



13 November 2009

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
Email: nswactgas@aer.gov.au

Dear Mr Buckley

ENA submission to the AER on the New South Wales Gas Access Arrangement Review 2010-2015

The Energy Networks Association (ENA) welcomes the opportunity to make this submission on the New South Wales (NSW) Gas Access Arrangement Review 2010-15 (GAAR).

This submission focuses on the proposal by Jemena Gas Networks (JGN) that the Fama-French Three Factor Model (FF Model) be used to determine the benchmark cost of equity within the rate of return used in the NSW GAAR process.

The National Gas Rules (Rule 87) require that the financial model used to estimate the rate of return be well accepted, such as the Capital Asset Pricing Model (CAPM). There is no requirement to use the Sharpe-Lintner CAPM (SL CAPM), which has been used in previous regulatory decisions.

ENA has reviewed materials submitted to the AER by JGN that relate to JGN's proposal on the calculation of the cost of equity in the NSW GAAR process—namely, the report by NERA, *Cost of Equity—Fama-French Three Factor Model, Jemena Gas Networks (NSW)*, and Chapter 9 of the JGN document *Access Arrangement Information*.

Having reviewed the above documents, ENA considers that:

- the FF Model appears to have substantial explanatory power in Australian, as well as other, capital markets, and
- based on the evidence presented by JGN in the context of this Access Arrangement review, the explanatory power of the FF Model could potentially be superior to that of the SL CAPM.

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ENA also notes that:

- the FF Model appears to be well accepted in academic literature
- variants of the FF Model are used by a sizeable proportion of US managers in making investment decisions, and
- the FF model was recently recommended to the New Zealand Commerce Commission by an international expert panel as an appropriate model for checking the allowed returns on equity for regulated businesses.

Given the above, ENA believes that the AER should seriously consider and thoroughly investigate the potential use of the FF Model for determining the rate of return in the NSW GAAR process.

If you have any questions or require clarification of any points discussed, please do not hesitate to contact me on (02) 6272 1500 or abylth@ena.asn.au.

Yours sincerely



Andrew Blyth
Chief Executive