Economic Regulation Authority

ERA Secretariat Cost of Debt Workshop

Summary of points

Date & Time: Wednesday 3 July 2013 from 10am to 3pm

Venue: Ground Floor Albert Facey House, 469 Wellington Street, Perth

This summary outlines the key topics and themes of the workshop, including views expressed, without ascribing particular comments to any one individual or organisation.

A range of stakeholders participated, including representatives of:

- regulated energy businesses;
- State authorities.

Matters raised by workshop participants for the Secretariat's further consideration include the following points:

- It is not clear that the concept of NPV=0 implies that the term of the risk free rate and aggregate cost of debt should match that of the regulatory period.
- The on-the day approach and the trailing average are consistent with the National Gas Rules, given that under both regimes firms face competitive pressures to manage finances efficiently.
- Chairmont Consulting's claim that transaction costs will not increase when a large amount of debt is being hedged is not correct. The fixed rate of the swap will increase in response. The limit of daily transactions, which do not 'move the market', is about $50m. Utilising an annual update to the WACC would not resolve this issue.
- There should be a choice for service providers to use either the 1) trailing average, 2) on –the-day, or 3) hybrid approach for estimating the return on debt.
- If the regulated cost of debt in WA was lower than that applying in the eastern states, due to differences in regulatory approaches, this could have a "chilling effect" on investment in WA.
- The ERA should undertake analysis of how the trailing average approach could be implemented, to prepare for some future point where it changed its view on the most efficient approach.
- Even though the on-the day approach may be more efficient, it may not be consistent with the revenue and pricing principles, for example in providing 'reasonable opportunity' to recover costs.
- The ERA has discarded the Bloomberg Fair Value Curve approach, even though it is the product of highly respected investment professionals. In addition, no economic interpretation can be placed on the ERA's joint-weighting mechanism under its bond yield approach for estimating the debt risk premium.
- The ERA's bond yield approach does not take appropriate account of the coupon rate on the bonds in the sample that have a greater than 5 year term. Also, concern was expressed over the undue influence of outliers in the bond sample.