File No:

Alan Tregilgas
Utilities Commission
5th Floor, 38 Cavenagh Street
DARWIN NT 0800

By Hand

Dear Alan

Re: Networks Pricing: Asset Valuation Off-Ramp Draft Decision

The Power and Water Corporation (the Corporation) welcomes the opportunity to provide comments on the February 2005 Draft Decision released by the Utilities Commission (the Commission) regarding the *Networks Pricing: Asset Valuation Off-Ramp*.

The Corporation would like to raise the following major areas of concern regarding the Commission's Draft Decision (with supporting evidence contained in attachments):

1. Off-Ramp Review Legitimacy
2. Off Ramp Review Process
3. Generally Accepted Regulatory Practice (GARP)
4. Writedown Impact

1. Off-Ramp Review Legitimacy

(a) Material Error

The Corporation notes that *c 71(b)* of the *Electricity Networks (Third Party) Access Code* (*Network Access Code*) provides that the regulator may only revoke or reset a price cap if it appears to the regulator that there was a 'material error' in the setting of the cap.

The Corporation is not convinced that a 'material error' in the Z factor or in the setting of the price cap has occurred and therefore questions whether this Review should be triggered at all and if the Commission has any power to reset the price cap if the Review is not valid.

The Corporation notes that the Commission has provided two different equations for the purpose of calculating 'material error' in its Networks Pricing 2004 Regulatory Reset Final Determination (2004 Reset) and that if one of the

equations is used, there is no material error. The Corporation also notes that *c 71(b)* provides that in order for the Commission to have power to reset the price cap, there must have been a material error in the setting of the cap. This power is not enlivened because of the results of applying an equation and as such the Commission must address whether there was material error in setting the price cap.

The Corporation submits that in considering whether the error in setting the price cap was material, the Commission should take into account the costs that will be incurred in a reset process. Significant costs in terms of time and resources may suggest that a relatively small error may not be material (refer to Attachment A).

(b) Independent Review

The Corporation agrees that the asset values provided to the Commission may contain asset identification errors, however this has not been proven by an independent review. The Corporation believes that any revaluation of the Regulated Asset Value (RAV) should only be made following an independent expert assessment of the precise amount of any over- or under-statement in the RAV approved in the 2004 Reset. This is consistent with point 2 (page 5) of the Commission's Draft Decision.

(c) Regulatory Risk

Every change that is introduced into the reset methodology by the Commission gives rise to greater regulatory risk for the Corporation. This Draft Decision also opens the prospect for future arbitrary changes to the base RAV and asset valuation methodology.

2. Off Ramp Review Process

(a) Timeframe

Three weeks is insufficient time for the Corporation to properly (in terms of research, analysis, etc) respond to such an important regulatory decision, even given the Commission's advance notice of its timeframes. The quality and quantity of the Corporation's modelling and submission has accordingly been diminished. The Corporation's understanding and interpretation of the Commission's timetable is at Attachment B.

(b) Regulatory Process

Any consideration of changes to the asset valuation methodology should be the subject of a separate regulatory process, and preferably deferred until the methodology that is to be applied in the third regulatory control period has been debated. The Corporation does not believe that it has had adequate input into the asset valuation methodology discussions regarding the 'business sustainability' methodology.

(c) Retrospective Refund

The Corporation has not been able to identify any specific provisions in the *Network Access Code*, the *Electricity Networks (Third Party Access) Act*, or the *Utilities Commission Act* which provide for the Commission to order the payment of refunds. The Corporation considers that the Commission needs legislative authority before it can order the payment of refunds. The approach and timing that the Commission has proposed for reporting the forecast refunds and actioning the refunds also places additional administrative burden and cost on the Corporation.

3. GARP

(a) DORC Valuation Method is the best method available

The Corporation notes that *c 6(2)(c)* of *Schedule 7* of the Code provides that the regulator must have regard to GARP in approving the basis of the asset valuation to be used.

The Corporation considers that its DORC valuation currently represents the best information available to it and the Commission about the appropriate regulatory asset base (refer to Attachment C). The Corporation also submits that DORC is a commercially viable method and is GARP.

The Corporation submits that the fact that the DORC valuation method is used by most other Australian regulators when valuing electricity network assets is evidence that its use is in fact GARP (refer to Attachment D).

(b) 'Business Sustainability'

The Corporation submits that the 'business sustainability' methodology is not GARP and as such it cannot be used as a basis for asset valuation. The Corporation also notes that *c 66(3)(b)* of the Code similarly provides that the price caps that are to apply during the second and subsequent regulatory control period are to be determined in a manner that is consistent with GARP at the time. The Corporation submits that the 'business sustainability' methodology is not GARP and that as such it cannot be used to determine price caps (refer to Attachment D).

(c) Financial Ratios

The Commission has determined that the financial viability of the Corporation's regulated network business is the ability to service its debt, and therefore focuses only on debt financial ratios such as Net Interest Cover as an indication of 'business sustainability'. The Corporation believes that it is important to consider other key financial ratios relating to liquidity and profitability to give a complete view of business sustainability, such as Return on Assets and Return on Equity.

(d) Net Cash Flows

The Corporation strongly believes that the negative 'interest-bearing financial assets (cash)' from 2010-11, as indicated in the Commission's modelling, is not consistent with the philosophy of 'business sustainability'. Negative cash flows have substantial commercial ramifications for both Network's and the Corporation's financial viability.

4. Writedown Impact

(a) Revenue and Profit

The proposed writedown is likely to have a substantial negative impact on Network's revenue and the Corporation's profitability.

Based on the Corporation's modelling, the Commission's Draft Decision of a $125m writedown of Network assets will have the following impacts on Network's and the Corporation's finances in the **2005-06 financial year** (in comparison to maintaining the *status quo*, and assuming Community Service Obligations (CSO) funding remains at current levels):

- 15.7% ($16m) decrease in Network's operating revenue
- 32.8% ($16m) decrease in Network's net profit (before tax)
- 2.2% ($9.4m) decrease in the Corporation's operating revenue
- 23.5% ($6.7m) decrease in the Corporation's net profit (after tax)
- 23.5% ($2.8m) decrease in the Corporation's tax payments
- 23.5% ($3.3m) decrease in the Corporation's dividend payments

The cumulative impact of the writedown over the current 5-year regulatory period (**2004-05 to 2008-09**) is forecast as follows (in comparison maintaining the *status quo*, and assuming CSO funding remains at current levels):

- 12.9% ($67.5m) decrease in Network's operating revenue
- 28.4% ($70.2m) decrease in Network's net profit (before tax)
- 1.8% ($39.6m) decrease in the Corporation's operating revenue
- 18.9% ($29.6m) decrease in the Corporation's net profit (after tax)
- 18.9% ($12.7m) decrease in the Corporation's tax payments
- 18.9% ($14.8m) decrease in the Corporation's dividend payments

Attachment E details modelling results and assumptions.

The impact on Network's finances is more severe than the impact on Corporation's overall finances as the Z Factor revenue impacts are only passed through to contestable customers, assuming CSO's remain at their current levels. However, the asset writedown will also reduce the dividend and tax paid to the Corporation's shareholder.

(b) Book Value

A writedown of regulatory assets will result in a writedown of book values when the Recoverable Amounts Test (RAT) is applied. The RAT is required at the end of each financial year and tests whether there needs to be a change to the book value as a result of the future revenue streams generated by the assets. A writedown in the regulatory assets will result in a decrease in the future revenue stream, which will affect the book value through the RAT. The quantum of the writedown in the regulatory asset base is likely to be much more than the quantum of the writedown in book values, but still significant.

The Corporation has not had sufficient time to model these impacts.

(c) International Financial Reporting Standards (IFRS) - Asset Revaluation Reserve

The modelled estimates above do not include the affect of the introduction of IFRS at 30 June 2005, specifically the requirement that asset revaluation increments and decrements be accounted for on an individual asset basis as opposed to classes of assets. The specific recognition of Network assets within the Asset Valuation Reserve needs to be undertaken to determine the Corporation ability to offset a writedown. The absence of an offset will impact directly on the net profit results.

The Corporation has not had sufficient time to model these impacts.

(d) Government Policy Changes

Although outside of the scope of the Commission's Draft Decision, the Corporation considers it important to note that the Draft Decision provides no guarantee that the Government's policy regarding CSO, dividends and debt for equity swaps will remain unchanged. The Draft Decision assumes these policies will continue and all modelling has been based on this assumption. A substantial writedown of the Corporation's assets as proposed will increase the financial impact that these shareholder policy decisions will have on the Corporation in the future.

(e) Service Standards

If the Corporation and the NT Government did not want the Corporation's profitability to be affected by a writedown, then the costs associated with providing regulated Network services would need to be reduced. As the Commission already sets the Network's price cap based on efficient costs, further cost reductions could negatively affect the reliability and quality of services and supply. This Draft Decision comes at the same time as the Commission is considering imposing Service Standards and Guaranteed Service Level (GSL) payments on the Corporation (refer to Attachment F).

(f) Government Owned Corporations (GOC) and CSO Considerations

The Corporation is a commercial entity under the *Government Owned Corporations Act*, and is required under that Act to earn a commercial rate of return on assets employed. Non-commercial activities required by NT Government are funded by CSO payments.

In paragraph 6.28, the Commission intimates that CSO shortfalls have been considered in the processes leading to the Draft Decision. The Corporation considers it inappropriate for the Commission to have regard to the impact of Retail CSO payments on Network prices. Access pricing is not the appropriate mechanism to pursue what are essentially NT Government policy initiatives. While the Code does provide the Commission with discretion, it is arguable whether the Commission may take the impact of social policy into account when setting access prices, particularly where policies relate to Retail supply conditions rather than Networks.

The Corporation's Preferred Position

The Corporation's preferred position is that the Commission should not make a final assessment on the Off-Ramp Review until:

1. the Corporation undertakes a physical asset stocktake in 2005-06 and a revaluation of these assets in 2006-07;

    If the Commission was to entertain this proposal then the Corporation would submit a scoping document, outlining the deliverables, timeframes and costs associated with this exercise to the Commission in a timely manner. The Corporation would welcome the Commission's input into this scoping document. The Corporation wishes to note that it is not seeking to have a new DORC valuation conducted at the start of every new regulatory period but rather wants to get the base right for future application.

2. an independent expert is engaged by the Commission to assess the precise amount of regulatory asset value overstatement (if any);
3. the Commission undertakes a separate regulatory process in 2007-08 (with a formal and agreed timeframe to revisit the asset valuation methodology). The regulatory reset may or may not apply the new asset valuation methodology in 2008-09 as part of the next regulatory control period.

Please direct any comments or queries regarding this matter to Mr Darren Nelson – Manager, Regulatory Affairs & Economic Services - (on darrenb.nelson@powerwater.com.au and/or 08 8924 7922).

Yours sincerely

Kim Wood
Managing Director

March 2005

Attachment A - MATERIAL ERROR

The Corporation acknowledges that there were asset identification errors in the regulated network asset values provided to the Commission for the 2004 Regulatory Reset, but does not believe that the difference is material.

The Depreciated Replacement Cost (DRC) value provided to the Commission for the 2004 Reset was $454.43 million. The DRC provided to the Commission in February 2005 based on the Corporation's 2005 asset desktop exercise was $455.52 million.[1] This represents a 0.24% variance ($1.09 million).

The Commission indicated in the 2004 Regulatory Reset Final Determination that:

> "*the off-ramp is applicable only if, prior to 31 March 2005, the Commission is satisfied that the valuation of the initial asset base at 30 June 2000 and/or the asset amounts rolled-forward during the first regulatory control period underlying the above determined value of the Z factor involved a "material error"*" (page 46)

The Corporation does not believe that a 0.24% variance in asset values could be considered a 'material error', and therefore the Off-Ramp Review should not have been triggered and there is no basis for resetting the price cap.

A 'material error' is defined in the 2004 Regulatory Reset Final Determination as *"one that involves an error in the Z factor that is at least equivalent to one year's allowed price increase"* (page 46). Within the Determination, the Commission has provided 2 different equations defining one year's allowed price increase:

- Page 9 of the 2004 Determination defines it as **ΔCPI * (1-(X1+X2))**.
- Page 46 of the 2004 Determination it as **ΔCPI – X1 - X2**.

Using the first equation, and given the Commission's original Z factor of 4.4%, X1 of 1.75%, X2 of 0.25% and CPI of 2.5% (as per the Commission's *Networks Pricing: Asset Valuation Off-Ramp Draft Executive Summary)*, one years allowable price increase is equal to 2.45%. This implies that a Z factor within the range of 1.95% to 6.85% represents an immaterial error. The Corporation's estimates using Network's revised asset figure (sent to the Commission in February 2005) implies a Z factor of 3.2%. As 3.2% is within one year's allowed price increase (ie. 1.95% to 6.85%), the Corporation's view that asset value error is not material.

Using the second equation, and the Commission's original Z factor of 4.4%, X1 of 1.75%, X2 of 0.25% and CPI of 2.5% (as per the Commission's *Networks Pricing: Asset Valuation Off-Ramp Draft Executive Summary)*, one years allowable price increase is equal to 0.5%. This implies that a Z factor within the range of 3.9% to 4.9% represents an immaterial error. The Corporation's estimated Z factor of 3.2% using Network's

[1] The 2005 asset desktop exercise was carried out for a number of internal reasons and followed prompting by the Commission to address asset identification issues flowing from the 2004 Reset Determination. This desktop exercise involved an in-house review of the network asset register. This did not involve a physical stocktake or independent review of assets.

revised asset figure does not fall within this range and by this definition represents a material error. However the Corporation still maintains that the actual asset value error is immaterial.

If the Commission is not satisfied with the asset values provided by the Corporation in February 2005, than this matter should be deferred until the next regulatory control period. The 2004 Regulatory Reset Final Determination states that if

> *"the investigations are not concluded to the Commission's satisfaction by 31 March 2005, the matter will be deferred until all factors can be taken into consideration at the time of the next regulatory reset."*

Attachment B - TIMETABLE

Date	Event
February 2004	UC's releases final determination for the 2004 reset
26 November 2004	UC's off-ramp review begins
2 February 2005	UC asks PWC for comments on UC's model & draft executive summary for draft decision
16 February 2005	PWC provides comments on UC's model & draft executive summary for draft decision
28 February 2005	UC releases draft decision on the off-ramp review
21 March 2005	PWC submission on off-ramp review draft decision due
31 March 2005	UC's final decision or on off-ramp review due
31 May 2005	PWC to provide UC with a forecast of the amount of network revenue to be collected during 2005-06 on account of the difference between the (preliminary) corrected Z factor and the 2004 Reset Z factor
1 July 2005 (onwards)	Z factor correction given effect
30 September 2005	Submissions on preliminary assessment of the off-ramp review (numbers but not methodology) due
30 November 2005	UC's final assessment due
30 June 2006	PWC Networks is to refund to PWC Retail at the latest & on-passing as appropriate to the Government and for the payment of a rebate to each of the affected contestable customers
1 July 2006 (onwards)	UC approved weighted-average price index of network tariffs in 2003-04 will be adjusted by the corrected Z factor and then escalated forward in accordance with the approved CPI-X values

Attachment C - DEPRECIATED OPTIMISED REPLACEMENT COST (DORC)

The Corporation would like to emphasise that DORC is an efficient value in that it represents the lowest alternative cost of replicating assets (that would be replaced) with a modern day equivalent asset with the same service delivery capability.

By setting the asset value below DORC the Commission is arguing that the Corporation should be recovering less than the cost of a hypothetically efficient new entrant. The Corporation does not believe that this should be the case as:

- DORC is an efficient value. By definition this value does not contain monopoly rents as these have been optimised out of the valuation; and
- By definition, no other party would invest on the basis of the prices that the Commission is proposing.

The Corporation acknowledges that the DORC methodology has shortcomings – these have been widely recognised and accepted in other jurisdictions where DORC has been applied as being the best available asset valuation option. Importantly:

- DORC avoids any circulatory arguments that are associated with values based on prices set by either unregulated monopoly or economic regulators; and
- Once a RAV has been established based on DORC, it is relatively straightforward and cost-effective to undertake roll-forward adjustments.

The Corporation therefore submits that the Commission should continue to rely on the DORC valuation, adjusted as appropriate for material errors following an independent review, as this is consistent with both its 2004 Final Decision and generally accepted regulatory practice for Australian distribution network service providers. The Commission should then roll this value forward year on year and between regulatory periods based on appropriate adjustments for disposals, capital expenditure, depreciation and inflation.

The Corporation's view is supported by the following Council of Australian Government (CoAG) recommendations:

At the CoAG meeting on 19 August 1994 it was agreed that the deprival value should be adopted as the preferred approach to valuing network assets, as evidenced by the following quotation:

"(b) for the purposes of developing network pricing and access charges, the methodology for asset valuation should be consistent with the National Performance Monitoring sub-committee report and with Australian Accounting Standards, and:

(i) that Deprival Value should be adopted as the preferred approach to valuing network assets;

(ii) that the approaches adopted for applying Deprival Value should be transparent and uniform across jurisdictions to avoid distortions to competition; and

(iii) that by 31 December 1994 the NGMC establish a set of agreed transparent and non-discriminatory methods and principles for applying Deprival Value."

Following this the Steering Committee on National Performance Monitoring of Government Trading Enterprises issued guidelines for the determination of deprival values of assets of government trading enterprises. These guidelines define the deprival value of an asset as

> *'the value to the entity of the future economic benefits that the entity would forego if deprived of the asset. Under this approach, assets are valued at an amount that represents the loss that might be expected to be incurred by an entity if that entity was deprived of the service potential or future economic benefits of these assets at the reporting date. Thus the value to the entity in most cases will be measured by the* ***replacement cost*** (emphasis added) *of the services or benefits currently embodied in the asset, given that deprival value will normally represent the cost avoided as a result of controlling the asset and that the* ***replacement cost*** (emphasis added) *represents the amount of cash necessary to obtain an equivalent or identical asset.'*
>
> *'In applying deprival value concepts, the basic principles are:*
>
> - *Where an entity would replace the service potential embodied in an asset if deprived of it, the asset should be measured at its current cost (ie. the lowest cost at which the gross service potential of the asset could currently be obtained in the normal course of business). This is the amount which an entity would need to receive in compensation to restore the asset to its former capacity.*
> - *Where an entity would not replace an asset if deprived of it, the asset would be measured at the greater of its market value and the present value of future net cash inflows expected for continued use of the asset. This is the amount by which an entity would be worse-off if deprived of the asset.*
> - *Where an asset is surplus to requirements, the asset should be measured at its market value.'*
>
> *'Some of the advantages of the deprival value approach are:*
>
> - *The measurement and depreciation of physical non-current assets at deprival value provides relevant information about the current cost of providing goods and services;*
> - *The measurement and depreciation of physical non-current assets at deprival value provides relevant information about the current value of the resources deployed for this purpose;*
> - *Deprival value reflects whether the capacity of the entity to continue its present level of operations has been maintained. Consequently, it avoids inadvertent erosion of the entity's operating capacity; and*

- *Deprival value reflects price changes that are relevant to the particular classes of assets held by an entity, as opposed to those based on a general index of price changes.'*

The Corporation's understanding is that CoAG has not made any subsequent decisions regarding the valuation of public sector assets that need to be considered for this off-ramp review.

Attachment D - GENERALLY ACCEPTED REGULATORY PRACTICE (GARP)

Clause 6(2)(c) of Schedule 7 of the *Network Access Code* states that the regulator must have regard to GARP in approving the basis of the asset valuation. Clause 66(3)(b) of the *Network Access Code* similarly provides that the price caps that are to apply during the second and subsequent regulatory control period are to be determined in a manner that is consistent with GARP at the time.

Typically, regulators have employed one of two approaches in determining the opening Regulatory Asset Value (RAV):

1. Roll-forward the assets from the previous regulatory period, which relies upon an assumption that the original asset value that has been rolled forward was well founded and has ongoing relevance because it is effectively entrenched in the next regulatory period; or
2. Undertake a new asset valuation for the new regulatory period.
   This is the approach that the Queensland Competition Authority (QCA) recently reflected in its Draft Determination and will apply in its Final Determination later this year. The QCA adopted this approach because it did not have confidence in the previous valuation and wanted to ensure that the RAV was soundly based going forward.

The table on the following page summarises the asset valuation approach taken in other jurisdictions in Australia.

REGULATOR	ASSET VALUATION APPROACH				
	DORC	BUSINESS SUSTAINABILITY (or similar)	OTHER	Roll Forward	Asset Revalue
MCE (Ministerial Council on Energy) National Framework for Electricity and Gas Distribution and Retail Regulation – Distribution Networks	✓				
QCA (Qld) Draft Determination December 2004	✓				✓
IPART (NSW) Final Determination June 2004	✓			✓	
ESC (Victoria) Issues Paper December 2004	✓			✓	
ESCOSA (SA) Draft Determination 2005-2010	✓			✓	
Economic Regulation Authority (WA)	✓				
OTTER (Tasmania)	✓				
ACCC Transmission Networks	✓				

Attachment E – MODELLING RESULTS AND ASSUMPTIONS

The Corporation has used the revenue and expense estimates as per the Commission's 'Business Sustainability Value Model' as inputs into its 'Corporate Forecasting Model' to model the impacts of various scenarios on the networks business and the Corporation as a whole.

With regards to Sales Revenue in the Commission's 'Business Sustainability Value Model', the Corporation notes that the revenue stream has not been updated in accordance with the model that accompanied the 2004 Regulatory Reset Final Determination. The Corporation believes this occurred due to the Commission updating the 2003-04 Sales Revenue figures with actual results for the financial year, as opposed to retaining the 2003-04 forecasts upon which the 2004-05 price cap was based. The Corporation has adjusted for this in its modelling by adjusting the 2003-04 year to be the Required Revenue (03-04 forecasts) in line with the 2004 Regulatory Reset Final Determination.

The Corporation also notes that the Commission adopted an escalation factor of ΔCPI-X1-X2 in its 'Business Sustainability Value Model'. This is not consistent with the escalation factor outlined in the 2004 Regulatory Reset Final Determination. The Corporation updated this escalation factor to reflect the multiplicative formula in the 2004 Regulatory Reset Final Determination ie. ΔCPI * (1-(X1 + X2)).

After applying the adjustments outlined above, the Corporation modelled the following scenarios:

- Base case: using the RAV from the 2004 Determination with a Z factor of 4.4%.
- Option one: using the Corporation's revised DORC figures (provided in February 2005), which results in a Z factor of 3.2%.
- Option two: using the 'corrected DORC' RAV which results in a Z factor of 0.1%.
- Option three: $100 million less than the 'corrected' DORC that results in a Z factor of –10.5%.
- Option four: $125 million less than the 'corrected' DORC that results in a Z factor of -13.4%.
- Option five: $150 million less than the 'corrected' DORC that results in a Z factor of –16.3%.

The results of these scenarios are detailed on the following pages.

NETWORKS	2004 Reset data		Jan 05 REVISED		Jan 05 data		$100m w/d		$125m w/d		Book Value	
Z Factor	4.40%		3.20%		0.10%		-10.50%		-13.40%		-15.80%	
Operating Revenue ($M) 04-05	*94.12*		*94.12*		*94.12*		*94.12*		*94.12*		*94.12*	
Operating Revenue ($M) 05-06	101.94	(196)	100.86	(195)	98.07	(192)	88.53	(183)	85.91	(180)	83.75	(178)
Operating Revenue ($M) 06-07	105.34	(301)	104.23	(299)	101.34	(294)	91.46	(274)	88.76	(269)	86.52	(264)
Operating Revenue ($M) 07-08	108.86	(410)	107.71	(407)	104.72	(398)	94.50	(369)	91.70	(360)	89.39	(354)
Operating Revenue ($M) 08-09	112.50	(523)	111.30	(518)	108.21	(506)	97.64	(466)	94.74	(455)	92.35	(446)
Operating Expense ($M) 04-05	*36.30*		*36.30*		*36.30*		*36.30*		*36.30*		*36.30*	
Operating Expense ($M) 05-06	34.55	(71)	34.55	(71)	34.55	(71)	34.55	(71)	34.55	(71)	34.55	(71)
Operating Expense ($M) 06-07	35.15	(106)	35.15	(106)	35.15	(106)	35.15	(106)	35.15	(106)	35.15	(106)
Operating Expense ($M) 07-08	35.26	(141)	35.26	(141)	35.26	(141)	35.26	(141)	35.26	(141)	35.26	(141)
Operating Expense ($M) 08-09	35.76	(177)	35.76	(177)	35.76	(177)	35.76	(177)	35.76	(177)	35.76	(177)
EBITDA ($M) 04-05	*57.82*		*57.82*		*57.82*		*57.82*		*57.82*		*57.82*	
EBITDA ($M) 05-06	73.13	(131)	72.05	(130)	69.26	(127)	59.72	(118)	57.11	(115)	54.95	(113)
EBITDA ($M) 06-07	76.07	(207)	74.96	(205)	72.07	(199)	62.19	(180)	59.49	(174)	57.25	(170)
EBITDA ($M) 07-08	79.63	(287)	78.47	(283)	75.48	(275)	65.26	(245)	62.47	(237)	60.15	(230)
EBITDA ($M) 08-09	82.92	(370)	81.72	(365)	78.63	(353)	68.05	(313)	65.16	(302)	62.76	(293)
EBIT ($M) 04-05	*45.99*		*45.99*		*45.99*		*45.99*		*45.99*		*45.99*	
EBIT ($M) 05-06	59.98	(106)	58.90	(105)	56.11	(102)	46.57	(93)	43.96	(90)	41.79	(88)
EBIT ($M) 06-07	62.33	(168)	61.21	(166)	58.32	(160)	48.44	(141)	45.74	(136)	43.51	(131)
EBIT ($M) 07-08	65.40	(234)	64.24	(230)	61.26	(222)	51.04	(192)	48.24	(184)	45.93	(177)
EBIT ($M) 08-09	68.29	(302)	67.10	(297)	64.00	(286)	53.43	(245)	50.53	(234)	48.14	(225)
NPBT ($M) 04-05	*34.25*		*34.25*		*34.25*		*34.25*		*34.25*		*34.25*	
NPBT ($M) 05-06	48.92	(83)	47.84	(82)	45.05	(79)	35.50	(70)	32.89	(67)	30.73	(65)
NPBT ($M) 06-07	51.44	(135)	50.29	(132)	47.30	(127)	37.09	(107)	34.30	(101)	31.98	(97)
NPBT ($M) 07-08	54.50	(189)	53.28	(186)	50.14	(177)	39.40	(146)	36.46	(138)	34.03	(131)
NPBT ($M) 08-09	57.71	(247)	56.43	(242)	53.12	(230)	41.83	(188)	38.74	(177)	36.18	(167)

Source:
04-05 figures taken from January 2005 MBR, Annual forecasts (based on actuals)
Figures from 05-06 to 08-09 are Financial Model forecasts, based on 03-04 SCI numbers
Figures in brackets are cummulative totals

Assumptions and Notes:
1. Operating Revenue is Total Revenue excluding Gifted Assets and Interest Received
2. Operating Expense includes internal expenses such as Transfer Pricing and Corporate Allocations
3. EBITDA includes Gifted Assets
4. The UC's forecasts (from Feb 05 Model) for Transfer Pricing Revenue, Other Revenue, Interest Revenue, Interest Expense, Gifted Assets and Depreciation has been used
5. The UC has assumed a Networks unit growth factor of 1% for Non Contestable customers, T1-3 customers and T4 customers
6. The UC has assumed interest payments at 7%

CORPORATION	**2004 Reset data**		**Jan 05 REVISED**		**Jan 05 data**		**$100m w/d**		**$125m w/d**		**Book Value**	
Z Factor	**4.40%**		**3.20%**		**0.10%**		**-10.50%**		**-13.40%**		**-15.80%**	
Operating Revenue ($M) 04-05	*422.07*		*422.07*		*422.07*		*422.07*		*422.07*		*422.07*	
Operating Revenue ($M) 05-06	424.03	(846)	423.40	(845)	421.76	(844)	416.17	(838)	414.64	(837)	413.37	(835)
Operating Revenue ($M) 06-07	429.11	(1,275)	428.45	(1,274)	426.74	(1,271)	420.89	(1,259)	419.29	(1,256)	417.97	(1,253)
Operating Revenue ($M) 07-08	438.90	(1,714)	438.23	(1,712)	436.49	(1,707)	430.54	(1,690)	428.91	(1,685)	427.56	(1,681)
Operating Revenue ($M) 08-09	446.18	(2,160)	445.48	(2,158)	443.66	(2,151)	437.45	(2,127)	435.75	(2,121)	434.34	(2,115)
Operating Expense ($M) 04-05	*323.40*		*323.40*		*323.40*		*323.40*		*323.40*		*323.40*	
Operating Expense ($M) 05-06	327.68	(651)	327.68	(651)	327.68	(651)	327.68	(651)	327.68	(651)	327.68	(651)
Operating Expense ($M) 06-07	326.36	(977)	326.36	(977)	326.36	(977)	326.36	(977)	326.36	(977)	326.36	(977)
Operating Expense ($M) 07-08	332.24	(1,310)	332.24	(1,310)	332.24	(1,310)	332.24	(1,310)	332.24	(1,310)	332.24	(1,310)
Operating Expense ($M) 08-09	338.65	(1,648)	338.65	(1,648)	338.65	(1,648)	338.65	(1,648)	338.65	(1,648)	338.65	(1,648)
EBITDA ($M) 04-05	*113.38*		*113.38*		*113.38*		*113.38*		*113.38*		*113.38*	
EBITDA ($M) 05-06	106.59	(220)	105.96	(219)	104.32	(218)	98.73	(212)	97.20	(211)	95.93	(209)
EBITDA ($M) 06-07	113.13	(333)	112.47	(332)	110.76	(328)	104.92	(317)	103.32	(314)	101.99	(311)
EBITDA ($M) 07-08	117.19	(450)	116.51	(448)	114.77	(443)	108.82	(426)	107.19	(421)	105.84	(417)
EBITDA ($M) 08-09	118.20	(568)	117.50	(566)	115.68	(559)	109.46	(535)	107.76	(529)	106.36	(524)
EBIT ($M) 04-05	*68.88*		*68.88*		*68.88*		*68.88*		*68.88*		*68.88*	
EBIT ($M) 05-06	61.77	(131)	61.14	(130)	59.50	(128)	53.91	(123)	52.38	(121)	51.11	(120)
EBIT ($M) 06-07	67.72	(198)	67.05	(197)	65.34	(194)	59.50	(182)	57.90	(179)	56.58	(177)
EBIT ($M) 07-08	69.38	(268)	68.71	(266)	66.97	(261)	61.01	(243)	59.39	(239)	58.04	(235)
EBIT ($M) 08-09	67.47	(335)	66.77	(333)	64.95	(326)	58.74	(302)	57.04	(296)	55.63	(290)
NPBT ($M) 04-05	*46.79*		*46.79*		*46.79*		*46.79*		*46.79*		*46.79*	
NPBT ($M) 05-06	39.98	(87)	39.34	(86)	37.71	(84)	32.11	(79)	30.58	(77)	29.32	(76)
NPBT ($M) 06-07	45.21	(132)	44.51	(131)	42.70	(127)	36.53	(115)	34.83	(112)	33.44	(110)
NPBT ($M) 07-08	47.61	(180)	46.88	(178)	44.98	(172)	38.51	(154)	36.73	(149)	35.27	(145)
NPBT ($M) 08-09	44.07	(224)	43.28	(221)	41.25	(213)	34.31	(188)	32.42	(181)	30.85	(176)
Tax ($M) 04-05	*14.03*		*14.03*		*14.03*		*14.03*		*14.03*		*14.03*	
Tax ($M) 05-06	11.99	(26)	11.80	(26)	11.31	(25)	9.63	(24)	9.17	(23)	8.79	(23)
Tax ($M) 06-07	13.56	(40)	13.35	(39)	12.81	(38)	10.96	(35)	10.45	(34)	10.03	(33)
Tax ($M) 07-08	14.28	(54)	14.06	(53)	13.49	(52)	11.55	(46)	11.02	(45)	10.58	(43)
Tax ($M) 08-09	13.22	(67)	12.98	(66)	12.38	(64)	10.29	(56)	9.73	(54)	9.25	(53)
NPAT ($M) 04-05	*32.76*		*32.76*		*32.76*		*32.76*		*32.76*		*32.76*	
NPAT ($M) 05-06	27.98	(61)	27.54	(60)	26.40	(59)	22.48	(55)	21.41	(54)	20.52	(53)
NPAT ($M) 06-07	31.65	(92)	31.16	(91)	29.89	(89)	25.57	(81)	24.38	(79)	23.41	(77)
NPAT ($M) 07-08	33.33	(126)	32.81	(124)	31.49	(121)	26.95	(108)	25.71	(104)	24.69	(101)
NPAT ($M) 08-09	30.85	(157)	30.30	(155)	28.88	(149)	24.02	(132)	22.69	(127)	21.59	(123)
Dividends ($M) 04-05	*16.38*		*16.38*		*16.38*		*16.38*		*16.38*		*16.38*	
Dividends ($M) 05-06	13.99	(30)	13.77	(30)	13.20	(30)	11.24	(28)	10.70	(27)	10.26	(27)
Dividends ($M) 06-07	15.82	(46)	15.58	(46)	14.95	(45)	12.78	(40)	12.19	(39)	11.70	(38)
Dividends ($M) 07-08	16.66	(63)	16.41	(62)	15.74	(60)	13.48	(54)	12.86	(52)	12.34	(51)
Dividends ($M) 08-09	15.42	(78)	15.15	(77)	14.44	(75)	12.01	(66)	11.35	(63)	10.80	(61)

Source:
04-05 figures taken from January 2005 MBR, Annual forecasts (based on actuals)
Figures from 05-06 to 08-09 are Financial Model forecasts, based on 03-04 SCI numbers
Figures in brackets are cummulative totals

Assumptions and Notes:
1. Operating Revenue is Total Revenue excluding Gifted Assets and Interest Received
2. The Z Factor revenue impacts has not been passed through to Non Contestable customers revenue, in recognition of the Government's current uniform tariff policy
3. EBITDA includes Gifted Assets
3. Power and Water retain 100% market share
4. CSO funding remains at currently approved levels
5. Assumes operating conditions remain unchanged
6. Tax charge is 30%
7. Dividend is 50% of after-tax profits

Attachment F – SERVICE STANDARDS

If the Corporation and the NT Government did not want the Corporation's profitability to be affected by the writedown, then the costs associated with providing regulated network services would need to be reduced.

The Corporation can only reduce Network cost in the following areas:
- Reductions in operations and maintenance costs;
- Reductions in planned capital expenditure; or
- Reductions in funds set aside to replace or refurbish assets (usually funded by depreciation charges).

Cost reductions in these areas will have serious implications for the way in which the Corporation provides regulated network services in the Northern Territory. In particular, the Corporation is concerned that as the Commission already sets the Network's price cap based on efficient costs, further cost reductions could negatively affect the reliability and quality of services and supply. It follows that any cost reductions will therefore be in excess of efficient costs.

This Draft Decision comes at the same time as the Commission is considering imposing Service Standards. Networks needs to have sufficient financial capacity to maintain the Network according to the standards imposed. Any degradation in those standards may then result in Guaranteed Service Level (GSL) payments to customers. Any GSL payments would be an additional cost to Networks.

Additionally, the Commission's Draft Decision assumes that reductions in costs can occur from 1 July 2005. The nature of the Corporation's costs suggests that these reductions must be phased in over a longer time frame, because the Corporation's cost base is relatively fixed.

The bulk of operational costs relate to personnel expenses for essential technical staff employed by Networks.The Corporation is obliged to rely on natural attrition for reductions in employee costs, and there is therefore limited capacity to reduce these costs immediately.

There is a direct correlation between reductions in repairs and maintenance expenditure and system security and reliability. Possible methods of reducing operational costs could include extending maintenance cycles for some types of assets, or reducing the scheduled vegetation clearance program. Repairs and maintenance schedules require long term planning in order to ensure that system security and reliability is not compromised, and therefore takes time to amend without impacting negatively on service standards or public safety.

Many of the Corporation's costs are contracted service agreements. Stores outsourcing, for example, is provided under a contract that sets out prices and management costs. Altering those contracts would see the Corporation incur penalties and would simply

result in the shifting of costs to other businesses within the organisation. Additionally, the efficiencies to be gained from these contracts would be limited as they were agreed through a process of competitive tendering.