Independent Panel Review of ERA Rate of Return Guidelines (2018)

Further questions for ERA

11 September 2018

Economic Regulation Authority Secretariat Response to the Independent Panel's Questions

1. In your response to our request of 21 August 2018 for a table showing all the parameter estimates for the proposed approach and the approach in the 2013 Guidelines you provided the following footnote in relation to the debt risk premium:

   6 On-the-day approach based on bond-yield approach together with a joint-weighting mechanism. Annually updated. This method has not been applied in any decision. Due to dispute, it was revised to the current approach soon after the 2013 Guidelines being released.

   Can you please confirm what the current approach is and provide an estimate for the most recent debt risk premium used in the current approach?

   Current debt risk premium approach

   The current approach is the hybrid trailing average using the revised bond-yield approach. A schedule of annual historic debt risk premium has been set for each of the last 10 years. New debt risk premium estimates (to roll into the 10 year trailing average) are calculated on the revised bond-yield approach using the BBB band (BBB-, BBB and BBB+).

   As at 29 March 2018, the current method produces a debt risk premium of 2.354 per cent.

   Draft Guidelines debt risk premium approach

   The approach detailed in the Draft Guidelines uses the same approach, but uses BBB+ for new debt risk premium estimates.

   That is, the Draft Guidelines utilises the hybrid trailing average using the revised bond-yield approach. The same 10 year schedule of annual historic debt risk premium continues to be used. New debt risk premium estimates (to roll into the 10 year trailing average) are calculated on the revised bond-yield approach using BBB+.

   As detailed in Table 1, based on the Draft Guidelines the debt risk premium is estimated at 2.327 per cent.

   The detailed instruction for implementing the revised bond-yield approach (used for both the current and Draft Guidelines) can be found in the Appendix 4C of the *Final*

Decision on Proposed Revision to Access Arrangement for Dampier and Bunbury Natural Gas Pipeline 2016-2020.

2. Can you please confirm the most recent relevant final decisions for the rate of return for each of the regulated Gas Pipelines? Our understanding is that they are as follows:

    a. ERA (2016a), Revised Decision of the Economic Regulation Authority's Access Arrangement for the Mid-West and South-West Gas Distribution Systems, 25 October.

    b. ERA (2016b), Final Decision on Proposed Revisions to the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline 2016–2020, Appendix 4 Rate of Return, 30 June.

    c. ERA (2016c), Final Decision on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline 2016–2020, Appendix 4 Rate of Return, 30 June, as amended on 21 July 2016.

    These dates are correct.

3. In the Explanatory Statement in the Chapter on the Value of Imputation Credits, for the last point at paragraph 880 of the Explanatory Statement it is stated the method:

    determines the share of equity held by investors eligible to use imputation credits as a proportion of the equity held by domestic investors that either use or waste imputation credits.

    Can you please confirm that the approach is identical to that described on pp. 4-160 and 4-161 of AER (2017), 'Final Decision, TasNetworks distribution determination 2017-18 to 2018-19, Attachment 4 – Value of imputation credits, April as follows:

    Calculate the equity held by those classes of investor that are eligible to utilise imputation credits as a share of the equity held by all classes of investor that either utilise or waste credits. In the National Accounts, this is calculated as the equity held by 'households', 'pension funds' and 'life insurance corporations' as a share of the equity held by these classes plus 'rest of world'. In the draft decisions released in 2014, our calculation of the refined domestic ownership share effectively assumed that governments 'wasted' the imputation credits they received. We noted in the draft decisions that there was no clear case for making this assumption. In this final decision, consistent with the approach we took for the decisions we released in 2015 (October and November) and 2016 (May and September), we exclude government-held equity from the calculation of the refined domestic ownership share. This is because the value of imputation credits forms part of our determination of the rate of return required by private investors in the benchmark efficient entity.[629] In doing this we are estimating market-wide utilisation rates (for both listed and all equity) reflective of the capital invested by private investors. We do not consider this is inconsistent with other parameter estimates used for estimating the WACC and consider this will lead to an overall return that should lead to efficient investment in regulated assets.

The Draft Guidelines' method applies the same approach adopted by AER to refine the equity ownership data from ABS National Accounts to calculate the utilisation rate.