

Our ref: RSC 014
Enquiries: William Street

NOTICE OF PUBLIC CONSULTATION – 2009 MAXIMUM RESERVE CAPACITY PRICE FOR THE 2011/12 RESERVE CAPACITY YEAR

The Independent Market Operator (IMO) as part of its obligations under the Market Rules determines the Maximum Reserve Capacity Price (MRCP). This sets the maximum bid that can be made in a Reserve Capacity Auction and is used as the basis to determine an administered Reserve Capacity Price if no auction is required.

As part of this process the IMO sought the services of the Allen Consulting Group to determine the parameter values for the Weighted Average Cost of Capital (WACC). The minor parameters were again reviewed in December, between the Draft and Final Reports, to obtain a more price reflective value for the WACC to account for the time required to publish the Final MRCP value.

Due to recent events in world financial markets, there has been a decrease in the calculated WACC from 8.27% in the Draft Report to 7.09% in the Final Report. This has resulted in a subsequent decrease in the value of the MRCP from **\$195,300 to \$170,700** (this also includes changes made in respect to the correction in the use of the Western Power Networks valuation of connection costs).

The IMO would like to invite participants to make submissions in respect of this change. The IMO notes that these changes are significant, but have been the result of price changes in world financial markets in recent months.

A full breakdown of the parameter values and calculation of the WACC are provided in Appendix 1 of this notice.

As a result of this change, the IMO will hold an additional period of public consultation to allow for comments on the new proposed price. This public consultation period will run from the 18 December 2008 to 24 December 2008. Submissions will formally close on:

5:00pm W DST on Wednesday 24 December 2008.

All enquiries should be directed to Troy Forward or William Street by email via imo@imowa.com.au or telephone (08) 9254 4300.

**TROY FORWARD
MANAGER, MARKET ADMINISTRATION AND SYSTEM CAPACITY**

18 December 2008

APPENDIX 1 - WEIGHTED AVERAGE COST OF CAPITAL

The pre tax real Officer WACC is used for the determination of the Maximum Reserve Capacity price. The formulae is shown below:

$$WACC_{real} = \left(\frac{(1 + WACC_{no\ min\ al})}{(1 + i)} \right) - 1$$

and

$$WACC_{no\ min\ al} = \frac{1}{(1 - t(1 - \gamma))} R_e \frac{E}{V} + R_d \frac{D}{V}$$

Where;

The nominal Return on Equity is calculated as:

$$R_e = R_f + \beta_e \times MRP$$

And

The nominal Return on Debt is calculated as:

$$R_d = R_f + DRP$$

The Allen Consulting Group reviewed the minor parameters and updated the relevant parameters in line with current prices and values. A table of the parameters and values are shown below:

Table A1: PRICECAP[2009] and associated parameters

Parameter	Value
Nominal Risk Free Rate of Return (%)	4.98
Expected Inflation (%)	3
Real risk free rate of return (%)	3.12
Market Risk Premium (%)	6
Asset beta	0.5
Equity beta	0.83
Debt Margin (%) , DRP (%)	3.2
Debt issuance costs (%)	0.125
Corporate tax rate (%)	30
Franking credit value	0.5
Debt to total assets ratio (%)	40
Equity to total assets ratio (%)	60

For the purposes of the 2009 MRCP:

WACC = 7.09%