

24 September 2008

Mr Chris Pattas
General Manager
Network Regulation South Branch
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3000



Dear Chris

RESPONSE TO ISSUES PAPER ON WACC

Thank you for providing Envestra with the opportunity to participate in the important process of reviewing the weighted average cost of capital (WACC) parameters to be adopted in determinations for electricity transmission and distribution network service providers.

Envestra's interest in this matter reflects the view put forward by the AER that the outcomes of this review may be used in setting the WACC parameters in forthcoming gas access arrangement reviews. The AER does however note that there may be differences between electricity and gas distribution, which issues will need to be considered separately by the AER.

Envestra has been involved in the Energy Networks Association (ENA) working group, which has put together a substantive response to the AER on the matters outlined in its Issues Paper. The working group has commissioned a range of pre-eminent Australian regulatory economist to assist the AER form its views on this matter.

Envestra therefore puts forward its primary submission on this matter through the ENA submission, which has been provided to the AER on behalf of the participating businesses. This submission represents the considered and collective views of industry and is therefore anticipated to be a vital input into the AER's decision making.

In addition to the ENA submission, Envestra thought it would be worthwhile to make some additional general comments that relate to the AER WACC review.

In particular, Envestra would like to note its support for the extensive consultation process being undertaken by the AER on this matter, including the publication of the AER Issues Paper.

Envestra is also supportive of the general approach to be followed by the AER, which is stated in the Issues Paper (pg. 9) as follows:

“Given that the WACC parameters subject to this review cannot be directly observed, the AER considers it may be that none of the WACC parameters can be determined with certainty. Therefore in accordance with the NER and as a matter of good regulatory practice, for each of the WACC parameters the AER intends on having regard to the national electricity objective and the need for persuasive evidence before departing from a previously adopted value or method.”

As alluded to in both the Issues Paper and ENA submission, it is not possible to estimate the WACC parameters with certainty, particularly those required by the capital asset pricing model. Envestra therefore agrees that good regulatory practice under such circumstances requires the AER to be mindful of its legal obligations but also of the need for strong evidence/reasons before departing from past regulatory practice.

Envestra has recently been exposed to regulatory decision making that has significantly departed from past practice. Such decision making, particularly when it is not supported by conclusive evidence, not only imposes considerable (and unexpected) shocks to the affected businesses but also creates significant uncertainty in the regulatory system going forward.

This decision has required the Board to reconsider its approach to spending capital in the affected jurisdiction, reflecting an inability of Envestra to recover the requisite cost of capital expenditure over the regulatory period. This issue has been compounded by the significantly higher cost of debt and equity experienced over the past year and the inability for Envestra to factor this into its pricing.

Envestra will continue to restrict its desired capital expenditure program for the remainder of the regulatory period, pending the final resolution of the matters currently subject to appeal. This is an unfortunate outcome for Envestra and consumers that would otherwise have benefited through an expanded capital program.

Envestra would appreciate the opportunity to discuss its position further should the AER consider this to be beneficial to its review. Please contact me (08 8418 1125) if you wish to arrange a time for such a meeting or to discuss any other aspect of this letter or the ENA submission.

Yours sincerely



Andrew Staniford
Commercial Manager