

10 November 2014

Mr Warwick Anderson
General Manager – Networks Finance and Reporting Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601



Dear Mr Anderson

Proposed amendments to the post-tax revenue models (version 3)

Energex Limited (Energex) appreciates the opportunity to provide written submissions on the Australian Energy Regulator's (AER's) proposed amendments to the post-tax revenue models (PTRMs). The proposed amendments to the PTRMs are required to give effect to the AER's rate of return guideline (the guideline) and will allow for an annual update of the return on debt over the course of the regulatory control period.

Energex provides the following responses to the specific issues raised by the AER in the explanatory statement to the proposed amendments:

Approach to setting future years return on debt

A key benefit of adopting the trailing portfolio average return on debt was that it reduced volatility in energy prices for customers. However, as the return on debt will be updated on an annual basis, it is reasonable to expect that there will be a level of volatility that will be inherent in the X-factors across a regulatory control period.

The two approaches assessed by the AER in setting future years' return on debt when updating the return on debt, depend on the movement in future interest rates. In certain scenarios, the AER's preferred approach outperforms the approach suggested by the Energy Networks Association (ENA) and vice versa. However, Energex agrees that the AER's preferred approach can potentially reduce the magnitude of largest single year on year variation in network prices and therefore 'price shocks' for customers. Energex considers it reasonable for the AER to proceed with its preferred approach.

Appropriate discount rate

The AER proposes to continue using a nominal vanilla weighted average cost of capital (WACC) when calculating the net present value (NPV) of unsmoothed and smoothing revenues across the regulatory control period. Energex notes that the form of discount rate (a post-tax WACC) used by the AER is inconsistent with the pre-tax cash flows being discounted. The appropriate discount rate to use is a pre-tax WACC.

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Notwithstanding that the AER has applied this approach consistently in previous determinations, Energex does not consider that to be a reasonable justification to continue with the inconsistency. Given that the AER is also using this consultation to make other non-consequential amendments to the PTRMs, the AER should also take the opportunity to amend an obvious error. Based on Energex's analysis, correcting this inconsistency will not have a material impact on network service providers' revenues.

If you have any questions in relation to Energex's submission please contact Mick Ryan, Regulatory Affairs Manager - Operations, on (07) 3664 4125.

Yours sincerely



Neil Andersen
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