Attachment to SP AusNet Submission to AER's review of WACC parameters:

The table below summarises the parameter values that SP AusNet proposes be adopted by the AER for the purpose of its WACC review. The proposed values are based on the detailed submissions lodged by the Joint Industry Associations. The table also provides a summary of the analysis and evidence presented in the submissions lodged by the Joint Industry Associations to substantiate the proposed WACC parameter values shown.

Parameter	Proposed value	Basis for proposed value
Nominal Risk Free Rate and term to maturity of the risk free rate	10 year Government bond yield	An actively traded security with a 10 year maturity date is the appropriate proxy for the nominal risk free rate. Persuasive evidence has not been provided to move from a 10 year maturing proxy. This proxy should be used for both the benchmark yield for determining the cost of debt and the cost of equity. It should also be used to estimate the market risk premium. Mixing maturities across these uses would introduce a bias in the cost of capital. Averaging observed yields in the period 5 to 40 days, and commencing as close as possible to the start of the regulatory period or as nominated by the service provider, is an acceptable method of determining the regulatory rate. The Issues Paper posits an alternative 5 year maturity date and we have provided a wealth of business information and expert opinion to explain why such an approach is demonstrably inferior to the current approach.
Capital structure	60% debt to debt plus equity	Businesses that are comparable to an Australian regulated electricity transmission and distribution business have exhibited average gearing ratios (expressed as book debt divided by book debt and market equity) of around 60 per cent over the last five years. Accordingly, maintenance of the currently adopted gearing ratio of 60 per cent is appropriate. SP AusNet considers that an appropriate and practical measure of gearing is the book value of debt divided by the sum of the book value of debt plus the market value of equity. When measuring the book value of debt, shareholder loans that are stapled to the underlying stock of a business should be treated as equity not debt.
Credit Rating	BBB+	The benchmark credit rating should not be determined by mechanistic application of any one methodology. Both a quantitative and qualitative assessment of the circumstances affecting a business' ability to repay debt should be taken into account in this review process. Appropriate comparators for reviewing the adopted benchmark credit rating would be transmission and distribution, gas and electricity companies, excluding those companies with characteristics not similar to a benchmark network service provider. Current information indicates that the previously adopted benchmark credit rating of BBB+ remains appropriate, although this information shows that BBB+ is probably at the upper end of an appropriate credit rating range.
Market Risk Premium	6% for a gamma value of zero, otherwise 7%	A value of 6% has been used historically as the Market Risk Premium (MRP) in regulatory decision making for electricity networks. However, an MRP value of 6% is predicated on imputation credits having no value to investors (that is to say, a value for gamma of zero). SP AusNet supports the continued use of an MRP value of 6% under an assumption that imputation credits have zero value. However, if imputation credits have a positive value (consistent with past regulatory practice) there is convincing and persuasive evidence to increase the expected MRP from 6 to 7 per cent.

Parameter	Proposed value	Basis for proposed value
Equity Beta	1.0	Estimates of equity beta for Australian electricity infrastructure businesses, based on the best available data are subject to a very high degree of uncertainty. This is because there is only a very small sample of comparators and even these are imperfect comparators. Estimates can and do vary substantially from one measurement period to the next, underscoring the high level of imprecision in the estimates. To date, the extent of this problem and how to compensate for it has only been partially recognised. A substantial amount of expert advice was obtained in the course of preparing the submissions of the Joint Industry Associations: • In light of the uncertain and sparse beta data, the Allen Consulting Group (ACG) has concluded that there is "no convincing or persuasive evidence that the equity beta for a regulated electricity transmission or distribution business is different from 1." • Other experts have examined the limitations of the Sharpe-Lintner CAPM (the model mandated in the National Electricity Rules), and demonstrated that it underestimates the true cost of equity. To make a sound estimate of the return on equity in accordance with the requirements of the Rules, the deficiencies of the Sharpe-Lintner CAPM must be recognised. This analysis lends further weight to the conclusion that in light of the uncertainty of the available data and the known limitations of the Sharpe-Lintner CAPM the best estimate of equity beta is 1. There is no persuasive evidence to adopt an equity beta value other than 1 if the equity beta to be adopted is to comply with the requirements of the National Electricity Law and Rules. In fact 1 remains the best estimate for the equity beta for regulated Australian electricity infrastructure given the limitations of the data and estimation methodology, and the deficiencies of the Sharpe-Lintner CAPM.
Gamma	0.2 for an MRP of 7%, or zero for an MRP of 6%	The previously adopted gamma is 0.5. There is considerable persuasive evidence that this value is inappropriate and that a different, lower value should be adopted. Considering gamma in isolation of the assumed MRP value, market evidence supports the adoption of a point estimate for the value of gamma of 0.2. However, detailed expert analysis commissioned by the Joint Industry Associations shows that the application of a non-zero value for gamma along with the adoption of an MRP value of 6% is likely to deliver a return that is below the cost of capital. Based on the latest available evidence, SP AusNet proposes the adoption of a gamma value of 0.2 coupled an MRP of 7%. Alternatively, if the pre-existing MRP value of 6% is to continue to be applied, then there is considerable persuasive evidence that a gamma value of zero should be adopted.

Parameter	Proposed value	Basis for proposed value
Inflation forecast	Range of reasonable indicators proposed by the network service provider	This matter falls outside the scope of the AER's prescribed 'rate of return reviews' under the Rules and is a separate consideration. That said, SP AusNet notes that there is no approach that establishes an appropriate forecast of inflation based on observable market information at this time. For the NSW and ACT electricity distribution determinations the AER has said that its approach will be to use a 'range of indicators' (to be identified at the time of the relevant price cap reviews) to guide its assessment of a service provider's proposed approach to inflation (to be outlined in the regulatory proposal). SP AusNet broadly supports this approach, but considers that the AER should expand the 'range of indicators' it has used in recent determinations to include a portfolio of inflation forecasts from recognised experts, including the RBA, if this is the approach proposed by a service provider.
Debt and equity raising costs	To be advised	These matters fall outside the scope of the AER's prescribed 'rate of return reviews' under the Rules and are separate considerations. That said, SP AusNet considers that the Revenue and Pricing Principles set out in section 7A of the National Electricity Law require the AER's decisions to provide allowances for benchmark costs of debt and equity raising. SP AusNet will provide further submissions in relation to these matters during the course of this review.