Our ref: [redacted]
Contact: Matt Veryard

6 September 2022

Jason Dignard
Principal Regulatory Advisor
Economic Regulation Authority

Via e-mail: publicsubmissions@erawa.com.au

Dear Jason

2022 Draft Gas Rate of Return Instrument

Thank you for the opportunity to make a submission to this process. Although the Economic Regulation Authority's (ERA's) Gas Rate of Return Instrument (RORI) does not directly apply to Western Power, Western Power understands it is likely to be used as a basis for the ERA to make a determination on our fifth Access Arrangement (AA5) currently underway. This brief submission sets out Western Power views on several key points that are also relevant to the AA5 process.

The term of the risk-free rate

Western Power fully supports the ERA's proposed approach to the term of the risk-free rate. As highlighted in our AA5 initial proposal, our view is that the appropriate regulatory task is to set the allowed return equal to the market cost of capital.

Since there is very strong evidence that the market approach is to use a 10-year risk-free rate, that is the approach that should be used when setting the allowed return. We note this approach, and reasoning, has been adopted by every Australian regulator other than in the Australian Energy Regulator's (AER's) recent draft RORI.

Western Power understands that Energy Networks Australia (ENA) has commissioned a report by Emeritus Professor Richard Schalensee from MIT which outlines the errors in the AER's interpretation of the mathematical analysis. Western Power understands this analysis confirms many of the statements made by Western Power and the ERA.

Equity beta

Western Power agrees with the ERA's proposed approach to having regard to international comparator firms when estimating beta. Western Power's view is that a domestic comparator set that consists of a single live firm is insufficient for estimating equity beta, therefore it is imperative that regard be given to international comparators.

. In the ERA's analysis, the domestic comparators receive approximately 14 times the weight of each international comparator.

We propose that, in its final decision, the ERA might consider reducing the weighting that is applied to domestic comparators, or at least explaining how that weight will be reduced over time to deal with evidence from de-listed comparators.

363 Wellington Street Perth 6000
GPO Box L921 Perth WA 6842
westernpower.com.au

t 13 10 87
f (08) 9225 2660
TTY 1800 13 13 51
TIS 13 14 50
Electricity Networks Corporation
ABN: 18 540 492 861

Allowed return on debt

As outlined in our AA5 initial proposal, our position is that the allowed return on debt is set using the standard 10-year trailing average approach, consistent with all other Australian regulators. The primary reasons for that conclusion are:

- The hybrid approach to the allowed return on debt does not reflect a financing strategy that a business operating in the market would adopt, other than to replicate the allowance provided to it by the ERA. Consequently, it is difficult to support the notion that such a strategy is prudent and efficient or reflective of the market cost of capital.
- The ERA now recognises that the trailing average approach is consistent with the NPV=0 principle. If it is prudent and efficient to issue 10-year fixed-rate debt on a staggered maturity basis, the regulatory allowance should reflect the cost of that strategy, consistent with NPV=0.
- Other Australian regulator now uses the standard 10-year trailing average approach applied to the entire return on debt, matching the regulatory approach with the approach generally observed in the market. Like the term of the risk-free rate, other Australian regulators consider that the NPV=0 principle supports their adoption of the standard 10-year trailing average approach.

Thank you again for the opportunity to make a submission to the RORI process. Please contact Matt Veryard if you have any queries on this submission.

Yours sincerely

Zahra Jabiri
Head of Regulation and Investment Assurance

CC: Jacqui Hall, Chief Financial Officer