

EnergyAustralia™

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Dear Mr Buckley

Bias in the measurement of the real risk free rate

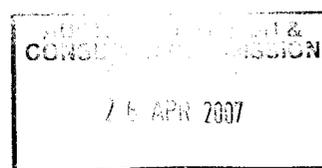
I welcome this opportunity to provide the AER with EnergyAustralia's response to the issues raised in Powerlink's supplementary submission and the attached NERA paper.

Having reviewed the submission and NERA paper, EnergyAustralia is convinced that there is compelling evidence that the difference between the nominal and indexed government bonds has been, and is being, systematically influenced by business decisions unrelated to the hedging of inflation risk. This being the case, ongoing use of the yields of both bonds without adjustment for the market's expectations of inflation is flawed.

The fact that such observations have been made domestically and internationally by respected and authoritative bodies provides further support to the observations and analysis contained in NERA's report. Further, regulatory bodies domestically and internationally have recognised that such a systematic measurement error must be corrected due to the material financial impact on the regulated businesses. The mounting body of evidence and regulatory precedent must not be ignored by the AER now that it has been raised.

Ignoring this information might be considered akin to the material error made by the ACCC in not accepting relevant information provided by TransGrid regarding the systematic bias in setting the debt margin based on CBASpectrum data. It would be a material error in the AER's process to fail to consider relevant information that identifies systematic errors in the measurement of key parameters.

The AER's objective of world's best practice regulation should motivate it to consider all relevant information presented to it and to make reasonable enquiries regarding the validity of such information. It should do this even if it initially appears to have an immaterial effect on the financial outcome. Only when the AER has fully informed itself regarding the information put before it can it conclude whether the information is irrelevant. The integrity of this process should not be compromised.



Partner

In this case, the financial effect on Powerlink appears to be material. Thus, the AER choosing not to accept Powerlink's proposal would likely not only compromise the AER's best practice regulation objectives, but also Powerlink's financial performance. It could only be considered a failure or error in the regulatory process and decision making. Hence, EnergyAustralia is pleased that the AER has recognised that this issue poses significant implications for not only the outcomes of the decision but also the process by which that decision is made.

Therefore EnergyAustralia submits its support to the analysis contained in the NERA paper and commends it for the AER's consideration. On the separate question specifically asked by the AER of whether there is sufficient time to consider the matter, EnergyAustralia's view is that time must be made to consider the issue. Failure to adequately consider such a measurement issue would be a failure of process. I recognise that there may be future work required to develop a regulatory policy in this regard that can be applied beyond the Powerlink revenue cap decision, however the requirement for such future work should not preclude the matter being recognised in the AER's final revenue cap decision for Powerlink.

If you have any queries regarding this submission please do not hesitate to contact me on (02) 4951 9411.

Yours sincerely,



Geoff Lilliss
Executive General Manager Network