

## 1. Initial Capital Base

As was the case with the Draft Decision, the Final Decision requires Envestra to amend its revised Access Arrangement to base its proposed Reference Tariffs upon a Capital Base at the commencement of the First Access Arrangement period (1 July 2003) of \$796.35 million (in dollar values of 31 December 2005).

As with the Draft Decision, the Commission's Final Decision has been made acting upon wrong principles and contrary to the Code, thereby leading the Commission to incorrectly calculate the Initial Capital Base.

In reaching its Final Decision, the Commission has not addressed the arguments set out in Envestra's response to the Draft Decision.

On page 83 of the Final Decision, the Commission states that it has adopted a "purposive approach" to the interpretation of SAIPAR's decision. No explanation is provided as to what is meant by a "purposive approach" nor how that approach has been applied. If a "purposive approach" is intended to be a reference to promoting the purposes of the Code, then the Commission's Decision, for the reasons noted in paragraphs (d) and (e) of section 2.7 of Envestra's response to the Draft Decision, runs contrary to the purposes of the Code. There is no economic or policy logic to calculating the Initial Capital Base based on forecast inflation. Envestra notes that the Commission has not responded to the arguments set out in paragraphs (d) and (e).

The Commission's Final Decision quotes selectively and therefore inaccurately from SAIPAR's December 2001 Final Decision. The Commission quotes from section 5.8 of that Final Decision (which says no more than that the Initial Capital Base "*will then be adjusted to take into account appropriate inflation rates*") but fails to refer to section 5.9 of the Final Decision which expressly states:

*"The final value for the Initial Capital Base as at the commencement of the Access Arrangement is to be SAIPAR's determined DORC valuation as at 30 June 1998, adjusted to take into account*

*Removal of Redundant Capital*

*Inflation adjustments*

*Capital Expenditure, and*

*Depreciation*

*Rolled through until the access commencement date as determined in the Final Decision.*

*The adjustment for inflation is to utilise the actual CPI (All Groups – Average of 8 state capitals) published by the Australian Bureau of Statistics" [emphasis added].*

Section 5.9 unequivocally states the Initial Capital Base is to be calculated using actual inflation.

As to pages 72-73 of SAIPAR's Final Decision, the table 5.8.11.1, for the reasons already explained by Envestra in its submission on the Draft Decision, sets out a roll forward of the Capital Base for the purposes of calculating Total Revenue. The table does not purport to calculate the Initial Capital Base as at the commencement of Envestra's Access Arrangement. The table does not form a basis from which the Commission is entitled to draw an inference as to how the Initial Capital Base is to be calculated.

The extract quoted from SAIPAR's Final Approval on page 85 of the Commission's Decision does not support the Commission's case:

*“The amendments from section 5 of the Final Decision have been incorporated by Envestra in Section 4.2 of the Access Arrangement Information, to the satisfaction of SAIPAR. The amendments pertaining to valuation methodology and modeling assumptions have been incorporated as required in arriving at the appropriate Regulated DORC valuation for the Initial Capital Base, and in the derivation of Total Allowable Revenue.”*

The quotation simply states that SAIPAR agrees that Envestra has amended its 30 June 1998 DORC Valuation as required by SAIPAR (i.e. to \$617 million) and has used the correct Capital Base for the purpose of calculating Total Revenue (that is, a Capital Base derived on the basis of forecasts). The Final Approval cannot be taken as an agreement that SAIPAR approved of Envestra's calculation of the Initial Capital Base as at the commencement of the First Access Arrangement Period, because there is no such calculation in the Access Arrangement or Access Arrangement Information.

The Commission appears to acknowledge that clause 3.3.3.2 of the first Access Arrangement supports Envestra's approach to the calculation of the Initial Capital Base. The Commission then goes on to state *“It is the Commission's view, however, that clause 3.3.3.2 of the first Access Arrangement must be interpreted in the context of SAIPAR's Final Decision.”* There is nothing in SAIPAR's Final Decision or Final Approval which contradicts Envestra's interpretation of clause 3.3.3.2. Indeed the Commission appears to ignore that one of the effects of SAIPAR's Final Approval was to approve clause 3.3.3.2 which clause provides that the Capital Base is to be adjusted to reflect *“the actual percentage change in the CPI.”* To state that SAIPAR *“did not contemplate that any further adjustments to the forecast inflation values would take place after the Access Arrangement took effect”* is clearly inconsistent with SAIPAR's approval of clause 3.3.3.2. Further it is incorrect to claim that Envestra is purporting to reopen SAIPAR's decision – rather Envestra is giving effect to and complying with that decision.

To summarise the correct interpretation of the Access Arrangement and SAIPAR's decisions:

- (a) the Initial Capital Base was to be calculated based on the 30 June 1998 DORC Valuation rolled forward to the commencement of the Access Arrangement and adjusted for actual values, including actual inflation. This is reflected in clause 3.3.3.2 of the Access Arrangement and section 5.9 of the Final Decision;
- (b) the Capital Base between reviews is to be rolled forward based on actual values, including actual inflation. This is also reflected in clause 3.3.3.2 of the Access Arrangement;
- (c) however for the purposes of forecasting Total Revenue within an Access Arrangement period, forecasts figures are to be used, including forecast inflation. This is reflected in

clause 3.3.3.1 of the Access Arrangement and Table 15 (in section 4.2.6) of the Access Arrangement Information.

As the Commission's decision to require Envestra to use a Capital Base at the commencement of the First Access Arrangement period (1 July 2003) of \$796.35 million is in error, Envestra has calculated the Initial Capital Base in the manner set out in the Schedule to Envestra's submission to the Draft Decision on the Initial Capital Base, which yields a value of \$810.21 million as at 1 July 2003.

Envestra has revised the value of the regulated asset base for the period from 1 July 2003 to 30 June 2011 relative to that set out in the Schedule to Envestra's submission in response to the Draft Decision. The changes to the value of the regulatory asset base reflect various aspects of the Commission's Final Decision, including:

- the Commission's revised New Facilities Investment for the 2006/07 to 2010/11 period, as set out in table 9.8 of the Commission's Final Decision;
- the Commission's forecast of 2005/06 New Facilities Investment, which is lower than the Envestra forecast previously used; and
- update of inflation for the December 2005 and March 2006 quarters.

These changes have led to a reduction in the value of the capital base submitted by Envestra. The revised 30 June 2011 value of \$904.86 million (expressed in 31 December 2005 dollar terms) is \$23.22 million lower than previously submitted by Envestra in response to the Draft Decision. The main contributing factor is acceptance by Envestra of the Commission's revised New Facilities Investment.