



CHAMBER OF COMMERCE AND INDUSTRY  
WESTERN AUSTRALIA

10 December 2007

Mr Mike Jansen  
Assistant Director – Rail  
Economic Regulation Authority  
PO Box 8469  
PERTH BC WA 6849

Dear Mr Jansen

**Review of the Weighted Average Cost of Capital to Apply to the Urban and Freight Rail Networks**

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia. It is the second largest organisation of its kind in Australia, with a membership of over 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

CCI's Transport Committee welcomes the opportunity to respond to the Economic Regulation Authority's review of the weighted average cost of capital (WACC) to apply to urban and freight rail networks.

CCI notes that the current WACC framework established in the 2003 Determination has been successful in providing a stable operating environment and pricing structure for the rail industry. Given the success of the 2003 Determination in ensuring on-going stability across the rail sector, CCI recommends that this framework be maintained wherever possible.

With respect to the methodology used for determining the cost of capital, CCI agrees with the recommendation put forward in The Allen Consulting Group October 2007 report. That is, use of the capital asset pricing model as a method for estimating WACC values should be maintained.

Regarding the determination of an appropriate inflation rate, CCI supports The Allen Consulting Group's recommendation that past practice of the Economic Regulation Authority be carried forward. That is, a nominal risk free rate is estimated from capital market data and an assumption is made regarding inflation forecasts.

Regarding the use of a pre-tax or post-tax WACC, CCI recommends that the Authority maintains consistency with previous practice by adopting the use of pre-tax figures when

determining the WACC. The Chamber does not believe that significant benefits would result from changing to a post-tax structure. However, such a change would increase the difficulty associated with comparing past and future WACC determinations. Use of pre-tax calculations has been the prevailing convention; given this methodology is now known and understood by stakeholders it should be maintained.

CCI notes that The Allen Consulting Group's report proposes a significant change to the debt-equity mix used in the WACC calculation. We recommend that the Economic Regulation Authority closely examine this proposed change to ensure the revised ratio is appropriate for the Western Australian rail network.

CCI recommends that the beta values proposed to represent the systematic risk be rejected in favour of a continuation of the existing values. We question why the beta values would change considering that the underlying risk profile of the rail business in WA has remained consistent. Furthermore, CCI notes that The Allen Consulting Group was unable to identify businesses exactly comparable with the Western Australian rail operations. It is unreasonable to justify variations to the systematic risk values based upon comparisons with non-equivalent businesses.

In conclusion, the Chamber of Commerce and Industry supports a rail pricing regime that offers fair and equitable access and pricing to the business community. The setting of appropriate floor and ceiling prices that accurately reflect rail usage costs is critical to the achievement of this goal.

CCI's Senior Adviser, Industry Policy, Andrew Canion would be pleased to provide further detail on this submission. Mr Canion may be contacted on (08) 9365 7688 or email [andrew.canion@cciwa.com](mailto:andrew.canion@cciwa.com).

Yours sincerely

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Executive Director Policy