23 March 2026

Mr Steve Edwell
Chair
Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
PERTH WA 6000

By email: publicsubmissions@erawa.com.au

Dear Mr Edwell

ERA 2006 Gas rate of Return Instrument Review - Consumer Reference Group Submission to ERA Discussion Paper

Thank you for the opportunity to respond to the ERA's Discussion paper on the 2026 gas rate of return instrument review and for providing the CRG with the time to make this submission, following the CRG's establishment in February 2026.

On behalf of CRG members, I attach our public submission to the Discussion paper which responds to the specific issues raised, but also raises a broader set of issues concerning the approach the ERA should take to determine its 2026 gas rate of return instrument.

Yours sincerely

signed

Chris Pattas
Chair
Consumer Reference Group

cc. Kieran Donoghue
Sarah Holman
Bobby Ditric
Jason Dignard
Deon Bishop

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Executive Summary

The Customer Reference Group has reviewed the ERA's discussion paper on its 2026 gas rate of return instrument review as well as previous ERA gas instrument decisions and the AER's rate of return instrument decisions. It considers that a holistic approach to the determination of a rate of return methodology is preferable to a more limited or selective approach, as is evident in the ERA's discussion paper where specific issues are highlighted.

While all the specific issues raised in the discussion paper are important, and which we cover in our comments in this submission, we also raise broader aspects on these and related matters with a view to understanding the ultimate impact on the overall rate of return and therefore on consumer gas prices.

Our key views are as follows:

- It is noteworthy the ERA's 2022 decision on the gas rate of return instrument has resulted in a higher return than other reviews for what are essentially similarly regulated monopoly network or pipeline entities, but without any apparent evidence that the higher returns have better promoted investment or service outcomes compared to other (non-WA) regulated entities. Conversely, the lower allowed returns in other decisions do not appear to have inhibited investment.
- This would suggest, prima facie, that some of the current parameters could safely be lowered (within the range of credible estimates and applying regulatory judgement) without undermining the long-term interests of customers of natural gas with respect to price, quality, safety, reliability and security of supply. This appears particularly the case for the equity beta.
- We urge the ERA to give consideration to changing back to a five year term for the cost of equity, given there was no evidence of actual under investment in the gas networks. It is noteworthy that using 10 year term would, all things equal, increase the allowable return on equity.
- We support the ERA's position that neither the arithmetic mean of historical excess returns (HER) nor the geometric mean are entirely appropriate benchmarks for setting the market risk premium (MRP) and that therefore the estimate should be based on an average of these two figures. On this basis we consider that a 50:50 weighting is reasonable, regardless of the term for equity.
- While we are wary of the use of DGM estimates to inform the derivation of the MRP, we would expect that, for the sake of consistency, the ERA is prepared to set a lower estimate than that implied purely by the HER data, if that is what the updated DGM estimate indicates at the time of the final decision.
- In recent reviews, estimates of equity beta have varied from less than 0.5 to more than 0.8, depending on the comparator set used, with estimates of around 0.5 appearing to be more consistent with Australian and foreign 'pure play' providers. Even if the ERA is not minded to reduce the beta to 0.5 at this time, it does highlight that a beta of 0.7 appears well above that applied for most other regulated firms in Australia since at least 2018, for what are essentially similarly regulated monopoly network/pipeline providers.
- It is also important the ERA does not maintain a relatively higher beta because of any concerns regarding asset stranding risk, given possible declines in gas use as a result of government policies to phase out gas in end-use applications – arguably more directly relevant in gas distribution. Such risks (to the extent relevant) are better addressed in the access arrangement process, such as though the treatment of depreciation.
- In relation to the benchmark credit rating, if the parameter group was narrowed to only include gas pipelines subject to full regulation and issuers with both full regulation gas and electricity networks, then the median credit rating would be A- rather than BBB+. In addition, debt: RAB ratios are considerably higher than implied by the market gearing data, and so it is likely that a benchmark 55 per cent gearing would support a higher credit rating than the current BBB+ benchmark.
- It appears the ERA sees particular benefits of moving from a hybrid to a full trailing average approach for the cost of debt. Such a change may produce more stable and predictable debt costs over time compared to the hybrid method, particularly in the face of heightened volatility in financial markets that have been observed in recent years and are likely to continue – probably even more so given recent developments in the middle east. For that reason, we would agree this is worth exploring. However, certain aspects of these effects and how they may impact customers should be examined further, for example how much customers are impacted by volatility in the rate of return.

- The difference between estimated and actual inflation can deliver windfall gains or losses to the regulated business. In the eastern states in recent years high inflation has delivered substantial windfall gains that exceed any losses from earlier periods of low inflation, which has tended to systematically favour regulated businesses. While the ERA estimates inflation differently to the AER, it should look further into this issue to ensure there is no systemic bias as we have seen in NEM jurisdictions.
- We note the ERA has arrived at a lower estimate of gamma (imputation credits) than the AER from essentially the same data. This results in slightly higher allowed tax costs (other things being equal) and thus higher allowed revenues. We consider this merits further investigation to understand the basis for the difference and why it is in customers' interests.

Introduction

As part of the Economic Regulation Authority's (ERA's) four yearly review of its gas rate of return instrument, it has set up a Consumer Reference Group (CRG) to provide direct and ongoing feedback to the ERA during its review that represents broad consumer perspectives, including by making submissions throughout the process.

The ERA published its Discussion Paper on its 2026 gas rate of return instrument review in October 2025, where it set out the ERA's working views on the key topics it identified and where it considered further work was needed to determine the 2026 gas rate of return instrument[1]

This is the CRG's first formal submission to the ERA's discussion paper, which addresses the key issues raised by the ERA in its discussion paper. However, given the broader remit of the CRG to represent broader consumer perspectives, we also take a somewhat wider view by looking at what we consider as relevant issues raised in previous ERA reviews as well as the current AER rate of return instrument review[2] that should be considered more directly and explicitly in this review by the ERA.

1. About the Consumer Reference Group (CRG)

The National Gas Law (NGL)[3] under which this review is being conducted, requires the ERA to establish and use the CRG as part of its consultation process for the 2026 gas instrument review. The CRG is to provide direct and ongoing feedback to the ERA that represents broad consumer perspectives, which is intended to balance what may otherwise be seen as a process in which only or predominantly gas pipelines or other large corporate entities have influence or sway in the ERA's determination.

That said, the CRG is only an advisory body. It can only make recommendations or suggestions. It does not negotiate on behalf of consumers or industry. While the ERA is not required to adopt or agree with the CRG's views, it must consider them in making its gas instrument.

The Customer Reference Group comprises of:

- Chris Pattas (Chair), experienced economic regulator
- Kieran Donoghue, energy industry consumer advocate
- Bobby Ditric, energy industry professional
- Sarah Holman, consumer policy advocate.

The CRG's focus is to advocate for all consumers, including future consumers. As part of this we intend to engage more directly with consumer views throughout this process, however, for the purposes of this initial submission to the discussion paper, it has not been possible to do obtain the direct views of a range of discrete consumer or customer representative groups in Western Australia. We expect there will be greater capacity to do this later in the process, including post the draft decision.

[1] Economic Regulation Authority, 2026 gas rate of return instrument review, Discussion Paper, 23 October 2025
[2] Australian Energy Regulator, Rate of Return Instrument Discussion Paper, August 2025. Available at https://www.aer.gov.au/industry/registers/resources/guidelines/rate-return-instrument-2026/discussion-paper
[3] Sections 30H and 30I of the NGL.

In preparing this submission, however, we have had the benefit, of the views of our CRG colleagues, Sarah Holman and Bobby Ditric, who have specific experience in WA consumer and customer energy issues – see next section.

2. Context for the review

2.1. Small use consumer perspective

Western Australian households, particularly low-income families and those in financial hardship, are facing acute cost-of-living pressures. Recent WA Council of Social Service (WACOSS) Cost of Living reports highlight that dual-income households are unable or struggling to meet basic living costs, marking the first time working households have been unable to achieve a basic standard of living.[4] [5]

A major driver of this stress is housing and utility costs. Housing now consumes over 40% of the income of the average financial counselling client in WA, up from around 37% four years ago, and significantly above the generally accepted 30% threshold for housing stress.[6] These conditions heighten the importance of ensuring the allowed rate of return is efficient and no higher than necessary, as network charges are largely fixed and unavoidable for small-use consumers.

As a result, many households are paying unsustainably high rents or mortgages, leaving limited income for essentials such as food, transport and utilities. Clients seeking help through WA's Hardship Utility Grant Scheme (HUGS), which provides emergency assistance for utility bills, have seen their average utility bill debt increase by 17% in just one year, from roughly $1,708 in 2023–24 to $1,993 in 2024–25.[7]

For small-use customers, particularly vulnerable households, the use of gas is not discretionary. Households cannot reduce their gas usage without compromising basic needs. Rising gas bill debts illustrate this vulnerability: between 2019 and 2024, total residential gas arrears in WA increased by 620%, reaching approximately $14.7 million.[8] By 2024/25, 3.1% of small-use gas accounts were in arrears, with average gas debt rising to around $596, up from $188 in 2019.[9] Thousands of households have been unable to pay their gas bills on time, leading to an elevated risk of disconnections. These figures underscore how even modest increases in gas or network prices can significantly affect household welfare, particularly for those already experiencing hardship or living in older, inefficient rental housing.

From a consumer perspective, the core question in the ERA's 2026 Rate of Return review is whether the new gas rate of return instrument will deliver an efficient rate of return, *no higher than necessary*, while maintaining safe and reliable service.[10] As the Australian Energy Regulator (AER) has noted, the return on capital typically accounts for 40–60% of a network's revenues[11], and network costs in turn make up a substantial share of end-user gas

[4] Western Australian Council of Social Service, Cost of Living Report 2024, WACOSS, December 2024.Available at https://www.wacoss.org.au/policy_publications/2024-cost-of-living-report/

[5] Western Australian Council of Social Service, *Cost of Living Report 2025*, WACOSS, December 2025. Available at https://www.wacoss.org.au/policy_publications/wacoss-cost-of-living-report-2025/

[6] Financial Wellbeing Collective, Financial Wellbeing in WA Snapshot 2024, Oct 2024. PDF available at https://thefwc.org.au/wp-content/uploads/2024/10/FWC-Financial-Wellbeing-in-WA-Snapshot-2024.pdf

[7] Western Australian Council of Social Service, *Cost of Living Report 2025*, WACOSS, December 2025. Available at https://www.wacoss.org.au/policy_publications/wacoss-cost-of-living-report-2025/

[8] Economic Regulation Authority, Energy Customers, Debt and Disconnections 2024/25 – Mini Report 2, ERA Western Australia, December 2025. PDF available at https://www.erawa.com.au/sites/default/files/debt-and-disconnections-mini-report-2.pdf

[9] Western Australian Council of Social Service, *Cost of Living Report 2025*, WACOSS, December 2025. Available at https://www.wacoss.org.au/policy_publications/wacoss-cost-of-living-report-2025/

[10] Australian Energy Regulator, Rate of Return Instrument Discussion Paper, August 2025. Available at https://www.aer.gov.au/industry/registers/resources/guidelines/rate-return-instrument-2026/discussion-paper

[11] Australian Energy Regulator, Rate of Return Instrument 2022 – Explanatory Statement, AER, 24 February 2023. PDF available at https://www.aer.gov.au/system/files/AER%20-%20Rate%20of%20Return%20Instrument%20-%20Explanatory%20Statement%20-%2024%20February%202023_1.pd

bills. If the allowed WACC is set higher than needed, customers ultimately pay more for the same service quality, with no additional benefit.

A 2024 analysis by the Institute for Energy Economics and Financial Analysis (IEEFA) suggests that, across fully regulated Australian gas networks in the NEM, realised returns exceeded approved allowances over the period 2014 to 2022, with no clear evidence of commensurate consumer benefits.[12] This analysis focuses on east coast networks, as it draws from the AER's annual reporting on profitability and other network metrics. Consumers would appreciate the ERA carrying out and publishing similar analysis for the networks it regulates so they can understand whether similar outcomes prevail in Western Australia.

Volatility in allowed returns and network prices also has significant consequences for small-use customers. Households and small businesses have limited ability to absorb sudden price fluctuations. A sharp increase in network costs in a single year can translate into bill shock that many consumers cannot manage. Predictable pricing is therefore critical for financial stability, and households on tight budgets overwhelmingly prefer price certainty. These considerations are relevant to the ERA's assessment of debt methodologies and parameter stability, which we discuss further in later sections of this submission.

2.2. Large user perspective

Large gas users would not have a uniform view on matters discussed in this paper, nor would they have a uniform exposure to the flow on effects of any outcomes from this review. Much will also depend on the impact or sensitivity of a higher rate of return on gas charges. As noted above, the return on capital could account for at least 40 per cent of network revenues.

Some large gas users, such as high commodity priced miners, are in a better position to absorb an increase to their gas prices resulting from changes to the gas rate of return. For these users, gas is a critical input and they have no alternative options to gas and their gas usage remains unaffected. These users are typically price insensitive, i.e. have an inelastic demand and trade in international markets. However, this is a very small group of gas users and higher or more volatile retail gas prices would still impact their bottom line.

For a larger group of gas users, gas is still a critical input but they can't easily absorb price increases because they are subject to other constraints. For example, gas powered electricity producers are prevented from including fixed costs when bidding into the electricity market, as fixed costs are expected to be covered the by the Reserve Capacity Mechanism. However, under the transitional pricing arrangements, the Reserve Capacity Mechanism fails to account for new increases to fixed costs. For these users a price increase could result in material impact on their revenues and profits.

Possibly the largest subset of large gas users, such as gas retailers or commercial & industrial users, are those who can pass on part or all of the increases in cost. These gas users have the ability to increase the price they charge for their product. However, this leads to the end consumer feeling the effects of the increase.

3. Taking an overall perspective

The ERA's starting point, in its discussion paper, is its previous decision – the 2022 gas rate of return instrument review. For example, one of the ERA's key concerns is that its approach in the 2022 gas instrument has supported the effective (mechanical) calculation of the rate of return in access agreement and tariff variation processes and that the instrument has performed well in reflecting changing financial market conditions, including recent and ongoing volatility in financial markets. To the extent it has been effective in these respects, the discussion paper then focusses on certain specific areas or topics where it has identified further refinements or developments may be required to improve the way the rate of return should be determined.

These areas for further work and where specific comments are sought include:

[12] Institute for Energy Economics and Financial Analysis, Australia program publications and submissions. Available at https://ieefa.org/

- Sample of companies to establish a benchmark efficient entity against the background of fewer listed Australian regulated entities;
- Establishment of benchmark credit rating;
- A change from a hybrid trailing average approach to a full trailing average approach for the return or cost of debt;
- Refinement of market risk premium methods, and;
- Estimation approach for equity beta.

While all these issues are important and are covered in our comments below, we also raise broader aspects on these and related matters with a view to understanding the ultimate impact on the overall rate of return on consumer charges.

3.1. Overall Parameter comparison

Apart from the ERA's 2022 rate of return instrument, additional relevant reference points for the ERA's 2026 review are its 2018 decision and the AER's 2022 rate of return instrument review. While the AER and ERA are different regulators, regulating different network businesses and are under no obligation to deliver the same decision, both are making decisions under similar, if not identical, legal/regulatory frameworks and largely draw on the same pool of Australian energy infrastructure (networks or pipelines) companies as their primary comparator set, although the ERA has removed older data and also uses international comparators.

More generally, it's instructive to look at what decisions have been made in recent reviews for what are essentially similarly regulated energy monopoly networks/pipelines. In each case, regulators are charged with providing network or pipeline service providers with a reasonable opportunity to recover at least the efficient costs they incur, and in the case of the rate of return, that they recover the efficient financing costs. An efficient financing cost is one where the allowable rate of return is neither too high or too low, so that customers pay no more than necessary for their gas services, both now and in the future.

Table 1 below sets out the individual parameter decisions and the overall rate of return for each of these three reviews, with an attempt to maintain comparability in each case. We have added in a fourth set of parameters, namely the recommendations by our predecessor, the 2022 CRG.

Table 1: Parameter comparison

Parameter	ERA 2018 (with current market data adjusted to 2022 levels)[13]	ERA 2022[14]	CRG 2022[15]	AER 2022 [16]
Term of the return on equity	5 years	10 years	5 years	10 years
Risk free rate	3.54%	3.78%	3.54%	3.6% (assume difference to ERA22 is due to timing of publication of final instrument)
Market risk premium	6.0%	6.1%	6.18% (implied, adjusting for difference in term)	6.2%
Beta	0.7	0.7	0.5	0.6

[13] Economic Regulation Authority, Final Gas Rate of Return Instrument Explanatory Statement, December 2022, p6
[14] Ibid
[15] Consumer Reference Group (2022), CRG submission to draft gas instrument, September 2022, p48
[16] AER, Rate of Return Instrument Explanatory Statement, February 2023, pp10-12

Return on equity (post-tax)	*7.74%*	*8.05%*	*6.63%*	*7.32%*
Gearing ratio	55% debt	55% debt	55% debt	60% debt
Credit rating	BBB+	BBB+	BBB+	BBB+
Cost of debt method	As 2022	10 year yield curve derived from Bloomberg BBB+ bond dataset. Hybrid on the day/10 year trailing average. Uses swap data	As per ERA	Derived BBB+ cost rating based on 1/3 A rated, 2/3 BBB rated from Bloomberg 10 year bond data. 10 year trailing average with transition from previous on-the-day approach.
Cost of debt	As per 2022, except Debt issuing and hedging costs 0.214%	*Swap 4.07% Debt risk premium 2.14%* Debt issuing and hedging costs 0.288% All-in 6.50%	As per ERA	4.7%, assuming fully transitioned to TA (NB AER's on-the-day rate was 6.52%)
Nominal after tax WCC	*7.02%*	*7.2%*	*6.56%*	*5.75%*
Inflation	Treasury bond approach over 5 years	Treasury bond approach over 5 years	As per ERA	RBA target approach over 5 years
Gamma (value of imputation credits)	0.5	0.5	0.5	0.57

Notably, the 2022 ERA decision produces the highest rate of return. While the ERA's assessment of its previous decision in the Discussion Paper considers its mechanical applicability and whether it varies appropriately with market conditions, it doesn't consider whether there is any evidence that it has set the rate too high or too low. We recognise that such an evaluation is not easy to carry out. However, if it has set a rate of return higher than necessary, the main outcome may be that the NSPs' shareholders pocket greater returns than they need given the risks they have taken. Another possibility is that they have invested more than is efficient, however, we have seen no evidence of this. By contrast, a rate of return that is lower than necessary will likely be more noticeable, such as service quality deterioration due to inadequate investment or financial distress due to an NSPs' inability to recover its finance costs or to raise new debt or equity capital.

There does not appear to be any evidence that the application of the 2022 instrument has led to any such investment or financial impacts, which would result from returns being too low. Equally, we are not aware of any evidence of inefficiently low returns in respect of the 2018 instrument, or the AER's 2022 instrument. This would suggest, prima facie, that some of the current parameters could safely be lowered (within the range of credible estimates and applying regulatory judgement) without undermining the long-term interests of customers of natural gas with respect to price, quality, safety, reliability and security of supply.

We examine this issue further for each of the return on debt and return on equity parameters.

3.1.1. Return on debt

The comparability of the return on debt between the AER and the ERA is limited by the difference in the choice of methodology – the AER uses a trailing average while the ERA uses a hybrid. Both target a BBB+ credit rating and a 10 year term, although they use different datasets to estimate the cost of 10 year BBB+ debt. The ERA's hybrid methodology requires it to include additional costs for hedging. The ERA's approach did not change from 2018 to 2022 (although the estimate of hedging and debt raising costs increased) and the 2022 CRG broadly supported the ERA approach. Accordingly, we don't consider that the historical reference points indicate the return on debt is either too high or too low. We consider further issues relating to the return on debt in sections 4.4 and 4.5 below.

3.1.2. Return on equity

The AER and ERA use a similar approach to the return on equity. Both allow NSPs to select an estimation period before the start of their access arrangement to estimate the current risk free rate. Both rely primarily on long term datasets to estimate beta and the market risk premium (MRP). However, there are differences between the two regulators and between the 2022 and 2018 instruments.

The ERA changed its estimate of the term of the risk free rate from five to ten years. This increased the return on equity.

The ERA maintained its beta estimate at 0.7 but the AER beta was estimated at 0.6. Notably, both the ERA 2022 CRG and the AER 2022 CRG estimated beta at 0.5, drawing on the same evidence base. The ERA's decision to maintain the equity beta at 0.7 resulted in a higher return to equity.

The ERA changed its method for its "base" estimate of the market risk premium from a 50:50 weighting of the arithmetic and geometric means of its dataset (which it organised into five different time periods) to a 60:40 weighting. This had the effect of increasing the return on equity.

All of these decisions were based on the ERA applying its regulatory judgment as it is entitled to do, given the information available, as there is no objectively "correct" estimate. But we contend that the historical reference points indicate the likelihood that in doing so, it made decisions that resulted in a return on equity higher than it needed to be. Accordingly, customers paid more than they needed to. So, while we cannot point to a specific objective error the ERA made in 2022, we are concerned that its judgments were overly conservative and we urge it to revisit these judgments.

We discuss the individual return on equity parameters in sections 4.1 to 4.3 below.

4. Individual parameters

4.1. Term of the return on equity and the risk free rate

The term of the rate of return was discussed very thoroughly during the 2022 review. A similarly exhaustive debate occurred during the AER's 2022 review. We consider that the ERA came to the right conclusion when it observed that two approaches could satisfy the NPV=0 principle:

- Setting the return on equity as a regulatory rate – A rate that provides required returns according to regulatory settings and principles, and recognises resets for every regulatory period.
- Setting the return on equity as a competitive market rate – A rate that provides the expected returns of equity investors according to market conditions and practices for infrastructure assets.[17]

Given that both approaches satisfy NPV=0, and given the ERA's existing practice was to use a regulatory rate (i.e. five years), which has been previously upheld by the Australian Competition Tribunal, it is unfortunate that the ERA chose to move to a 10 year rate in 2022. Its reasoning cited well known factors that have not changed for many years and so hardly constituted new evidence to justify a change. We urge the ERA to give consideration to changing back to a five year rate, given there is no evidence that the previous approach undermined investment in the gas networks. It is noteworthy that a change to 10 years would, all things equal, would increase the allowable return on equity.

4.2. The market risk premium (MRP)

The ERA has used a range of evidence to inform its estimate of the MRP in the last two reviews. It has given most weight to evidence from Historical Excess Returns (HER) data. We support the ERA's position that neither the arithmetic mean of HER nor the geometric mean are entirely appropriate benchmarks and that therefore the

[17] Economic Regulation Authority, Final Gas Rate of Return Instrument Explanatory Statement, December 2022, p111

estimate should be based on an average of these two figures. This position is supported by the Pink Lake Analytics report commissioned by the ERA during the 2022 review:

"*The surveyed literature and simulation study in this report both support the use of a composite estimator of the market risk premium, that is a compromise between the arithmetic mean and geometric mean*".[18]

The 2018 decision to weight the two means 50:50 was a pragmatic one given that it is not possible to objectively determine the correct weighting. We don't support the 2022 decision to weight 60:40 in favour of the arithmetic mean. Pink Lake Analytics observed that "the ideal estimator placed more weight on the geometric mean as the horizon length increased",[19] making it counterintuitive that the ERA would simultaneously decide on a longer term of equity *and* decrease the weight given to the geometric mean. We therefore consider a 50:50 weighting is reasonable regardless of the term of equity.

In 2022 the ERA adjusted its HER estimate based on two indicators that it considered represented current market conditions at the time. This was the output of its Dividend Growth Model (DGM), and whether a series of conditioning variables were above, below or around their long-term average. Our understanding of the 2022 decision is that the ERA chose an MRP estimate slightly higher than its HER estimate on the basis that conditioning variables implied current returns should be above trend and that the DGM estimate was higher than the HER estimate. Similarly, in 2018 the ERA chose a point estimate higher than it would have done had it relied solely on the HER data, which reflected a significantly higher DGM estimate (and mixed evidence from the conditioning variables)

The CRG is wary of the use of DGM estimates to inform the MRP. As the ERA has previously noted: "The dividend growth model suffers from some weaknesses including the form of the model, its input assumptions, its sensitivity to assumptions and its upward bias".[20] Perhaps the only factor in its favour is that it purports to represent current market conditions.

We agree that DGM estimates cannot be the primary basis of the MRP estimate. We note that the latest DGM estimate is well below HER estimates (which due to their long-term nature vary only modestly between review periods) despite the current economic growth assumptions appearing overly optimistic. Given that ERA appears to have used prior estimates of the DGM to set a higher MRP estimate than that implied purely by the HER data, we expect that, for the sake of consistency, the ERA is prepared to set a lower estimate than that implied purely by the HER data, if that is what the updated DGM estimate indicates at the time of the final decision.

We may give further consideration to the ERA's proposal to abandon the use of conditioning variables. In this regard, it would be useful to understand what impact they would have if they were applied as previously. The ERA could consider elaborating on this issue in their draft decision.

4.3. Beta

Beta is the measure of systematic risk to which a firm is exposed compared to the market. It's effectively a ratio of a firm's systematic risk to the market's systematic risk. Thus, beta is in part dependent on the market in which the firm is located (i.e. listed). For this reason, regulators such as the ERA would ideally rely on domestic comparators operating in the same industry under comparable regulatory frameworks. Energy networks subject to price regulation by either the ERA or the AER are likely to meet this criterion. Unfortunately, due to choices made by investors, such businesses have been gradually delisted. The only potentially relevant comparator left on the ASX is APA, and as the AER has noted: "APA has around 90% unregulated revenue, so its inclusion may be less representative of the risks involved in providing regulated service"[21] - though we acknowledge it owns one of the three gas businesses to which this Rate of Return Instrument will apply.

[18] Pink Lake Analytics, Evaluating the Market Risk Premium - Statistical properties of the historic market risk premium, December 2022, p27
[19] ibid
[20] Economic Regulation Authority, 2018 Explanatory statement, December 2018, p164
[21] AER, Rate of Return, Explanatory statement, February 2023, p92

The ERA addressed this data problem in 2022 by introducing a range of international comparators (an approach it had roundly rejected in 2018). However, there are significant problems with using such comparators, including:

- Addressing the fundamentally different operating environments faced by international energy firms and Australian energy networks – including differences in regulatory frameworks, business cycles, local geographies, political contexts, and corporate profiles (i.e. vertical integration and horizontal diversification).
- Overcoming the "leverage anomaly" – upward bias in estimates – when attempting to correct for the difference in gearing between international firms and domestic networks by de-levering and re-levering the equity beta estimates of international firms.
- Accounting for the difference between the structure of the Australian market and market composition of each international market – and their differing exposures to systematic risk.

There is no objectively correct solution to any of these problems, and so the use of international comparators is fraught. Nonetheless, we recognise the lack of more robust options, where the ERA has to address the diminishing value of Australian comparator data. If the ERA is minded to continue using international comparators, we recommend that it minimise the risk of inclusion of fundamentally inappropriate comparators – i.e. those that have material levels of exposure to competitive markets rather than purely regulated networks – by adopting the filtering approach recommended by Electricity Market Advisory Services (EMAS). EMAS in its report for Energy Consumers Australia (ECA) on the AER's rate of return process[22] recommended that three (currently listed) international comparators be added to the Australian comparator set: National Grid, Hydro One and Vector. On that basis, EMAS considers the evidence supports an equity beta of 0.5 or below.[23]

Even if the ERA is not minded to agree with the EMAS view of a beta of 0.5 at this time, it does highlight that a beta of 0.7 appears well above that applied for most other regulated firms in Australia since at least 2018, for what are essentially similarly regulated monopoly network providers.

It is also important the ERA does not maintain a relatively higher beta because of any concerns regarding asset stranding risk, given possible declines in gas use, as a result of government policies to phase out gas in end-use applications – arguably more directly relevant in gas distribution. Such risks (to the extent relevant) are better addressed in the access arrangement process, such as though the treatment of depreciation.

4.4. Benchmark credit rating

The benchmark credit rating is an important input to the estimation of the cost of debt. In 2022 the ERA selected a BBB+ credit rating as being the median credit rating across a set of Australian energy network comparators. Fortunately, there remain considerably more comparators for this parameter than for market-based parameters, and the median credit rating of the group remains at BBB+. However, we make two observations.

The group includes electricity networks and also APA, which as discussed above has the majority of its business in lightly regulated pipelines. If the parameter group was narrowed to only include gas pipelines subject to full regulation and issuers with both full regulation gas and electricity networks, then the median credit rating would be A-.

Table 2: Issuer credit ratings – selected companies

Issuer	2020	2021	2022	2023

[22] EMAS, Report for Energy Consumer Australia's Submission to the AER's 2026 Rate of Return Instrument Review, December 2025. Available at https://www.aer.gov.au/documents/eca-attachment-emas-report-energy-consumer-australias-submission-aer-2026-rate-return-instrument-review-december-2025

[23] Ibid. See sections 4.2-4.6, Appendices C and D for further details

ATCO Gas Australia LP	BBB+	BBB+	BBB+	BBB+
DBNGP Finance Co P/L	BBB	A-	A-	A-
Energy Partnership (Gas) P/L	BBB+	A-	A-	A-
Australian Gas Networks Ltd	A-	A-	A-	A-
AusNet Service Holdings P/L	A-	A-	BBB+	BBB+
SGSP (Australia) Assets Pty Ltd	A-	A-	A-	A-
Industry Median	*A-/BBB+*	*A-*	*A-*	*A-*
APA Infrastructure Ltd	BBB	BBB	BBB	BBB
Industry Median (incl. APA)	*BBB+*	*A-*	*A-*	*A-*

We recognise that choosing to narrow the set of comparators may entail consideration of the impact on other parameters, but we consider this is worth investigating.

Additionally, and as discussed further below, these credit ratings take account of leverage ratios calculated as debt: RAB, not to market gearing. Debt: RAB ratios are considerably higher than implied by the market gearing data, and so it is likely that a benchmark 55 per cent gearing would support a higher credit rating than the current benchmark.

4.5. Cost of debt

The benchmark financing assumption used by the ERA in 2022 was to assume a 10 year equal weighted trailing average of ten year corporate BBB+ bonds, with swap options used to hedge debt for the upcoming access arrangement at market rates. This provides the benchmark entity with confidence that it has "locked in" its cost of debt for new investment during the access arrangement. Under this approach, the ERA also makes an allowance for the cost of raising debt and the cost of the hedging instruments, both expressed in terms of an increment in basis points to the overall cost of debt.

For this review, the ERA proposes to consider the merits of switching to a full trailing average, which would remove the need for hedging costs to be included. It appears the ERA sees particular benefits of such a change as it may produce more stable and predictable debt costs over time compared to the hybrid method, particularly in the face of heightened volatility in financial markets that have been observed in recent years and are likely to continue. For that reason we would agree this is worth exploring.

However, in exploring this change further, we would suggest certain aspects are looked at in more detail. More specifically, the ERA has identified several differences between its current hybrid approach and the full trailing average. We comment on three of these below which we think deserve more scrutiny.

Volatility – the ERA observes that the full trailing average is less volatile than the current approach, and so should produce more stable and predictable revenue allowances between access arrangements. Volatility manifests for customers in different ways. Large customers seek to lock in contracts for several years that cover both commodity and network costs (and potentially other less material costs). Retailers are likely to price in a premium for volatility. So large customers should experience lower volatility as lower absolute prices. Small customers typically see price changes year to year based on the costs of service. So volatility manifests as

unanticipated changes in their gas price, which affects their ability to budget for it. Either way, customers are likely to prefer lower volatility, other things being equal. However, what is less clear is whether they would trade off lower volatility for slightly higher costs.

The key question is whether there is any reason to think that (excluding hedging costs) the current approach results on average in a lower cost of debt, a higher cost of debt or the same.

The CRG aims to investigate further customers' attitudes to volatility to support its future submissions. However, it would be desirable for the ERA to consider this matter in more detail in its draft decision.

Hedging costs – as these will no longer be required, this should, other things being equal, reduce the cost of debt, which is beneficial for customers.

Simplicity – while simplicity has some merit, we consider it rates as a low priority, given that overall, the rate of return estimation process remains very complex with or without this element.

Additionally, we note one potential drawback when a change is made from one approach to another at successive reviews. That is, for customers to benefit it must be maintained through a full interest rate cycle. We would expect there will be swings and roundabouts, since end-user customers who may have been worse off when the trailing average is higher, will be better off when it swings the other way. There is always a risk that the approach will keep changing to ensure the regulated entity will always benefit from changes to the interest rate cycle; when the trailing average is lower than the current cost of debt, businesses will advocate for change on the basis that they will be unable to finance new investment, whereas, if it is higher, they can outperform the benchmark by hedging their debt at on-the-day rates. In making this change, the ERA should be mindful of these possible effects.

This issue has also been raised in the AER process. It also reflects the timing of the AER's introduction of the trailing average, which for several years was well above on-the-day rates (which was its previous approach). We note the ERA is considering the change at a time when the trailing average is likely to result in a lower cost of debt than the current approach. In that light it is unsurprising that ATCO opposes the change and AGIG is seeking an extensive transition if the change is made.[24]

We do not consider that the case for a transition has yet been made. The underlying premise of the current approach is that the benchmark entity finances itself using a trailing average approach. All it needs to do to convert to the full trailing average is to refrain from entering into swap options in the run up to its next access arrangement. Should the businesses consider they will incur actual costs due to the change, the onus is on them to demonstrate this, and also that these costs are a result of following the benchmark strategy. The AER's previous introduction of a trailing average is not a good analogy as they changed from an on the day rate and so did not assume the underlying trailing average was already being used by the benchmark entity.

We also note in passing that the full trailing average is the AER's current approach, although they are now considering adopting a *weighted trailing average*. This is driven by concerns around the ability of some transmission networks to finance very large investments (relative to their current RAB) if the simple trailing average is lower than current debt costs. We don't consider there is an analogous situation for WA gas networks and pipelines and therefore no need to consider a weighted trailing average in this review. This also introduces various complexities and other issues (currently being explored in the AER process).

The ERA's methodology for estimating BBB+ corporate debt, appears to us to be reasonable on the face of it, but we have yet to review it in detail.

[24] ATCO Australia, Submission to the Rate of Return Instrument Discussion Paper, December 2025 & AGIG, Submission to the Rate of Return Instrument Discussion Paper, December 2025

4.6. Debt: Equity ratio

It's common for regulators to use a single debt: equity ratio, or gearing, across multiple elements of the rate of return. In cases where businesses trade at large multiples of their RAB, as was common in Australia when there were several listed businesses, different debt: equity metrics diverge. This can be illustrated by the AER's annual rate of return update, which shows that book gearing exceeds market gearing by an average of 15 per cent. We consider there is a case for a "horses for courses" approach. We acknowledge that market gearing is the most appropriate metric to use in beta estimation, if a regulator is de-levering an re-levering betas. However, we don't consider market gearing is especially relevant for determining the amount of leverage a business can sustain or what credit rating would be consistent with that leverage. Credit rating agencies tend to use debt: RAB as a leverage ratio (if they use it at all) and most of their other ratios are influenced by this ratio.[25] They do not tend to use market gearing.

The CRG does not have access to debt: RAB data for the relevant networks. Using the AER's book gearing as a proxy, it seems clear that a 70 per cent debt: RAB ratio would be a reasonable benchmark and would be consistent with a credit rating based on the same comparator set. This would not entail any change in the beta calculation.

We acknowledge that this would be a change in approach and would require the ERA to obtain debt: RAB data for the relevant networks. Since it could only do so for the gas networks it regulates, if it wanted a larger dataset, it could work with the AER to collect data as a joint exercise. In any case, we consider this aspect worthy of further investigation.

5. Other parameters

5.1. Inflation

EMAS have identified an issue with the AER's approach to inflation.[26] The difference between estimated and actual inflation can deliver windfall gains or losses to the regulated business. In recent years high inflation has delivered substantial windfall gains that exceed any losses from earlier periods of low inflation. This is because outturn inflation outcomes are not a normal distribution, and so this variation systematically favours regulated businesses. We recognise that the ERA has a different approach to estimating inflation from the AER, and this may mitigate the issue. We consider this issue merits further investigation to ensure there is no systemic bias towards regulated businesses.

5.2. Gamma

We note that the ERA has arrived a lower estimate of gamma (imputation credits) than the AER from essentially the same data. This results in slightly higher allowed tax costs (other things being equal) and thus higher allowed revenues. We consider this merits further investigation to understand the basis for the difference and why it is in customers' interests. It was not clear from the discussion paper whether gamma was to be considered explicitly in this review.

[25] See for example, Moodys Investor Services, "Regulated Electric and Gas Networks Rating Methodology," 2017, p17

[26] EMAS, Report for Energy Consumer Australia's Submission to the AER's 2026 Rate of Return Instrument Review, December 2025, pp12-15