the parameters being considered as part of the review. The businesses commend it to the AER as representing the best evidence available at this time.

The businesses are deeply concerned with the AER's proposed WACC parameters because:

- They have been derived using a theoretical bottom-up approach without any evidence of the consideration of the reasonableness of the overall result. The overall WACC result must be tested against the prevailing market cost of capital to satisfy key requirements in the Rules and the Law, that is, to 'promote efficient investment', to provide 'a reasonable opportunity to recover at least the efficient costs the operator incurs', and to deliver 'a forward looking rate of return that is commensurate with prevailing conditions in the market'. The JIA presents strong evidence that the proposed overall WACC does not meet these requirements.
- They are premised on the belief that current market conditions will be short-lived and the valuation of risk will quickly return to levels experienced prior to the Global Financial Crisis. The businesses are particularly concerned with this assumption since the AER will be making final distribution pricing decisions in relation to the businesses in 15 months and 21 months time¹. The JIA presents evidence that the Global Financial Crisis has deepened substantially since the time of preparation of the AER's draft

¹ Additionally, the Victorian Advanced Metering WACC decision due in 9 months time will be partly based on the AER statement of regulatory intent applied to market data over November/December 2008 when the global financial crisis reached a new low.

decision. The AER now has the opportunity to properly consider the impact of the Global Financial Crisis on the regulatory WACC that will apply shortly to our businesses.

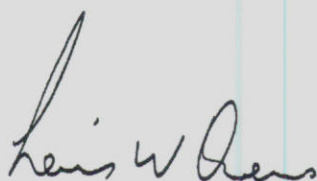
- The theoretical bottom-up approach results in relative regulatory costs of debt and equity which are not reflective of market requirements. If the regulatory cost of debt and cost of equity are calculated over the 20 business day period ending 27 January 2009, there would be a 1.65% premium for equity over debt. Historically this premium has been about 5%, and today it is likely to be even larger.
- The Rules require the application of a persuasive evidence test for each WACC parameter for good reason – stability, predictability and consistency in regulatory decision making are critical to attracting the required investment in long-lived network assets. However, the AER has been inconsistent in its consideration of persuasive evidence, and has generally not given appropriate weight to previously adopted values or methods.

The businesses are alarmed about the substantial risk that insufficient equity funding would be made available by our investors to meet the significant network investment required to:

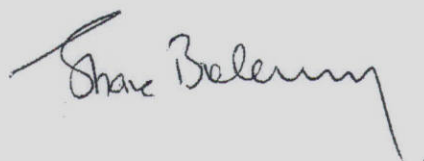
- meet continued and growing demand for electricity, particularly during peak periods;
- replace the businesses' rapidly aging existing network; and
- install advanced metering and demand management infrastructure.

Should you have any questions arising from this submission please do not hesitate to contact Lew Owens, CEO ETSA Utilities on (08) 8404 5854 or Shane Breheny, CEO Powercor and CitiPower on (03) 9683 4569.

Yours sincerely



Lew Owens, CEO
ETSA Utilities



Shane Breheny, CEO
Powercor and CitiPower