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Mr Chris Pattas
General Manager Networks
Australian Energy Regulator
Level 35, 360 Elizabeth Street
Melbourne 3000

Email: chris.pattas@aer.gov.au

Dear Chris

United Energy's 2011-2015 efficiency carry over

1. Introduction

I am writing to request the AER to correct an error in our 2010 reported opex to ensure the accurate calculation of our 2011-2015 efficiency carry over.

This error relates to confidential third party information contained in this letter. In accordance with the AER's Confidentiality Guideline, this information is highlighted in yellow and the reasons for confidentiality are explained in accordance with the AER's confidentiality template at **Attachment 2**. A public version of this letter, which removes the confidential information, is also attached.

2. Calculation of United Energy's 2011-2015 efficiency carry

The AER's 2016 to 2020 Preliminary Decision on the calculation of our 2011-2015 efficiency carry over assumes that 2011 should be treated as "year six" of the calculation, not "year one". Accordingly, the calculation commences in 2009.

In our Revised Regulatory Proposal, due to the AER by 6 January 2016, we will accept the AER's Preliminary Decision. We agree that the efficiency gain should be calculated in accordance with the formula in the AER's Final 2008 EBSS (Final EBSS) being:

$$E_6 = (F_6 - A_6) - (F_5 - A_5) + (F_f - A_f)$$

Importantly, the Final EBSS also requires that:

> *The efficiency gains or losses to be carried over, the measurement of actual opex over the regulatory control period <u>must be done using the same cost categories and methodology used to calculate the forecast opex for that regulatory control period</u>.*

The same cost categories and methodology <u>must</u> be used because the scheme defines efficiency with reference to the AER's forecasts and the company's prior year performance. If inconsistent data is used, the scheme will fail to accurately measure and reward efficiency improvements, which is the purpose of the scheme.

UNITED ENERGY

The AER has therefore made an error calculating our 2011-2015 carryover because it has used inconsistent data being:

- Our 2009 reported adjusted base year costs of $106.7 million of which [[redacted]] relates to "adding back" the Jemena Asset Management (JAM) losses that it incurred in providing services under the Operating Services Agreement (OSA) (2009 adjusted opex); and
- Our 2010 opex of [[redacted]] from our 2010 Annual RIN (i.e. our 2010 Regulatory Accounts), which excludes the JAM loss of [[redacted]] [1] in that year (2010 unadjusted opex).

The AER's use of 2010 unadjusted opex is inconsistent with the use of 2009 adjusted opex as well as the AER's 2011-2015 expenditure forecasts, set out in its 2011-2015 Distribution Determination, which are also adjusted for the JAM losses.

To give effect to the requirements of the Final EBSS, the AER should use a 2010 opex value of [[redacted]], which includes adjustments for:

- The JAM loss of [[redacted]]; and
- Movement in provisions of $3 million

Table 1 below shows that the use of inconsistent data (2009 adjusted opex and 2010 unadjusted opex) produces the erroneous conclusion that or actual costs in 2011 increased by 22.9 per cent compared to 2010. This in turn results in us being inappropriately penalised under the EBSS. Table 1 also shows that if the correct 2010 value of opex is used ([[redacted]]), the actual increase in opex between 2010 and 2011 is only 7.3 per cent.

Table 1: United Energy's actual costs for EBSS calculation

	2009	2010	2011	2012	2013	2014
AER's preliminary decision[2] ($M real 2010)	106.7	[[redacted]]	121.8	115.1	121.5	119.3
AER's annual percentage change		-7.1%	[[redacted]]	-5.5%	5.6%	-1.8%
United Energy's corrected data ($M real 2010)	106.7	[[redacted]] *	121.8	115.1	121.5	119.3
Corrected annual percentage changes		6.4%	[[redacted]]	-5.5%	5.6%	-1.8%

** The adjusted 2010 opex of [[redacted]] includes $3 million for movements in provisions related to opex – see cell E51 of Attachment 1*

Correcting for the error in the 2010 opex value results in a carryover amount of $40.9 million rather than $24.7 million as set out in the AER's Preliminary Decision.

A revised spreadsheet containing the correct data is provided as an **Attachment 1** to this letter.

3. Closing

Should you have any questions, please contact Stephanie McDougall, Price Review Manager, on (03) 8846 9538 or Stephanie.McDougall@ue.com.au.

Yours faithfully

Stephanie McDougall
Price Review Manager

1 United Energy's Regulatory Accounting Statement, 31 December 2010, page 39 shows the loss attributable to operating expenditure is [[redacted]].

2 AER, Preliminary Decision EBSS spreadsheet, cells D53:H53.

ATTACHMENT 2 – AER's Confidential Information Template

Title, page and paragraph number of document containing the confidential information	Description of the confidential information.	Topic the confidential information relates to (e.g. capex, opex, the rate of return etc.)	Identify the recognised confidentiality category that the confidential information falls within.	Provide a brief explanation of why the confidential information falls into the selected category. If information falls within 'other' please provide further details on why the information should be treated as confidential.	Specify reasons supporting how and why detriment would be caused from disclosing the confidential information.	Provide any reasons supporting why the identified detriment is not outweighed by the public benefit (especially public benefits such as the effect on the long term interests of consumers).
Letter from UE to AER, 30 November 2015, United Energy's 2010 Reported Opex	Information relating to third party service providers' contracted costs.	Opex cost relating to third party contracts.	Market sensitive cost inputs	Commercially sensitive third party costs are specified in the letter.	Supplier costs are commercial-in- confidence. Disclosure of external service provider cost information would have the potential to adversely affect future tender processes.	There would be a net public detriment if this information were disclosed. Possible impacts include the distortion of competition among suppliers, leading to tender prices being higher than may otherwise be the case. Such outcomes would be to the detriment of the long term interests of consumers