18 November 2013

Mr Richard Begley
Rate of Return Guidelines Review
Economic Regulation Authority
PO Box 8469
Perth BC, WA 6849
publicsubmissions@erawa.com.au

Dear Richard,

RATE OF RETURN GUIDELINES REVIEW

Alinta Energy (on behalf of Alinta Sales, herein referred to as Alinta) welcomes the opportunity to comment on the proposed Rate of Return Guidelines for Gas Network Operators currently being prepared by the Economic Regulation Authority.

Alinta is a major shipper of gas through both the transmission and distribution networks within Western Australia, and is a retailer of gas to residential, commercial and mining loads within the state. Further, Alinta owns and operates power stations in the Pilbara region, in addition to power station assets connected to the South West interconnected system (SWIS) at Pinjarra and Wagerup.

Background

The Australian Energy Market Commission (AEMC) recently made changes to the National Gas Rules to include an allowed rate of return objective to focus rate of return determinations on delivery of an efficient outcome. To facilitate this objective the AEMC also made changes to both:

- Enable greater flexibility in the process of rate of return determinations by requiring that relevant estimation methods, financial models, market data and other evidence be considered; and

- Require the regulator to periodically make and publish rate of return guidelines which set out and explain the approach to be taken in determining the allowed rate of return.

Subsequently the ERA is currently developing its rate of return guidelines, which are required to set out the:

- Methodologies that the Authority proposes to use in estimating the allowed rate of return, including how those methodologies result in a determination that is consistent with the allowed rate of return objectives; and

- Estimation methods, financial models, market data and other evidence that the Authority proposes to take into account in estimating the return on equity, the return on debt and the value of imputation credits.

Alinta notes that the guidelines are intended to provide guidance for subsequent gas access decisions by the ERA for Western Australian gas pipelines and networks.

Alinta's views

Alinta believes it's important for the ERA to consider the impact on end users of regulated assets when determining the rate of return to apply during an access period. In particular, network customers such as Alinta require price certainty to minimise financial risks when entering into energy contracts with end users for an extended period. Without certainty the only way to manage this risk is by passing it on to end use customers via higher overall energy prices. The ERA should take this issue into account particularly when setting the Debt Risk Premium (DRP).

Alinta understands the ERA's consideration of Option B given that fixing the value of the DRP for five years creates a risk that at any point in time the value being used in a Weighted Average Cost of Capital (WACC) calculation may not be consistent with prevailing capital market evidence. However, this risk needs to be balanced against:

- the impacts of a more volatile WACC on both investment decisions and end use customers; and

- the additional cost and complexity associated with annually reviewing the DRP value.

Specifically the ERA should ensure that network owners remain incentivised to continue to invest in the network. A volatile DRP means that any fixed interest rate loans used to underwrite an investment may be "out of the money" during the relevant period. The only option is for investors to invest at a variable interest rate which could increase their refinancing and rollover risk of their financing. This will jeopardize any maintenance or development programmes during the relevant access arrangement period, thereby potentially impacting on security of supply.

Greater volatility in the DRP will also flow through to end use customers via higher and potentially more volatile prices from network customers who seek to minimise their financial risks (as referred to above). Alinta notes that it is not in the best interests of end use customers to be subject to tariffs that vary significantly year on year.

On balance, given the significant value that investors and end users place on price certainty Alinta considers that the Authority should continue with its previous practice of fixing the value of the DRP for five years (Option A) to allow certainty for investors and consumers and ensuring continual investment in the network.

Alinta provides no comments at this time on the other aspects of the ERA's proposed rate of return guidelines.

Yours sincerely

Fiona Edmonds
Wholesale Regulation Manager