

20 April 2007

Mr Mike Buckley
General Manager
Network Regulation North
Australian Energy Regulation
PO Box 1199
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Dear Mr Buckley

Powerlink submission and NERA report – bias in the real risk-free rate

The Energy Networks Association (ENA) welcomes the opportunity to respond to the Australian Energy Regulator's (AER) consultation on Powerlink's submission – bias in the real risk-free rate and the accompanying report by NERA on this issue.

ENA considers the findings within NERA's report to have a crucial impact on the calculation of the real risk-free rate as used in the capital asset pricing model (CAPM), the NERA report provides substantial and significant evidence that a bias exists within the risk-free rate. The primary conclusion of the NERA report is that Australian regulators need to add 20 basis points (bp) to the real cost of equity and debt, this bias estimate is relative to nominal Commonwealth Government Securities (CGS) yields. The ENA also notes that based on Reserve Bank of Australia (RBA) data, the current yield on nominal CGS is downward biased as a proxy for the CAPM risk free rate by around 42-44bp, although further analysis on this data is required.

The AER has sought interested parties' views as to whether the above issue can be properly addressed in the time remaining for the finalising of its decision in May 2007, in response, the ENA considers the issue can and should be properly addressed in the time remaining. Firstly, the identified bias in the real risk-free rate will have a considerable impact on revenue adequacy and maintaining efficient investment signals, this is not an 'on the fringes' issue. Secondly, the NERA report has provided compelling evidence that a bias within the real risk-free rate exists. Thirdly, the bias with the risk-free rate is not an issue at its infancy stage, this bias has been identified by various parties including within the United Kingdom, United States and by the Essential Services Commission in Victoria, RBA as well as within academic research.

ENA strongly urges the AER to address this essential issue and incorporate the findings within its Powerlink final decision in May 2007. If you would like any further information on the above matters, please contact me on (02) 6272 1555.

Yours sincerely



Garth Crawford
Acting Chief Executive Officer