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Discussion Paper: Measuring the Debt Risk Premium
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DISCUSSION PAPER – MEASURING THE DEBT RISK PREMIUM: A BOND-YIELD APPROACH

Thank you for the opportunity to comment on the Economic Regulation Authority's (ERA) discussion paper Measuring the Debt Risk Premium: A Bond-Yield Approach (*December 2010*).

The Water Corporation recognises the difficulty faced by the ERA in estimating the debt risk premium when the information previously provided by external sources is no longer available. It therefore accepts that an alternative method needs to be determined.

As a utility provider in a capital intensive industry, approximately half of the Water Corporation's total regulated revenue is derived from its return on assets, based on the ERA's weighted average cost of capital (WACC). Accordingly, the impact on the WACC from modest changes in the debt premium can have a significant impact on the Corporation's revenue requirements and hence, prices to customers.

Furthermore, the Corporation also notes that its assets typically have long lives, with new assets often averaging more than 50 years. It does not (as is implicitly assumed by the ERA's regulatory period) finance its business in 3 yearly portions, with longer term financing options generally sought through WA Treasury Corp.

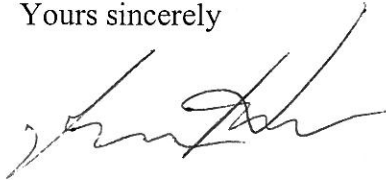
With the above in mind, in considering the discussion and questions raised by the ERA in its paper, the Corporation provides the following comment: yes, the approach proposed for estimating the debt risk premium is likely to better reflect prevailing conditions in the Australian BBB/BBB+ bond market and yes, these conditions currently show a preference for shorter term financing than the previous 10 year option.

However, the Corporation is concerned the prevailing shorter term approach for a specific 20-day trading period does not reflect longer term conditions and may lead to more volatility in its triennial pricing determinations. The Corporation would favour an approach based on longer term facilities with care taken to ensure the 20-day sample period is considered a reasonable representative of longer term positions.



It is recognised that all methods for determining the debt risk premium have different merits, and that any alternative may not actually reflect the specific circumstances of an individual company. Accordingly, the Corporation does not wish to propose an alternative approach. It accepts the ERA's approach as one which is reasonable, but encourages the ERA to refine it to one which shows a preference for longer term debt options with minimal annual volatility, which better reflects the Corporation's Balance Sheet and the environment in which commercial entities operate.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ross Hughes', written in a cursive style.

Ross Hughes
CHIEF FINANCIAL OFFICER