14 November 2013

Hi Richard,

Issues Raised in Rate of Return Guidelines Workshop on 7 November 2013

The Water Corporation welcomes the opportunity to comment briefly on the issues raised at the rate of return guidelines workshop held by the Economic Regulation Authority (ERA).

Determining return on equity

The proposed approach to estimating return on equity as outlined on P3 of the ERA's paper entitled "A potential approach to estimating the return on equity" is an approach that is workable but as noted at the workshop it requires a link to achieving the Allowable Rate of Return Objective.

Water Corporation does not however agree with the conclusion in the draft guidelines that the Sharpe Lintner Capital Asset Pricing Model is the only relevant model for determining cost of equity. This would suggest that the approach needs to be broadened.

Determining Cost of Debt

The approach to estimating cost of debt as outlined in the ERA's paper entitled 'Cost of debt Comparative Analysis' does not properly consider the trailing average approach in the context of the new National Gas Rule 87(10). The Water Corporation is of the view that inclusion of a trailing average option should be reconsidered in light of the discussion at the workshop.

Benchmark Efficient Entity

It was suggested at the workshop that the efficient financing costs of a benchmark efficient entity with a similar degree of risk to the service provider is a standard which cannot and is not intended to be achievable. A benchmark is a standard that should be achievable to provide an incentive to improve See for example discussion in the ERA's report "Inquiry into the Tariffs of the Water Corporation, Aqwest and Busselton Final Report" dated 7 January 2013, pages 39, 46 and 47. Water Corporation does not support the view that a benchmark standard should be one that is not achievable.

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Water Corporation