



2 February 2009

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

Dear Mr Pattas

**Submission to the AER's review of the weighted average cost of capital parameters**

The Joint Industry Associations' (JIA) welcomes the opportunity to make this submission in response to the Australian Energy Regulator's (AER) proposed determination and accompanying explanatory statement on the weighted average cost of capital (WACC) parameters for electricity network service providers, published on 12 December 2008.

The JIA provided a comprehensive package of data and analysis to the AER prior to the proposed determination and we are disappointed that the AER reached preliminary views that do not adopt core propositions established in that material.

Moreover, the JIA members are extremely concerned that the proposed determination would, if implemented in the final determination, lead to a downward revision of the WACC at a time when the global financial crisis has triggered unprecedented capital constraints and sharp increases in the risk premia required by lenders and equity investors. Further, at a time when very substantial additional capital needs to be attracted to the sector, the proposed determination would move the parameters in the opposite direction. In this environment, any downward revision of the WACC would not only be contrary to the principles enshrined in the National Electricity Law and Rules, it would have broad-ranging and long-lasting negative consequences for investment in Australian energy infrastructure.

We continue to regard the material contained in the first JIA submission as correct and appropriate and we consider that many errors of fact and analysis have been made in the proposed determination. Therefore, we now provide a further substantial package of material in response to the explanatory statement. This substantiates our original position. The overview document attached to this letter explains why the JIA considers that the AER's WACC proposal:

- would be contrary to the facts, the legislative requirements and the economic analysis;
- does not properly consider the importance of the global financial crisis and its impact on the forward looking cost of capital;
- misapplies the CAPM by adopting an overly mechanistic approach that is inconsistent with the National Electricity Law and the Rules;

- revisits and overturns long-standing regulatory precedents in relation to the WACC methodology with consequences for certainty of WACC regulation in the future; and
- would substantially diminish future investment in the leading-edge technologies and processes that are urgently required to address climate change.

The JIA's response to the AER's proposed determination consists of a detailed submission (enclosed) which addresses the key issues arising from the AER's proposed determination, along with detailed supporting papers prepared by various experts. With the chapters, witness statements and expert analysis addressing the detail, the purpose of the overview to the submission is to highlight the JIA's key concerns, focusing on the broader context in which the AER must conduct its WACC review. These concerns are regarding the application by the AER of the legal framework and its implications for the WACC review; the impact of the global financial crisis; the effect of the AER's WACC proposals on investors' perceptions of regulatory risk; and the incentives for the substantial new investment required to address climate change.

The pace at which the JIA has had to respond to such a wholesale proposed change is far from satisfactory. While the JIA acknowledges that there are mandatory time constraints in the Rules once the process has commenced, it is disappointing that more transparency of the AER's thinking could not have been provided before the formal process commenced. The fact that the whole of the Christmas, New Year and Australia Day period fell within the time we had to respond has added to the time pressures and we note the potential for us to have to respond further if more material comes to light.

The JIA would welcome the opportunity to engage in further constructive dialogue with the AER to ensure that its Final Determination addresses the industry's concerns, and accords with the requirements of the National Electricity Law and Rules. We would be pleased to discuss this submission with you at your convenience.

Yours sincerely



Andrew Blyth  
Chief Executive Officer, Energy Networks Association



Gordon Jardine  
Chairman, Grid Australia



Cheryl Cartwright  
Chief Executive, Australian Pipeline Industry Association