

Wilson Cook & Co

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Reply to: Auckland Office
Our ref: 0902
Email: jeffrey.wilson@wilsoncook.co.nz

31 March, 2009

Mr Mike Buckley
General Manager,
Network Regulation North Branch
The Australian Energy Regulator
Marcus Clarke Street
CANBERRA ACT 2601

Dear Mr Buckley,

RE: REVIEW OF PROPOSED EXPENDITURE OF ACT & NSW ELECTRICITY DNSPS: INTEGRAL ENERGY'S SUBMISSION OF JANUARY

In response to your instructions, we have reviewed one matter in Integral Energy's submission to the AER of January 2009 in relation to its forecast capital expenditure in the next regulatory period, FY 2010 to FY 2014, and submit our report.

1 Scope of Review

The requested scope of the review was to:




- (a) review and provide technical advice on Integral Energy's submission of January 2009 comprising a revised regulatory proposal and supporting documents;
- (b) provide technical advice on specific issues raised in Integral Energy's submission;
- (c) consider any new information provided by Integral Energy and advise of any revisions needed in the recommendations made by us in our Final Report to the AER of 21 November 2008 (Final Report);
- (d) provide details of any proposed revisions to Integral Energy's levels of opex and capex as a result of any changes in the recommendations;
- (e) identify any new information that has led to the revision of our previous recommendations (or, if no revisions are proposed, why Integral Energy's submissions and new information do not lead to revised recommendations); and
- (f) have regard to stakeholder submissions (which were expected by 16 February 2009) raised in relation to the issues to be reviewed.

The only matter referred to in (b) above related to Integral Energy's substation replacement capital expenditure, as set out in section 5.2.2 of its submission.

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Other Matters

Our terms of reference required us to consult with the DNSPs as necessary and to seek any additional information needed. However, there was not sufficient time available to enter into a dialogue, in addition to which we considered it reasonable to rely on Integral Energy’s submissions as presented to the AER.

We were to present our draft report to the AER by 27 February 2009 and we consulted the AER before the work began to clarify what it was practical to achieve in the limited time available for the review. The scope of this report reflects the conclusions so reached.

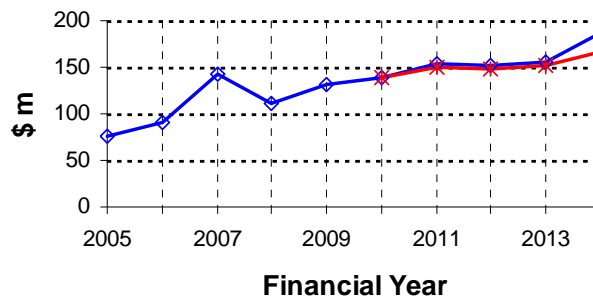
2 Matters Not Reported On

The review was limited to the context of our instructions – namely, to report on matters affecting or potentially affecting the adjustments to Integral Energy’s expenditure that we recommended in volumes 1 and 2 of our Final Report.

3 Reassessment

On p. 21 of our Final Report, we noted in relation Integral Energy’s proposed substation replacement expenditure that fourteen further substation renewal projects for which business cases have not yet been developed were identified in its strategic asset renewal plan. The projects had been identified based on condition assessment and risk ranking and mostly fell at the end of the period. We accepted that the scope of work involved in the projects and their timing might change and noted that the inclusion of such work in the programme was to be expected but we also noted that expenditure in this category was projected to increase in the final year of the estimates to a level above the trend. We asked integral Energy for a further explanation of this work and it advised us that it expected an increasing level of work in this area, as more substations become candidates for renewal. However, whilst acknowledging that might be the case, we noted that the expenditure trend remained relatively flat up to and including FY 2013 and we considered that provisions of this type ought not to cause a deviation from the trend. In other words, we considered that a level of expenditure based on established levels of work ought to take precedence over an increased level of expenditure that lacked the same degree of supporting documentation. We therefore proposed an adjustment in respect of that item in FY 2014. The adjustment had the effect of maintaining the level of expenditure in the category at that in the preceding two years. Details of the adjustment were given in section 7.3 of our Final Report and the effect of the adjustment was illustrated in the following figure.

Impact of Recommended Adjustment (\$ m 2009)



The adjusted expenditure is in red in the figure and continues to exhibit a rising trend that we consider appropriate in replacement capex and consistent with our general observations on Integral Energy’s network replacement needs, albeit not at the rate that Integral Energy’s forecasts indicated.

We noted in our Final Report that Integral Energy, in commenting on our draft report, had considered the deductions unwarranted. However, we retained the view that it was not reasonable to accept the sharp upwards turn in the curve at the end of the period when it was based on less cogent evidence than the established preceding levels of expenditure.

Reconsideration

Integral Energy has claimed in its January 2009 submission that our recommendation was in error. It has argued that the recommendation was inconsistent with its renewal planning data and the logic outlined in section 6 of our Final Report. It argued that we had accepted a rising trend in replacement capex, recognised that the fourteen additional renewal projects were “needs based” and that it (Integral Energy) was not satisfied that our Final Report took full account of the information it had provided on this matter. No further information was provided with the January submission.

We have reconsidered our decision and are satisfied that the information provided to us in 2008 was taken into account.

We consider that the argument set out in our Final Report is clear, that it anticipated and accepted a rising trend in expenditure but rightly, in our opinion, did not accept the acceleration of the curve in the final year.

Our view on the expenditure thus remains unchanged.

4 Independence

Wilson Cook & Co Limited and its reviewers are all independent of Integral Energy and the AER, other than in the context of providing the AER with professional advice on expenditure matters from time to time.

Whilst the AER’s staff provided the requisite data for this review and whilst our findings were discussed with the AER on the conclusion of our draft report, we are satisfied that the comments made by the AER have not influenced our opinion improperly but served only to ensure that it addressed the issues sufficiently fully for its purposes.

5 Conditions Accompanying Our Opinion

Assessment Not an Assessment of Condition, Safety or Risk

Notwithstanding any other statements in this review, this review is not intended to be and does not purport to be an assessment of the condition, safety or risk of or associated with the DNSP’s assets and nothing in this report shall be taken to convey any such undertaking on our part to any party whatsoever.

Final Report Remains Unchanged

For the avoidance of doubt, we confirm that the opinions expressed in our Final Report to the AER remain unchanged unless specifically modified in this review.

Disclosure

Wilson Cook & Co Limited has prepared this report in accordance with the instructions of its client on the basis that all data and information that may affect its conclusions have been made available to it. No responsibility is accepted if full disclosure has not been made. No responsibility is accepted for any consequential error or defect in our conclusions resulting from any error, omission or inaccuracy in the data or information supplied directly or indirectly.

Disclaimer

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as to the accuracy or completeness of the information or opinions set out in the report to any person other than to its client including any errors or omissions howsoever caused, and do not accept any liability to any party if the report is used for other than its stated purpose.

Non-Publication

With the exception of its publication by the AER, in relation to its review of the DNSP's expenditure proposals, neither the whole nor any part of this report may be included in any published document, circular or statement or published in any way without our prior written approval of the form and context in which it may appear.

Yours faithfully

Wilson Cook & Co Limited

A handwritten signature in blue ink that reads "Wilson Cook & Co." with a period at the end. The signature is written in a cursive, flowing style.