ElectraNet SA
electricity transmission network

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31 August 2001

Mr Michael Rawstron
General Manager, Regulatory Affairs - Electricity
ACCC
PO Box 1199
DICKSON ACT 2602

Dear Michael,

Queensland Transmission Draft Revenue Cap Decision – Cost of Capital

The ACCC published its Draft Decision on the Queensland Transmission Network Revenue Cap for 2002-2006/07 on 18 July 2001 and invited submissions in response to this document.

This submission by ElectraNet SA is focussed on the issue of the cost of capital.

ElectraNet SA strongly supports the view that the risk free rate should be aligned as far as possible with the actual life of the transmission assets and recommends that the ACCC use the yield to maturity on long-term ten-year Commonwealth Government bonds for this purpose (consistent with the National Electricity Code, the ACCC decision on TransGrid and the approach taken by other regulators in Australia and overseas).

We have attached a submission prepared by the Network Economics Consulting Group (NECG) supporting our views.

ElectraNet SA believes that aligning the risk free rate with a shorter five-year duration in order to match the regulatory cycle would not be supported by the investment community as it leads to a fundamental misalignment with treasury management principles which require, as much as possible, the matching of asset and liability duration.

While the ACCC approach could be viewed as encouraging a hedging arrangement similar to an interest rate swap, it pre-supposes that this could or should occur every five years. However, when businesses are "going concerns" with existing swap arrangements this matching may potentially take many regulatory cycles unless the ACCC intends to provide compensation in the revenue cap for the unwinding of any existing swaps.

Furthermore, there are funding cost consequences of such an approach. Firstly, it is important to recognise that the choice of a shorter-term five-year bond rate will increase the financial risk of regulated businesses by the mismatching of revenues with real business costs and thereby potentially lowering the business credit rating and increasing its cost of funding. Such increased financial risk would need to be compensated for in the WACC. Secondly, if the ACCC intends to continue with a five-year bond rate, it must be internally consistent and allow regulated businesses a debt issuance cost margin either within the debt margin used to determine the WACC or as a notional cost within the cash flows.

The Draft Decision is wrong where it states (p14) that its use of a bond rate maturity corresponding to the regulatory period is consistent with the recent decision by the jurisdictional regulator (QCA in relation to the Queensland distribution businesses). The QCA based its decision on the risk free rate on an average of the 10-year Commonwealth bond. If the ACCC is to maintain consistency with jurisdictional decisions, as it did with TransGrid, then it should base the risk free rate for Powerlink on an average of the 10- year Commonwealth bond.

We note that the ACCC has not published any real explanation for assigning a debt margin of only 120 basis points to Powerlink when the ORG and QCA in recent decision on largely equivalent risk businesses assigned a debt margin of between 150-165 basis points.

Please don't hesitate to contact Rainer Korte on 08 8404 7983 if you would like to discuss any aspect of this submission.

Yours sincerely

(Signed)

Kym Tothill
CHIEF EXECUTIVE OFFICER