



NOTICE

Invitation for Public Submissions

ESTIMATING THE DEBT RISK PREMIUM

The Economic Regulation Authority (Authority) is seeking public comment on the methodology to measure the debt risk premium component of the rate of return on capital.

Interested parties are invited to make submissions in print and electronic form on the discussion paper *Measuring the Debt Risk Premium: A Bond-yield Approach* by **4:00 pm (WST) on Friday, 7 January 2011**. The discussion paper is available on the Economic Regulation Authority [website](#).

Submissions should be marked to the attention of Dr Duc Vo, Senior Analyst.

Postal address: PO Box 8469, PERTH BC WA 6849
Office address: Level 6, 197 St Georges Terrace, PERTH WA 6000
Email address: publicsubmissions@erawa.com.au

Background

The Authority, in its decision making seeks to ensure that the rate of return on capital is commensurate with the prevailing conditions in the market for funds and the risks involved in providing the regulated services. The debt risk premium is one component of the rate of return on capital. The Authority exercises its discretion to ensure that the debt risk premium is set in accordance with these principles.

The Authority's method for estimating the debt risk premium, as well as the nominal risk free rate, has in the past assumed the borrowing term is 10 years. A 10-year term has been consistently adopted by all Australian regulators in the energy sector since the Australian Competition Tribunal's 2003 GasNet decision.

In estimating the debt risk premium the Authority has previously relied on the estimates of 10-year fair yield curves derived by Bloomberg and CBASpectrum. However, this approach to estimating the debt risk premium is no longer practical because Bloomberg has in recent times progressively shortened the periods for its estimates of fair yields across credit ratings for Australian corporate bonds and CBASpectrum ceased publishing its estimates of the fair yield curves across all credit ratings for Australian corporate bonds in September 2010.

This means that the method of calculating the debt risk premium that was applied in the Authority's August 2010 Draft Decision on WA Gas Networks' (WAGN) proposed access arrangement, which used CBASpectrum data, is no longer available.

As the proposed replacement method is a departure from current regulatory practice, the discussion paper sets out the Authority's intended approach for estimating the debt risk premium. The key components of the discussion paper include a rationale for the Authority's decision to depart from its standard approach to estimate the debt risk premium; a rationale for the Authority to adopt a new approach to estimate the debt risk premium; and a detailed example of the intended approach with numerical illustrations.

The purpose of this discussion paper is to present the Authority's proposed future method for calculating the debt risk premium in its regulatory roles, and also when undertaking inquiries referred to the Authority by the State Government.

The Authority has two gas pipeline decisions in the near future: the Final Decision on WAGN's revised access arrangement and the Draft Decision on Dampier Bunbury Pipeline's revised access arrangement. The Authority is also about to issue the Draft Report for the inquiry into the Funding Arrangements of Horizon Power. Subject to feedback on this discussion paper, it is the intention of the Authority to use this proposed method for these decisions or recommendations.

Confidentiality

In general, all submissions from interested parties will be treated as being in the public domain and placed on the Authority's website. Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission for which confidentiality is claimed, and specify in reasonable detail the basis for the claim. Any claim of confidentiality will be considered in accordance with the provisions of the relevant legislation.

The publication of a submission on the Authority's website shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority.

For further information contact:

General Enquiries

Bruce Layman
Director, References and Research
Ph: 61 8 9213 1900
Fax: 61 8 9213 1999

Media Enquiries

Sue McKenna
The Communications Branch Pty Ltd
Ph: 61 8 9254 4044
Mb: 0424 196 771

LYNDON ROWE
CHAIRMAN

30 November 2010