

Warwick Anderson

General Manager - Networks Finance and Reporting Branch

GPO Box 131

Canberra

Australian Capital Territory 2601

Dear Warwick,

Thank you for our meeting earlier in the week in relation to our Victorian and Albury Access Arrangement (AA) proposal, which we found very useful.

As noted at this meeting, which we now raise in the context of your current consultation process regarding proposed amendments to the Roll Forward Model (RFM) for electricity distributors, we are concerned over the extent that actual inflation (currently averaging around 1.4%) differs from the forecast of inflation current used by the AER (currently around 2.4%) in its modelling (including in the RFM).

Our key concern is whether the AER forecast of inflation is consistent with the forecast of inflation embedded in allowed rates of return (or put differently, whether the two inflation forecasts are "correctly matched"). Evidence of the (potential) inconsistency can be found when comparing the estimate of the real risk free rate of -0.5% (derived by deducting the AER forecast inflation from the nominal 10 year CGS yield) and the indexed 10 year CGS yield of +0.25%.

This difference materially impacts on our ability to recover our efficient costs, maintain a reliable network and provide appropriate returns to investors. We are therefore keen to address this issue jointly with the AER as part of our Victorian AA review process. Given this is a wider issue, we understand that the Energy Networks Association is also keen to work with the AER on this matter. The key work, from our point of view, is to determine:

- whether we are applying the best available estimate of inflation; and/or
- whether there are other solutions to resolve this issue.

We will be in contact with you in the near future to discuss how best to take this issue forward. Please however feel free to contact either myself (08 8418 1129) or Peter Bucki (08 8418 1112) at any time should you wish to discuss this letter in the meantime.

Yours sincerely,

**Craig de Laine****General Manager Regulation**