

10 October 2008

Mr John Tamblyn
Chairman
Australian Energy Market Commission
Level 5, 201 Elizabeth Street
Sydney NSW 2000

By email: submissions@aemc.gov.au

Dear John,

AEMC Draft Rule Determination – WACC Parameters, Equity Beta and Gamma

Grid Australia welcomes the opportunity to comment on the Commission's draft Rule determination dated 28 August 2008 concerning the Energy Users Association of Australia (EUAA) Rule change proposal in relation to the above.

Grid Australia supports the Commission's draft determination not to make the Rule change originally proposed by the EUAA, or the alternative change submitted during first round consultation. The Commission is correct in concluding that the current framework, involving a review of the parameters every five years by the AER, should remain in place and is the most appropriate process to determine the best estimate for the revenue determination parameter values.

The Commission's draft determination clearly addresses the requirements of the National Electricity Objective, the transitional arrangements for the NSW and ACT distribution businesses, and the revenue and pricing principles in the National Electricity Law.

Specifically the Commission recognises that the EUAA Rule change proposal (and the alternative raised in submissions):

- would retrospectively amend the provisions applicable to regulatory determination processes which have already commenced;
- would be contrary to the NEL which prohibits retrospective application;
- would increase the uncertainty and regulatory risks faced by network service providers and create a precedent that revenue determination processes can be amended after they have commenced;

- does not support a stable investment climate for those determinations which commence before the completion of the first AER parameters review; and
- is inconsistent with the MCE position in setting the determination framework for distribution network service providers and the transitional arrangements for NSW and ACT distribution businesses.

The Commission also correctly observes that another effect of the Rule change proposal would be to change the reference point for the AER review of WACC parameters and that the AER must have regard to the need for persuasive evidence to justify any change to the current values where the parameter values cannot be determined with certainty.

Applying this same test the Commission concludes that the EUAA has not provided compelling evidence to accept its revised values and has not fully considered all of the implications of amending the equity beta and gamma values on the other WACC parameters. The Commission further concludes that a full assessment of the appropriate values would be required for this aspect of the Rule change and the Commission considers that it would be neither appropriate nor efficient for the AEMC to conduct a concurrent review of the parameters.

The Commission's position on this matter now appears to be fully supported by the expert reports provided by the network businesses with their submissions to the AER review currently underway. Among other matters, these submissions highlight the linkage between gamma and market risk premium and provide compelling evidence for either a reduction in gamma from 0.5 to zero, or an increase in market risk premium to seven percent. The expert reports also highlight the significant data and measurement issues associated with determining a value for beta with confidence, as well as the possible need to adjust beta to offset bias in the Sharpe-Lintner CAPM model.

The AER review is now well underway with submissions from interested parties having been provided. This process should now 'run its course' without the inefficient duplication of work that implementing the EUAA Rule change would entail.

In summary, the Commission's final Determination on this matter would be soundly based if it was to reflect the findings of the draft Determination and not accept the Rule change originally proposed by the EUAA, or the alternative change submitted during first round consultation.

Yours sincerely,



Rainer Korte
Chairman
Regulatory Managers Group