14 October 2026

Ms Jenness Gardner, CEO
Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
Perth WA 6000
*By online submission form*

Dear Ms Gardner

**Response to the ERA's 2026 Draft Gas Rate of Return Instrument and Explanatory Statement**

Energy Networks Australia (ENA) welcomes the opportunity to respond to the Economic Regulation Authority's (ERA) 2026 *Draft Gas Rate of Return Instrument* and *Explanatory Statement* (Draft Instrument). ENA is the national industry body for Australia's electricity transmission and distribution and gas distribution networks.

ENA and its members approach this review conscious that investors and lenders assess the settings of Australia's rate of return instruments as a whole, at a time when long-lived gas networks continue to play a substantial role in a low carbon energy future for Western Australian consumers and businesses. In that environment the stability and predictability of this type of instrument through time matters as much as the level of any single parameter.

**Overview**

ENA supports the Draft Instrument as a broadly balanced outcome and welcomes the regulatory certainty that it provides in key areas.

The ERA has treated the 2022 instrument as a sound starting point, retained the core framework and its principal parameters, and confined change to those areas where market developments or new information raised a specific question.[1] This is an approach which ENA considers appropriate to the periodic review of a binding instrument e.g. there is scope for parameters to change where new evidence warrants it and are maintained where such evidence does not exist.

ENA's position on the matters on which the ERA has invited comment is summarised below.

| Element of the Draft Instrument | ENA position |
|---|---|
| **Framework and retained parameters** | Supported: nominal vanilla WACC, 55 per cent gearing, Sharpe–Lintner CAPM, 10-year term for equity, gamma of 0.5 and Treasury bond-implied inflation. |

[1] ERA *Explanatory statement for the 2026 draft gas rate of return instrument – Overview,* 27 July 2026 (Overview), sections 3 and 5.

Energy Networks Australia
energynetworks.com.au
info@energynetworks.com.au
Level 33, 385 Bourke Street,
Melbourne VIC 3000
+61 3 9103 0400
Energy Networks Association
T/A Energy Networks Australia
ABN: 75 106 735 406

| Element of the Draft Instrument | ENA position |
|---|---|
| **Equity beta** | ENA support retaining a beta of 0.7 given comparator evidence remains stable, and there is no evidence that systematic risk has reduced since 2022. Stability in the parameter value in the face of inconclusive evidence for change is supported. |
| **Market risk premium** | ENA consider the ERA should adopt an MRP of 6.5 per cent consistent with data on the historical arithmetic mean of equity returns and, if it proposes to depart from it, to provide fuller reasoning. |
| **Return on debt** | Priority is the design of the transition enabling a reasonable opportunity to recover efficient costs. |

### Framework and retained parameters

ENA supports the retention of the nominal vanilla WACC, 55 per cent gearing, the Sharpe–Lintner CAPM, the 10-year Commonwealth Government Security risk-free rate, and the Treasury bond-implied inflation approach.[2]

The 2022 instrument was developed through extensive consultation and independent review, was applied in three access arrangement determinations, and was found by the networks and pipelines that used it to be clear and implementable. In the absence of new evidence, ENA agrees with the ERA that there is no case for wholesale change.

ENA particularly supports the decision to retain a 10-year term for equity. The ERA's reasons – the long life of network assets, investors valuing cash flows across multiple access arrangements, competition for capital with unregulated infrastructure, and consistency with the NPV=0 principle – remain sound, and no new evidence has been put forward to displace them.

### Equity beta assessment

ENA supports the ERA's proposal to retain an equity beta of 0.7.

The evidence before the ERA is, as the ERA recognises, mixed. The domestic sample is made up of delisted firms, meaning the market estimates are incapable of reflecting prevailing conditions of investors' expectations. APA is the only listed comparator but it does not closely reflect characteristics of the benchmark firm. International estimates range from 0.5 to 0.8 on a gearing adjusted basis, the UK and New Zealand samples have been stable or higher, while five-year US and Canadian estimates fell after April 2025 as an artefact of the five-year sampling window, with no clear link to fundamental factors.[3]

On that evidence the ERA has concluded that a beta of at least 0.6 is supported and has declined to reduce 0.7 on the strength of recent volatility, in the absence of unambiguous evidence that systematic risk has fundamentally changed.[4] ENA agrees with this approach.

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[2] ERA (July 2026), Overview, Table 1 and section 3.

[3] ERA (July 2026), Attachment 5, paras 215, 347–349 and 353, and Table 5.7.

[4] ERA (July 2026), Attachment 5, para 354.

A reduction driven by a single market episode captured in one estimation window would exchange a durable estimate for a transient one and would sit uneasily with the ERA's own objective of stable and predictable outcomes.

**Proposed market risk premium estimate**

*Market risk premium: adopt 6.5 per cent*

ENA is not persuaded that the evidence supports the proposed reduction in the market risk premium (MRP) from 6.1 to 5.8 per cent, and consider the ERA should, consistent with the common regulatory practice across Australia, use an arithmetic average of historical equity returns as a starting point for an estimate of a forward-looking market risk premium.

At present, this suggests a historical estimated MRP value of 6.5. ERA should apply caution in considering the AER's draft Rate of Return Instrument as a support for any downward movement. The Independent Panel reviewing the AER draft instrument has highlighted that the AER's proposed movement of MRP appears contrary to the direction of available empirical evidence, and not consistent with its 2022 decision, and the AER is conducting further consultation on this matter.

*The primary HER evidence has barely moved*

The ERA's historical estimate is 5.9 per cent, compared with 6.0 per cent in 2022.[5] The proposed reduction in the MRP is three times as large. In 2022 the MRP was set marginally above the historical estimate; the draft sets it below, although the ERA states that it places more reliance on the historical estimate than on the dividend growth model (DGM) and expects the MRP to be stable over time.[6]

The only input below 5.9 per cent is the DGM estimate of 3.8 per cent, and the Draft Instrument does not explain how the two inputs are combined to reach 5.8 per cent. On the ERA's own illustration, this change accounts for essentially all of the nine-basis point reduction in the allowed return on equity and hence the illustrative nominal WACC.[7]

The proposed change in MRP risks been driven to an undue degree by single and questionable methodological choice, an approach that conflicts with the ERA's stated expectation of regulatory stability.

*The DGM is carrying weight that the ERA says it cannot bear*

The ERA acknowledges that the DGM is unreliable on its own, sensitive to its assumptions and highly variable from month to month and gives it less weight than the historical estimate.[8] Yet it is the DGM alone that pulls the proposed MRP estimate below the historical estimate. The ERA describes the MRP methodology as unchanged apart from parameter updates. A revised approach to long-run growth, resting on sources whose long-run forecasts are inherently uncertain, should not determine the outcome for this parameter considering the small movement in the primary HER evidence.

*The 60:40 weighting lacks an analytical basis.*

ENA also questions the weighting of the arithmetic and geometric means in the historic estimate, which the ERA has retained from 2022.

The effect of this proposed methodological decision is material. As an example, on the ERA's sub-period means (arithmetic 6.55 per cent, geometric 4.89 per cent), the 40 per cent weight on the geometric mean alone reduces the historic estimate by about two-thirds of a percentage point. The

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[5] ERA (July 2026), Attachment 5, paras 62 and 130.

[6] ERA (July 2026), Overview, section 4.3; Attachment 5, paras 190–194.

[7] ERA (July 2026), Overview, Table 2 (nominal after-tax WACC of 8.02 per cent under the 2022 approach and 7.93 per cent under the draft; return on equity parameters otherwise unchanged).

[8] ERA (July 2026), Attachment 5, paras 138, 155, 174 and 194.

application of a weighting approach that moves the proposed estimate by more than half a percentage point, risks introduction of avoidable regulatory uncertainty and risk.

The proposed weighting is also out of line with broader Australian practice and difficult to reconcile with the theory underlying the CAPM. In its 2018 and 2022 instruments the AER estimated the MRP from the arithmetic mean of historical excess returns.[9] The CAPM requires the expected return for a single period, the rate at which expected cash flows are discounted, and on the standard assumption of independent returns the arithmetic mean is the unbiased estimator of that quantity; the geometric mean measures compound growth over the sample.

ENA acknowledges the studies on which the ERA relies for weighted estimates of long-horizon returns, but the ERA has not shown that a horizon-adjusted compound return is the relevant input to a single-period CAPM.

*6.5 per cent is consistent with the market evidence*

The ERA's historic evidence supports estimates from 5.9 per cent (at the 60:40 weighting in the ERA's draft Instrument) to 6.55 per cent (arithmetic mean only). The ERA should apply the arithmetic mean estimate for the reasons noted above.

**Return on debt: adopting a transition that recognises legacy benchmark exposure**

The change from the hybrid to a full trailing average is the one material departure from the 2022 instrument. The impacts of this proposed move will vary according to differing financing strategies, and individual members will address these directly in detail.

ENA's submission focuses solely on the high-level principles and design questions.

ENA's guiding principle is that the allowance should match the benchmark efficient cost of debt, so that the NPV=0 condition is met and a service provider has a reasonable opportunity to recover at least its efficient costs. The ERA finds that both the hybrid and the full trailing average approaches satisfy that condition.[10] The case for change therefore rests on the value of smoothing allowances between access arrangements, weighed against greater variation within them.

That is a matter of regulatory judgement, and ENA does not oppose the ERA's judgement provided the transition is properly designed. ENA cautions, however, against selecting design features by reference to today's level of interest rates. The transition will begin with access arrangements commencing from around 2030, when rates may be higher or lower than at present, and the design must be appropriate to either.

*A gradual transition is essential.*

ENA supports the ERA's decision to provide a gradual transition and agrees that no transition would be inappropriate. The ERA's information request found that pipelines' implementation of the hybrid approach ranges from close to partial to none, and the ERA correctly concluded that failing to recognise the benchmark entity's legacy exposure would create regulatory uncertainty and deny a reasonable opportunity to recover costs.[11]

ENA also notes the ERA's conclusion that a weighted trailing average is not warranted for Western Australian gas pipelines on present evidence, and its acknowledgement that it would revisit the question in the 2030 review if a material expansion is proposed.[12]

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[9] ENA *Rate of Return Instrument Review: Response to AER Draft Instrument and Explanatory Statement*, 31 July 2026, section 6.

[10] ERA (July 2026), Attachment 4, para 155.

[11] ERA (July 2026), Attachment 4, paras 484 and 488.

[12] ERA (July 2026), Attachment 4, paras 176–177.

Where the regulated asset base is stable or declining, a weighted trailing average produces the same result as a simple trailing average; the question arises only where debt is raised materially above the standard refinancing profile. ENA encourages the ERA to scope the necessary analysis well ahead of the 2030 review, so that any such case can be assessed in an orderly and consultative way.

**Next steps**

In summary, ENA supports the framework and the certainty the Draft Instrument provides, supports the equity beta of 0.7, and asks the ERA to reconsider its approach to MRP and to design the debt transition around the benchmark entity's legacy exposure.

ENA would welcome the opportunity to further discuss any of these matters with the ERA. Please contact me should you wish to arrange this [redacted].

Yours sincerely,

[redacted]

Garth Crawford
**Special Advisor, Regulatory Finance**