

23 June 2008

Dr John Tamblyn
Chairperson
Australian Energy Market Commission
Level 5, 201 Elizabeth Street
Sydney NSW 2001



BY EMAIL: submissions@aemc.gov.au

Dear Dr Tamblyn

**WEIGHTED AVERAGE COST OF CAPITAL (WACC)
SUBMISSION TO THE CONSULTATION ON THE EUAA'S RULE CHANGE APPLICATION**

We refer to the notice of intention to commence the consultation process on this rule change request (RCR) under the National Electricity Law (NEL) published by the Australian Energy Market Commission (AEMC) on 22 May 2008.

This letter argues that the changes flowing from this RCR should be reflected in the allowed revenue determinations for TransGrid, Transend and New South Wales and Australian Capital Territory transmission and distribution revenue resets (the current reviews).

Process

Our rule change was lodged with you on 22 May 2008. At that time, the Australian Energy Regulator (AER) flagged that it was also planning to introduce an RCR to combine the distribution and transmission WACC reviews so that a combined review would commence in July 2008 and conclude in March 2009. The AER has now done this. It was also open to the AER to seek a rule change to ensure that any revised WACC parameters (including the *equity beta* and *gamma*) would be applied in the current reviews. It has not done this.

Our RCR now provides the AEMC with the opportunity to ensure that reconsidered *equity beta* and *gamma* values, at the very minimum, can be applied in the current reviews. If the AEMC does not take the opportunity to ensure this, then the unsatisfactory situation could arise where the AER makes a finding about the appropriate values of these parameters in March 2009, but these are not applied in the current reviews to be completed by the middle of 2009. Our RCR, if accepted, would clearly result in a significant downward movement in the WACC based on new values for the *equity beta* and *gamma*. A failure to ensure that revised values are used in the current reviews would provide the businesses concerned with inflated rates of return that would not be in the long term interests of consumers of electricity.

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The EUAA's Rule Change Request

We consider that the current WACC parameters in place for regulated businesses in the National Electricity Market (NEM) are delivering allowed returns well above those that should apply to regulated networks considering the risks that those networks face. This over-recovery is substantial. Applying an *equity beta* of 1 against an *equity beta* of 0.7 to the asset bases of the businesses subject to current reviews amounts to a difference of more than \$100 million annually. This involves a direct wealth transfer from consumers to those businesses.

We urge the AEMC to amend the rules so that the AER is required to incorporate the outcome of the AER's current WACC review in the Tasmanian and ACT/NSW determinations. An alternative course of action which would be consistent with our initial RCR, would be for the AEMC to consider the RCR and then to ensure that the outcome of this consideration applies to the current reviews.

We do not believe that application to the current reviews would pose a problem for the following reasons:

- Parameters used to establish the WACC for regulated businesses such as the *equity beta* and *gamma*, should be set using the most contemporary information available and should be based on parameters applying at the time of the making of the final determination;
- Regulated businesses already face uncertainty about the bond rate, inflation rates and the risk-free rate to be used in revenue resets and are required to accommodate this uncertainty; and
- Regulated businesses are required to make revenue applications on the basis that those applications represent a prudent and efficient level of operating and capital expenditure, independent of what the WACC is or might be;

There is a strong argument on the grounds of economic efficiency and wealth distribution that the allowed returns for regulated businesses should reflect contemporary assessments of the WACC.

If you have any further questions in relation to this letter, you are welcome to contact me at the EUAA on (03) 9898 3900.

Yours sincerely



Roman Domanski
Executive Director