



## United Energy Distribution

### Electricity Distribution Price Review 2011-2015

2011 -2015

#### Regulatory Proposal

##### A: Introduction

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TRUenergy welcomes the opportunity to comment on the Regulatory proposal submitted by United Energy Distribution (UED) as part of the Electricity Distribution Price Review for 2011-2015. We recognise that this submission has made late, however we understand that the Australian Energy Regulator (AER) has the discretion to consider our comments.

We view the comments in this submission as critical from a retailer's perspective. As such, we hope that the AER will consider our comments in good faith as part of this review.

TRUenergy will limit its comments to the UED regulatory proposal to three key elements. They include:

1. The Energy Forecasts for 2011-15
2. The Market Risk Premium value submitted by UED in the Capital Asset Pricing Model (CAPM) for its proposed WACC
3. The revised version of the 'S'

We hope that the information in this submission can inform the AER in its deliberations of these key issues.

##### B: The Energy forecasts from 2011 -15

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TRUenergy has some fundamental concerns regarding the energy forecasts submitted by UED in its regulatory proposal for its distribution area from 2011-15. In short, UED forecasts a significant reduction in energy consumption going forward into the next regulatory period from 2011-2015.

The following (table 13-5 ) in its regulatory proposal provides a "snap shot" of the energy forecasts that they predict over the next regulatory period.

Parameter	2011	2012	2013	2014	2015
Energy Consumption (GWh)	7,793	7,734	7,592	7,478	7,486

Data source: UED EDP R Regulatory Proposal November 2009

TRUenergy observes that the energy forecasts put forward by UED reduce on average by approximately 1.0% every year from 2011 to 2014.

The principal justifications for the negative growth in energy forecast by UED are expressed in its regulatory proposal. UED argues that the national and state energy and climate change policies will have a significant impact on UED's future energy sales. If energy and climate change policies are fully implemented, energy sales will reduce over the period of 2011-2015. :

TRUenergy does not produce specific energy forecasts for the UED distribution area. However, we use a number of sources to help us get a better understanding of the energy forecasts demand over the regulatory period for the UED distribution area for 2011-2015.

In particular TRUenergy uses the AEMO Statement of Opportunities (SOO), which provides a valuable source of information on the projections of annual energy for Victoria. TRUenergy acknowledges that these forecasts apply to the state wide – compared with the UED forecasts that apply only to their distribution area. However, these projections do include the following critical assumptions for the forthcoming regulatory period and so TRUenergy believes that they can be used as a credible and prudent basis for forecasting energy growth within the UED distribution area:

- The Carbon Pollution Reduction Scheme
- The Expanded Renewable Energy Target
- Minimum Energy Performance Standards
- Federal Insulation Program
- Energy Saver Incentive
- Advanced Metering Infrastructure

TRUenergy regards AEMO's energy forecasts as reliable and realistic given they are undertaken by an independent body. We regard them as more credible than the UED energy forecasts.

**Table B.3 Victorian Annual Energy Projections (GWh)**

Financial Year	Medium	High	Low
2010-2011	47,127	49,221	45,665
2011-2012	47,781	50,023	45,420
2012-2013	48,630	51,141	46,206
2013-2014	48,836	52,142	46,280
2014-2015	49,361	53,332	46,638

Data source: AEMO Statement of Opportunities 2009 table B.3

TRUenergy observes that the annual energy projections (GWh) for Victoria actually increase annually by approximately 1.15% under the medium growth scenario as forecast by AEMO from 2011 to 2015. Under the high growth scenario, which we think is relevant given these forecasts were undertaken in the height of the Global Financial Crisis and therefore err on the side of being conservative, annual energy projections increase by approximately 2% from 2011-2015. Therefore, we believe that the UEDenergy forecasts for the regulatory period 2011-2015 should be adjusted in line with the trends presented in this information from AEMO.



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### **C: The Market Risk Premium**

TRUenergy has some serious concerns regarding the value submitted by the UED regarding the Market Risk Premium (MRP) in the Capital Asset Pricing Model (CAPM).

UED put forward a MRP of 8% in the current price proposal. In their regulatory proposal, they argue:

- The on going uncertainty regarding the outlook for global economic and capital market conditions in the context of the global financial crisis
- The new evidence presented regarding investors' forward looking required rates of return in the present environment of on going high uncertainty
- That under these circumstances an MRP of 6.5% would fail to meet the National Electricity Objective

Accordingly, they submit an MRP of 8% is justifiable on these grounds.

In the Statement of Regulatory Intent on the revised WACC parameters (Distribution) published in May 2009, the AER acknowledges the additional uncertainty associated with the global financial crisis justified an increase in the MRP from 6% to 6.5%. However, the AER made it clear that prior to the on-set of the global financial crisis, an estimate of 6% was the best estimate of a forward looking long term MRP, and, accordingly, under relatively stable market conditions – assuming no structural break had occurred in the market – this would remain the AER's view as to the best estimate of the forward looking MRP.

TRUenergy submits that the relatively unstable market conditions that were current during the global financial crisis do not currently exist. Even when the GFC was at its peak, the AER did not consider that the weight of evidence suggested that a MRP significantly above 6% should be set.<sup>1</sup> As such, and based on the analysis provided by the AER in the past in the Statement of Regulatory Intent on the revised WACC parameters (Distribution) published in May 2009, we can see no firm case exists for increasing the MRP to 8%. On the contrary, the return to a more stable situation in the Australian capital markets suggests that the MRP should go back to its traditional historical value of 6%.

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### **D: The "S" factor**

TRUenergy supports this revised "S" factor scheme to be applied by the AER in the next regulatory period. Under the revised scheme, the total "S" factor revenue that UED is able to achieve is capped at 5% of its total regulated revenue.

Under the current Essential Services Scheme (ESC), there is no cap on the amount of revenue that a distributor can achieve under the scheme. As a result of this, this could lead to a large amount of "S" factor revenue being achieved in any one year.

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### **E: Conclusion**

TRUenergy appreciates the opportunity to make a submission on the UED regulatory proposal. We would welcome the opportunity to further discuss our submission (if required).

For further inquiries regarding this submission, please feel free to contact Mr. Con Noutso – Manager Regulation (Access) at TRUenergy on Tel: 03 8628-1240.

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<sup>1</sup> Statement of Regulatory Intent on the revised WACC Parameters (the Distribution Statement) May 2009 p. 238

"Whilst it can not be which of these scenarios explain current financial conditions, both are possible, and both suggest an MRP above 6% at this time may be reasonable. However, having regard to the desirability of regulatory certainty and stability, the AER does not consider that the weight of evidence suggests a MRP significantly above 6% should be set."

Regards

A handwritten signature in black ink, appearing to read "G. Martin". The signature is written in a cursive style with a long horizontal stroke at the end.

Gary Martin  
Director Customer and Information Services  
TRUenergy