Rate of return guideline review – Pre-issues paper forum

Date	Monday 18 September 2017
Time	9:30 am to 1 pm (plus lunch)
Location	Stamford Plaza Sydney Airport Corner Robey St and O'Riordan St, Mascot NSW

Agenda item #5

Handout for group discussion – possible listing of high, medium, and low priority issues for review

High priority

1. A review of the available data series for estimating the return on debt
2. Update empirical analysis:
    2.1. Benchmark gearing ratio
    2.2. Benchmark credit rating
    2.3. Estimates of equity beta for listed Australian energy networks.
    2.4. Market risk premium material including historical returns, dividend growth model estimates, surveys, and conditioning variables.
    2.5. Tax statistics from the ATO, equity ownership stats from the ABS, distribution rate data from listed equity
3. The level of prescription for the return on equity, and whether the guideline should set out an estimation method that can be more mechanically implemented at each determination (similar to the return on debt in the current guideline) or preferred parameter estimates (similar to the value of imputation credits in the current guideline) or a combination of both.
4. Consider implications of Tribunal and Federal Court decisions on our approach to a trailing average return on debt with a transition into the trailing average.
5. Consider implications of Tribunal and Federal Court decisions on our approach to estimating the value of imputation credits.
6. Refine processes for the selection of averaging periods to increase certainty and procedural efficiency.

Medium priority

7. Update consideration of the relative weight afforded to material informing the market risk premium
    7.1. We currently provide the most weight to historical stock returns and less weight to the dividend growth model, surveys, and conditioning variables.
8. Update consideration of the relative weight afforded to material informing the equity beta estimate
    8.1. We currently provide the most weight to empirical beta estimates from domestic energy networks and less weight to empirical estimates of international energy networks, empirical estimates of domestic non-energy infrastructure companies, the theory of the Black CAPM, the conceptual approach.
9. Consideration of the approach to estimating the benchmark gearing ratio based on RAB values, book values, or market values.
10. Interpolation and extrapolation methods for estimating the return on debt – may need to be adapted to the data series used to estimate return on debt.
11. Contingencies for the annual updating of the return on debt – may need to be adapted in light of the data series used to estimate the return on debt, plus incorporate learnings from recent application.

Low priority

12. Use of a nominal vanilla weighted average of the return on equity and the return on debt.
13. Estimating the benchmark efficient rate of return for a 'pure-play' Australian energy network.
14. Use of a ten-year term for the return on equity and return on debt.
15. Approach to estimating the gearing ratio and credit rating based on benchmarking of comparable companies.
16. Approach to estimating the risk free rate for the return on equity by reference to interpolated yields on nominal Australian government securities.
17. Approach to estimating the return on debt by benchmarking to yields on corporate bonds of the benchmark credit rating.
18. The classification of material as relevant or not, and the role afforded to relevant material (distinct from the relative weight afforded to the material). For example, the Sharpe-Lintner CAPM is relevant to the return on equity; the Fama-French model should be provided no role in informing the return on equity; dividend growth model and surveys may inform estimates of market risk premium.
19. Consideration of the approach to estimating the value of imputation credits outside of implications from Tribunal and Federal Court decisions.