

14 January 2009

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

Dear Mr Buckley

### **2009 Revised Regulatory Proposal**

Integral Energy is pleased to provide its revised regulatory proposal (*revised proposal*) to the Australian Energy Regulator (AER). The revised regulatory proposal applies to the regulatory control period from 1 July 2009 to 30 June 2014 (the *2009 regulatory control period*) and is submitted in accordance with the clause 6.10.3 of the Transitional Rules.

Integral Energy has carefully reviewed all of the matters raised by the AER in its draft decision including, in particular, where the AER has made adjustments to Integral Energy's *original proposal*. Integral Energy's *revised proposal* incorporates a number of amendments to the original proposal as a result of the draft decision. Where Integral Energy has not fully adopted the AER's draft decision, the *revised proposal* provides additional information, including expert reports, to address the matters raised by the AER and to demonstrate that the *revised proposal* satisfies the requirements of the Rules.

Integral Energy notes that although it has implemented many of the AER's adjustments to its original proposal, this does not necessarily mean that Integral Energy accepts the rationale provided by the AER or its consultants for making them.

Notably, many of the revisions to Integral Energy's original proposal are required to address the onset of the global financial crisis that occurred following the preparation and lodgement of the original proposal on 2 June 2008. Consequently, neither Integral Energy nor the AER were able to adequately consider the impacts of the global financial crisis on the expenditure programs and forecasts put forward that ultimately formed the basis of the draft decision.

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The effect of the global financial crisis is far reaching and impacts on Integral Energy's *original proposal* in the following ways:

- Energy and customer number forecasts have declined due to the slowdown in economic activity;
- Capital expenditure is also expected to decline to some extent as a result of lower customer connections and deferral of some major projects;
- The nominal risk free rate is at an abnormal level that does not represent a reasonable expectation of interest rate movements over the *2009 regulatory control period*; and
- The costs of contributing to defined benefits superannuation schemes have increased as a result of the loss in value of the funds.

As requested by the AER, Integral Energy has revised its forecasts underpinning the original proposal for energy and customer numbers and incorporated the audited 2007/08 weighted average price cap (WAPC) information.

While the AER has provided guidance on the matters for which Integral Energy was to revise its forecasts as stated above, Integral Energy considers that it is not reasonable to ignore the implications of the global financial crisis and the impacts that it has on Integral Energy and its customers.

Revisions to the original proposal include:

- Updated energy and customer number forecasts that take into account the requirements of the AER's draft decision and the downturn in economic conditions as a result of the global financial crisis;
- Associated reductions to capital expenditures as a result of the global financial crisis;
- A revised nominal risk free rate averaging period that recognises the weight of regulatory precedent, both in Australia and internationally, that strongly supports the view that it is not appropriate to adopt the most recent averaging period if it overlaps with abnormal levels or periods of economic crisis;
- Updated cost escalators that reflect the AER's draft decision and recent commodity price movements;
- An adjustment to operating costs to remove the forecast "fair value" adjustments to the provisioning for superannuation liabilities that are no longer relevant given current market conditions;
- An adjustment to the efficiency benefit sharing scheme (EBSS) excluded cost categories to enable Integral Energy to move to leasing arrangements for certain assets currently capitalised, including new vehicles; and
- Other adjustments as required to address the issues raised in the draft decision.

The inclusion of the above amendments in the *revised proposal* result in a number of consequential changes to individual the building block components and X factor calculations as outlined in the *revised proposal*.



The *revised proposal* is submitted in accordance with, and complies with, the requirements of:

1. The National Electricity law;
2. The National Electricity Rules including the Transitional Rules;
3. The relevant AER guidelines (including the post tax revenue model (PTRM), roll forward model (RFM), efficiency benefit sharing scheme (EBSS), control mechanism for direct control services, demand management incentive scheme and control mechanism for alternative control services;
4. Preliminary positions paper regarding the AER's approach to determining materiality thresholds for possible pass through events;
5. The Accounting Separation Code for Electricity Distributors in NSW prepared by IPART;
6. The NSW Licence Conditions;
7. Relevant Acts and regulations as listed in pro forma 2.3.4 of Integral Energy's original proposal; and
8. The AER's regulatory information notice (RIN) issued to Integral Energy on 24 April 2008.

Clause 6.8.2(c)(6) of Appendix 1 of the National Electricity Rules requires Integral Energy to include in its revised regulatory proposal an indication of the parts of the proposal Integral Energy claims to be confidential and wants suppressed for publication on the grounds that the information is confidential. Integral Energy claims confidentiality over the following:

- Appendix E, expert report by SAHA International Limited;
- Attachment 1 comprising the completed PTRM;
- Attachment 2 comprising the completed RFM; and
- Attachment 3 comprising the revised energy and customer number forecasts.

Integral Energy strongly supports the consultative approach that the AER has established for this review and looks forward to continuing to work with the AER and other key stakeholders during the review process. For further information on Integral Energy's *revised proposal*, please contact our General Manager Regulatory and Corporate Affairs, Karen Waldman, on (02) 9853 6166.

Sincerely



Vince Graham

**Chief Executive Officer**