



**SUBMISSION 65: Regulatory Estimate of gamma in light of recent decisions of the Australian Competition Tribunal**

**Date Submitted: 20 July 2011**

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## 1. INTRODUCTION

- 1.1 On 14 March 2011, the Economic Regulation Authority (**ERA**) made its draft decision (**Draft Decision**) in relation to the full access arrangement proposal filed by DBNGP (WA) Transmission Pty Ltd (**DBP**) on 1 April 2010 (**Original AA Proposal**).
- 1.2 The Draft Decision also fixes a period for amendment of the Original AA Proposal (**revision period**), which revision period expired on 18 April 2011.
- 1.3 On 18 April 2011, DBP submitted the following documents pursuant to Rule 60 of the NGR, which make up the amended access arrangement proposal (**Amended AA Proposal**):
  - (a) Amended Proposed Revised Access Arrangement; and
  - (b) Amended Proposed Revised Access Arrangement Information.
- 1.4 Rule 59(5)(c)(iii) of the NGR requires the ERA to allow at least 20 business days from the end of the revision period for submissions to be made (in relation to both the Draft Decision and the Amended AA Proposal). The ERA advised that interested parties were to make submissions on the ERA's Draft Decision up until 4:00pm (WST) Friday 20 May 2011.
- 1.5 In accordance with Rule 59(5)(c)(iii) of the NGR, DBP filed a number of submissions that explain and substantiate the amendments and additions in the Amended AA Proposal that have been made to address various matters raised in the Draft Decision.
- 1.6 The submissions were as follows:
  - (a) Submission (49) Response to Specific Amendments
  - (b) Submission (50) Reference Service
  - (c) Submission (51) Terms & Conditions
  - (d) Submission (52) Opening Capital Base
  - (e) Submission (53) Capital Expenditure
  - (f) Submission (54) Operating Expenditure
  - (g) Submission (55) Rate of Return
  - (h) Submission (56) Other Tariff Matters
  - (i) Submission (57) Non Tariff Matters
- 1.7 In the notice dated 26 May 2011 the ERA proposed to extend the time available for the public consultation process for interested parties to respond to the ERA's Draft Decision on the DBNGP AA issued 14 March 2011, DBP's revised access arrangement proposal (18 April 2011) and DBPs supporting submissions (20 May).

- 1.8 DBP's Submission 55 attachment 1 and supported by attachment 3 (prepared by SFG) provided an estimate of gamma required for the calculation of a real pre-tax WACC in accordance with requirements of Rule 87(2).
- 1.9 In light of recent decisions made by the Australian Competition Tribunal, DBP sees it necessary to provide an update to the sections in submission 55 dealing with gamma.

## 2. VALUATION OF IMPUTATION CREDITS (GAMMA)

- 2.1 For the purpose of calculating a real pre-tax WACC in accordance with the requirements of Rule 87(2), DBP has used an estimate of gamma of 0.
- 2.2 This estimate of gamma is based on advice which DBP has received from Strategic Finance Group (**SFG**). SFG's report (on the value of imputation credits) for DBP was attached to Submission 55 as Attachment 3.
- 2.3 The ERA used an estimate of 0.53 for gamma to determine the nominal pre-tax WACC shown in Table 46 of the Draft Decision. The reasons why zero, and not 0.53, is the better estimate of gamma are presented in section 5 of Attachment 1.
- 2.4 Since the lodgment of submission 55 by DBP, the Australian Competition Tribunal (the **Tribunal**) has released reasons for its decisions on merits based reviews of other regulatory decisions relating to gamma. DBP has sought further advice from SFG requesting that the findings of the Tribunal relating to gamma be addressed and to opine on how they affect conclusions made in relation to DBP's estimate for gamma under the National Gas Rules.
- 2.5 DBP provides SFG's paper as attachment 1 to this submission and notes that in the context of the Tribunal's findings, SFG advise that the following issues support DBP's adopted estimate of gamma of 0:
- (a) there is no support for the adoption of a gamma estimate above 0.25; and
  - (b) in determining the best available dividend drop-off estimate, leading to its gamma estimate of 0.25, the Tribunal did not have reason to specifically consider the issues of internal consistency and market practice set out in SFG's report (attachment 1).
- 2.6 SFG conclude that an appropriate range for the point estimate of gamma is 0 to 0.25 and note that a value at the lower end of the range is:
- (a) Consistent with market practice
  - (b) Consistent with the ERA's approach in estimating the required return on equity; and
  - (c) Consistent with the estimate presented in Cannavan, Finn and Gray (2004), which is the only estimate published in a journal that is rated A\* by the Australian Research Council.
- 2.7 SFG have also note that if a value toward the top end of the range is to be used, the corresponding 0.85 value of cash dividends must be used throughout the WACC estimating process.
- 2.8 Considering SFG's additional advice, DBP maintains its submission that 0 is the most reasonable estimate for gamma in calculating a real pre-tax WACC in accordance with the requirements of Rule 87(2).