

The required rate of return for the RCM method applied to PEXA

Report prepared for PEXA

Professor Stephen Gray

31 July 2026

Contents

1	Executive summary	3
1.1	Author of report	3
1.2	Instructions	3
1.3	Summary of conclusions	3
2	Implementations of the recovered capital method in this case	5
2.1	The mechanics of the recovered capital method	5
2.2	Alternative implementations of the RCM in this case	5
2.3	The role of the rate of return in the RCM	6
2.4	'Target' versus 'expected' returns	7
2.5	Implied probability of failure	8
3	The RCM analysis in IPART's <i>Draft Report</i>	10
3.1	The RCM analysis in the <i>Draft Report</i>	10
3.2	The 'portfolio returns' argument	10
3.3	The 'low risk of failure' argument	12
3.4	The scenarios considered in the Draft Report	15

1 Executive summary

1.1 Author of report

1. This report has been authored by Professor Stephen Gray. I am the Malcolm Broomhead Chaired Professor of Finance at the UQ Business School, University of Queensland and I am a Director of Frontier Economics, a specialist economics and corporate finance consultancy.
2. I have Honours degrees in Commerce and Law from the University of Queensland and a PhD in Financial Economics from Stanford University. I teach a range of courses in finance, corporate valuation and econometrics. I have published widely in high-level academic journals, and I have more than 25 years of practical finance consulting experience.
3. My teaching, research and consulting experience extends to issues relating to required returns and the weighted-average cost of capital (WACC). I have published widely in the areas of financial econometrics and empirical finance, including papers in relation to the estimation of discount rates. I have also prepared numerous reports for firms and regulatory bodies relating to the estimation of required returns and the WACC.

1.2 Instructions

4. IPART has recently published its *Draft Report* on Electronic Lodgment Network Operator service fees.¹ Among other things, the *Draft Report* implements a Recovered Capital Method (**RCM**) calculation of the initial Regulated Asset Base (**RAB**) to apply to PEXA, rejecting the implementation of the RCM proposed in the PEXA submission.
5. I have been asked to set out my views on the implementation of the RCM adopted in the *Draft Report* and on the reasons identified for rejecting PEXA's proposed implementation.

1.3 Summary of conclusions

6. My key conclusions are as follows:
 - (a) In accordance with standard commercial and regulatory theory and practice, the required return should always be commensurate with the risk involved.

Consistent with this principle, when implementing the RCM, the PEXA submission and the *Draft Report* both adopt rate of return paths that involve returns that reduce over time. Both identify that the risk of the PEXA business failing was higher during the initial start-up phase, with that risk reducing over time as the PEXA business developed. Both adopt higher initial returns to reflect the higher initial risk.
 - (b) In the case at hand, the key risk is that the PEXA business might fail and any investment would be lost. Within this context, I show how the proposed return at any point in time can be used to compute the implied probability of failure at that point in time.

I show that, during the initial start-up phase of the business, the PEXA submission implies a 1 in 3 chance of failure and the *Draft Report* considers a number of scenarios including one with a 1 in 4 chance of failure.
 - (c) There are several reasons to indicate that the risk of failure was high during PEXA's initial start-up phase, including that previous attempts to build eConveyancing businesses in Australia—including attempts that benefited from financial support and investment from

¹ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*.

government—had failed and no eConveyancing business exists anywhere else in the world.

(d) The *Draft Report*:

- (i) Contains no analysis and provides no estimate of what IPART considers the risk of failure to be;
- (ii) Performs no calculation of the failure risk that is implied by its various rate of return scenarios; and
- (iii) Performs no assessment of whether the implied failure probabilities are reasonable or even plausible.

(e) Rather, the *Draft Report*:

- (i) Takes issue with the framework that PEXA used as the basis for computing the required returns in its proposed RCM analysis – without proposing a different implementation or an alternative framework for determining those returns;
 - (ii) Appears to confuse the concepts of an ex ante ‘target’ or ‘required’ return on early-stage ventures with the average observed return on a portfolio of such investments – and the relevance of each to the implementation of the RCM; and
 - (iii) Provides a number of conjectures for why the risk of failure for PEXA might have been lower than for the average start-up venture – without testing those conjectures or quantifying the effect that those conjectures, if true, might have on the rates of return that should be used in the RCM analysis.
- (f) In my view, the *Draft Report* falls well short of the usual standard of regulatory decisions. Particularly in the circumstances of a draft decision that proposes a very substantial reduction to the allowed revenues that the regulator has previously approved.

2 Implementations of the recovered capital method in this case

2.1 The mechanics of the recovered capital method

7. IPART's *Draft Report* explains the implementation of the RCM as follows:

The recovered-capital method tracks, year by year, how much of the expenditure on PEXA Exchange remains unrecovered from subscribers. Each year it sets that expenditure against the revenue PEXA Exchange earned, and carries the running balance of unrecovered expenditure forward with a return that reflects the time value of money. The balance at any point shows how much of the historical investment in PEXA Exchange has not yet been recovered at that time.

The method builds up this balance one year at a time. In each year:

- 1. We start with the unrecovered balance carried over from the previous year (the opening capital base).*
- 2. We apply a return to that opening balance at the current year's rate of return (WACC). This reflects that the opening balance is investment that has not yet been returned, and so has a time value.*
- 3. We then add the year's expenditure (capital expenditure, operating expenditure, and net tax liabilities) and subtract the year's revenue and any proceeds from asset disposals.*
- 4. The result is the closing capital base for that year, which becomes the opening balance for the next year.*

In any year, where expenditure and the return on the opening balance together exceed revenue and disposal proceeds, the balance rises. Where revenue and disposals are greater, the balance falls.²

8. I agree with IPART's explanation of the RCM above. The RCM is a mechanical calculation that requires a number of inputs including cash flows, depreciation charges and assumptions about rates of return.

2.2 Alternative implementations of the RCM in this case

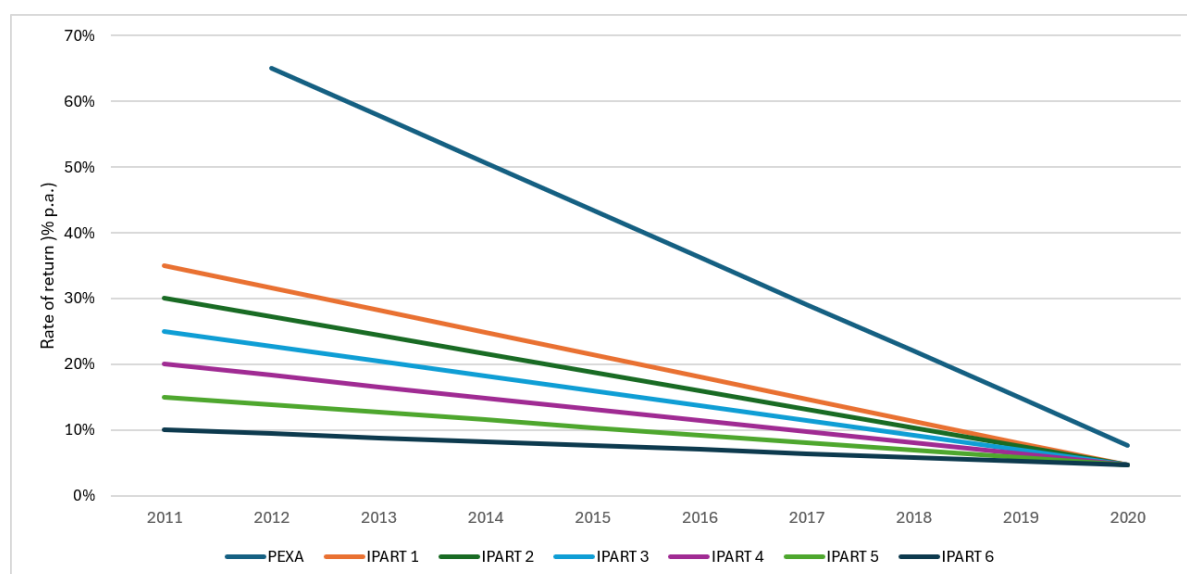
9. A number of different implementations of the RCM are available in the case at hand:
- (a) The PEXA submission of May 2026 contains an implementation of the RCM;³ and
 - (b) IPART's *Draft Report* sets out a number of implementations of the RCM, differing in terms of the rates of returns that have been used in the calculations.
10. The primary difference between the various implementations of the RCM is the series of annual rates of return that have been adopted.⁴ The various rate of return paths are summarised in Figure 1 below.

² IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 73.

³ PEXA, May 2026, *PEXA submission to IPART Methodology Paper*, pp. 16-18.

⁴ There are other differences between the PEXA and IPART implementations relating to the cash flow inputs, however the primary driver of differences in the outputs of the RCM calculation are the different rates of return that have

Figure 1: Rate of return paths used in RCM calculations



Source: PEXA, May 2026, PEXA submission to IPART Methodology Paper, p. 17; IPART, July 2026, Draft Report: Electronic Lodgment Network Operator service fees, Table 7.1, pp. 76-77.

11. The differences between the proposed rate of return paths are:
 - (a) PEXA's initial rate of return is materially higher than any of the alternatives considered by IPART;
 - (b) PEXA has adopted an 'indicative' 2020 regulated rate of return of 7.6% whereas IPART has adopted the actual regulated rate of return of 4.6% using market information available as at 2020; and
 - (c) There is a minor difference in the way timing is interpreted whereby:
 - (i) IPART includes a rate for FY2011 and applies that rate to cash flows from within that year; whereas
 - (ii) PEXA first records a rate of return for FY2012 and applies that rate to inflate cash flows from FY2011 to the end of FY2012.
12. The key difference is the initial rate of return that is applied in 2011 and 2012, respectively. This is because the returns applied to subsequent years (under both the PEXA and IPART approaches) are linear interpolations between that initial rate of return and a (relatively similar) ending point return for 2020. Consequently, I focus on the rate of return for the initial years when PEXA was an early-stage venture.

2.3 The role of the rate of return in the RCM

13. Implementation of the RCM requires an estimate of the rate of return that would reasonably be required by investors in the business in question in each year of the analysis.
14. A basic principle that underpins both commercial practice and normal regulatory settings adopted by IPART when regulating other industries is that the required rate of return should reflect the risk of the investment in question. Thus, the relevant task is an estimate of the return that investors might reasonably require from an investment in a business such as PEXA in each year of its

been adopted. For this reason, and also because I have been asked to focus on the basis for the rates of return that are used in the RCM calculations, the remainder of this report considers the different rates of return that have been adopted.

development. That, in turn, will depend on the risk that investors would bear on their investment in each of the relevant years. To the extent that the risk changes over time, the required return would be expected to change accordingly.

15. PEXA and IPART appear to agree that the risk, and consequently the required return, was materially higher in 2011 (when PEXA was a very early stage start-up business) than it was in 2020 (by which time PEXA was operational, had captured significant market share and become subject to economic regulation).
16. PEXA and IPART also appear to agree that the primary reason for the higher risk (and the commensurately higher required return) early in PEXA's life is due to the possibility that the business might fail, resulting in complete loss of the investment.

2.4 'Target' versus 'expected' returns

17. At this point, I consider it useful to develop a simple framework, and to define some terms, to explain the relevance of the risk of the business failing to returns used in the RCM framework. In particular, I consider the case where:
 - (a) When the business becomes established with a very large market share and mandates from relevant authorities (i) there is no material chance of failure, and (ii) the business becomes subject to formal regulation the regulatory allowed return is set on that basis. This occurred in 2020 in the case at hand; and
 - (b) Prior to formal regulation, there is a risk of failure, but that risk is entirely non-systematic. That is, the possibility of failure is unrelated to the state of the economy – it is no more likely that the business would fail during a recession than during an economic boom. This would be the case, for example, where failure might result from technological problems with the platform rather than from adverse economic conditions. In this case, the 'expected' return required by investors will be the same as the regulatory allowed return – because the risk of failure is not systematic and has no impact in beta.
18. I define the 'target' return to be the return that would be earned, conditional on the venture succeeding. That is, if the venture succeeds and generates cash flows in line with forecasts, that is the rate of return that will be earned.
19. There is an obvious relationship between the target return, the probability of failure and the expected return. The PEXA submission sets out an example whereby a target return of 57.1% and a 30% probability of failure produce an expected return of 10%.⁵ In this case, there is a 30% chance of failure and loss of the investment and a 70% chance of success and achievement of the target return of 57.1% such that the expected return is the probability weighted average of the two outcomes:

$$\begin{array}{l} \textit{Expected} \\ \textit{return} \end{array} = 30\% \times -100\% + 70\% \times 57.1\% = 10\%.$$

20. In the context of an RCM calculation, the 57.1% figure in the above example is the required return (for the relevant year) that (in light of the probability of failure in that year) produces an ex ante expected return of 10% – which is an estimate of the fair return that would be required in the case where there is 0% chance of failure.
21. That is, having determined that:
 - (a) 10% would be a fair return in the absence of any chance of failure; and

⁵ PEXA, May 2026, *PEXA submission to IPART Methodology Paper*, pp. 19-20.

(b) There is a 30% chance of failure in this case,

it is a mechanical calculation to derive the allowed return of 57.1% that would be required to match the 10% expected return.

22. I note that it is the target rate of return, computed in the manner set out above, that must be used as the allowed return under the RCM approach in the case where there is some prospect of the venture failing. The required return must be computed in this manner in order for investors to obtain the appropriate ex ante expected return.

2.5 Implied probability of failure

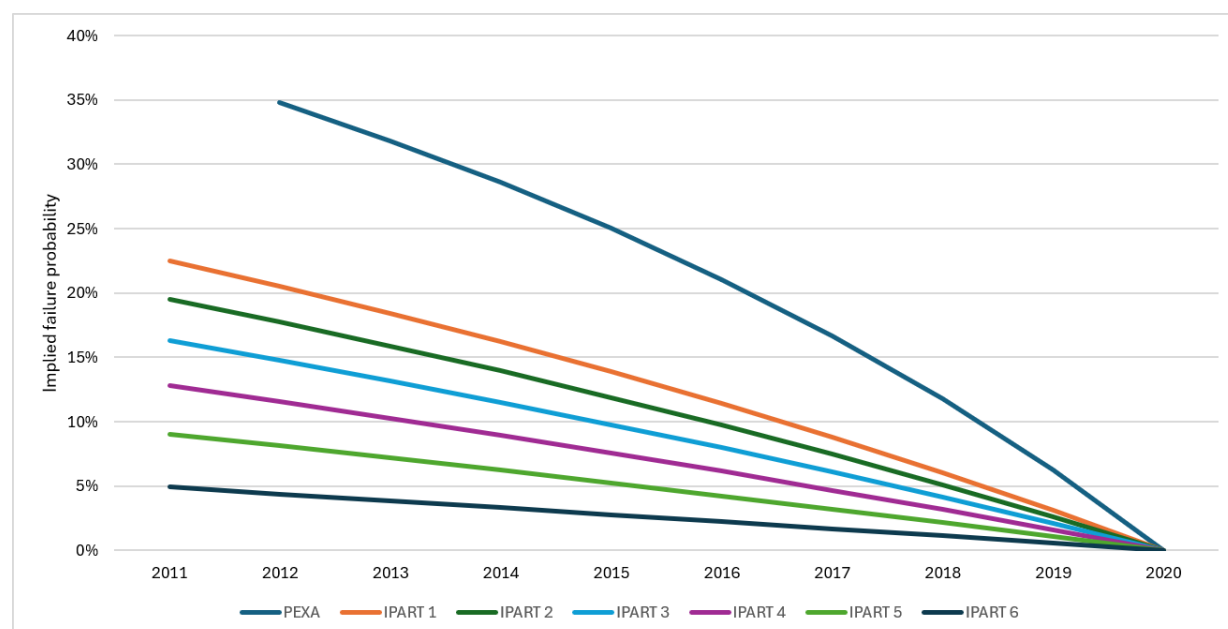
23. For a given allowed return, the expected return formula from above can be rearranged to compute the implied probability of failure. To compute the implied probability of default for each of the rate of return paths set out in Figure 1 above, I have:

- (a) Taken the 2020 'regulated' return as the appropriate expected return for each year; and
(b) I have solved for the implied probability of failure that produces that expected return for each point on the above rate of return paths.

24. The implied failure probabilities computed in this way are set out in Figure 2 below, which indicates that:

- (a) The probability of failure reduces over time as the PEXA business passes various milestones in terms of platform development, regulatory approvals, acquisition of market share and so on; and
(b) By 2020, the risk of failure had been reduced to zero such that the allowed return required no premium to compensate for the possibility of failure of the business.

Figure 2: Implied failure probabilities



Source: Frontier Economics calculations.

25. Figure 2 shows that:
- (a) The PEXA submission implies that the probability of failure in the first year of the venture was slightly less than 35%; and

(b) The IPART *Draft Report* implies first-year failure probabilities ranging between 5% and 23%.

26. In the next section of this report, I consider the reasonableness of those failure probabilities and other aspects of IPART's implementation of the RCM in its *Draft Report*.

3 The RCM analysis in IPART's *Draft Report*

3.1 The RCM analysis in the *Draft Report*

27. The key element of the RCM analysis that is presented in the *Draft Report* is the rate of return paths that are summarised in Figure 1 above. As explained above, the rate of return for each year implies a unique probability of failure for that year – as set out in Figure 2 above.
28. However, the *Draft Report*:
 - (a) Contains no analysis and provides no estimate of what IPART considers the risk of failure to be;
 - (b) Performs no calculation of the failure risk that is implied by its various rate of return scenarios; and
 - (c) Performs no assessment of whether the implied failure probabilities are reasonable.
29. In my view, this falls well short of the usual standard of regulatory decisions. Particularly in the circumstances of a draft decision that proposes a very substantial reduction to the allowed revenues that the regulator has previously approved.
30. Rather, the *Draft Report*:
 - (a) Takes issue with the framework that PEXA used as the basis for computing the required returns in its proposed RCM analysis – without proposing a different implementation or an alternative framework for determining those returns; and
 - (b) Provides a number of conjectures for why the risk of failure for PEXA might have been lower than for the average start-up venture – without testing those conjectures or quantifying the effect that those conjectures, if true, might have on the rates of return that should be used in the RCM analysis.
31. I address each of these shortcomings in the remainder of this section.

3.2 The 'portfolio returns' argument

32. The PEXA submission cites a number of studies that document the 'required' or 'target' rates of return that are used for venture capital investments into early-stage ventures.⁶ The majority of these studies indicate that target rates of return are 50-70% for start-up or seed capital investments and 40-60% for first-stage or early development investments.
33. These are 'target' rates of return. For example, these returns might be used to discount a series of forecasted cash flows back to present value to determine the value of the initial investment. Thus, if the venture succeeds and generates cash flows in line with the forecasts, the investor will have earned the target rate of return.
34. These are not expected or average returns across a portfolio of venture capital investments, these are the sorts of returns that will be earned only on that subset of ventures that succeed. There will, of course, be another subset of investments that fail and which generate a return of -100% (i.e., a complete loss of the original investment). As explained above, the expected or average return across a portfolio of such investments will be a weighted average of the -100% return that

⁶ PEXA, May 2026, *PEXA submission to IPART Methodology Paper*, pp. 20-21.

is delivered on the failed ventures and the relevant target returns that are delivered on the successful ventures.

35. Thus, the average observed returns generated on a portfolio of venture capital investments will be materially lower than the target returns – because the former is an average over successes and failures and the second is conditional only on success. Damodaran (2009), one of the studies cited in PEXA’s submission, makes this point as follows:

How do we know that these rates of return have survival risks built into them? In addition to the intuitive rationale that they decrease as firms move through the life cycle and the chance of failure drops off, the actual returns earned by venture capitalists at every stage of the process are much more modest.⁷

36. For the reasons set out above, it is the relevant target return that is required in the implementation of the RCM. Within the RCM regulatory setting, an investor makes an investment of capital into an early-stage venture, with some probability that investment is lost and the return is -100% and with some probability the investment succeeds and the investor receives the target return. This replicates what occurs in a commercial environment. In this case, the ex ante expected return on the investment is the probability weighted average of those two outcomes, which again replicates the commercial environment.
37. The PEXA submission proposes a particular target return, drawing upon estimates from the literature, for each stage of the investment lifecycle.
38. By contrast, IPART’s *Draft Report* states that:

First, venture-capital benchmark returns are portfolio returns. They reflect the performance of many investments, most of which return little or nothing, averaged with a small number of successes. The high average return compensates for the probability of failure across the portfolio, so applying it to a single investment that is known to have succeeded overstates the return that was required on that investment ex ante, because it applies the portfolio’s failure probability, with hindsight, to the surviving investment alone.⁸

39. In my view, the above paragraph is almost exactly wrong in almost every respect. In particular:
- (a) The reference to venture capital benchmark returns as being “portfolio returns” is incorrect. The return generated by a portfolio of investments is the weighted average return – averaged over the successes and failures in the portfolio. Observed portfolio returns might serve as an estimate of the ex ante expected return on such investments – because it factors in the relative chances of success and failure. However, the PEXA submission does not propose any role for expected/average portfolio returns and, for the reasons set out above, there is no appropriate role for such returns in the RCM approach. Rather, PEXA proposes that target returns should be used, which I consider to be entirely appropriate for the reasons set out above. That is, IPART is regulating a single business and the relevant rate of return should reflect the (ex ante) risk of failure of that business at each point in time;
 - (b) IPART then states that “the high average return compensates for the probability of failure across the portfolio.” That is also incorrect. It is the target return that must be high – in order that the returns generated on the successes ‘make up for’ the losses incurred on the

⁷ Damodaran, A., May 2009, “Valuing Young, Start-up and Growth Companies: Estimation Issues and Valuation Challenges,” NYU Stern School of Business working paper.

⁸ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 76.

failures. The observed average returns are more modest – as explained by Damodaran (2009) above;

- (c) IPART then appears to suggest that, because PEXA is known to have succeeded, there is no need to apply a higher target return to account for the possibility of failure. This is clearly incorrect. Returns, and failure probabilities, must be determined ex ante at the time of the relevant investment (which is annually under the RCM). For example, what is relevant when computing the RCM return for FY2011 is the ex ante probability of failure in 2011, assessed using information available in 2011 and not hindsight information from today. One cannot say that, because PEXA was known to have succeeded in 2020, it should be assessed as never having had any chance of failure.

40. In my view, to the extent that the last sentence in the passage above has any meaning at all, it is exactly wrong. It would, of course, be wrong to use the observed average return as though that were the target return. But that is not what PEXA has done. And even if PEXA had done that (which it has not) the correction would require an increase to the return that has been used.
41. Moreover, IPART's *Draft Report* sets out a range of rate of return paths, all of which begin in 2011 with a return materially higher than the regulated rate of return ultimately applied to FY2020, reducing to that regulated return over time. These return paths are designed to account for a risk of failure that reduces over time as the PEXA venture matures and passes various business development milestones. In this regard, the *Draft Report* states that:

*We agree that PEXA Exchange faced greater risk in its formative years than it does today, and that its risk profile changed over time. The systematic risks during development differ from those during ongoing operation, so a single, constant rate of return across all years is not necessary, and the rate should reflect the type of project PEXA Exchange was in its early years.*⁹

42. In this case, the key question is whether the return for each year properly reflects the (ex ante) risk of failure in that year. The *Draft Report* finds fault in the basis for PEXA's proposed returns. But even if the *Draft Report* is correct about that (which it is not – for the reasons set out above) standard regulatory practice would be to identify an alternative basis for determining the appropriate returns. But the *Draft Report* does not do that – it simply considers a number of alternative return paths “including several that apply an elevated return in the early years.”¹⁰
43. The *Draft Report* does not explain the basis for those alternative return paths or explain which, if any, IPART considers to be reasonable, or how it would determine the reasonableness of a particular return path.
44. This falls well short of standard regulatory practice – particularly in circumstances where allowed revenues are being reduced substantially relative to previously approved levels.

3.3 The ‘low risk of failure’ argument

45. IPART's *Draft Report* goes on to conjecture that the PEXA platform had a relatively lower risk of failure due to the involvement of government and major banks:

Second, we consider that PEXA Exchange's establishment did not carry the risk profile of an arm's-length seed-stage venture. The platform was established with government sponsorship and funding from major banks that were expected to be subscribers,

⁹ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 76.

¹⁰ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 76.

*which would be expected to reduce the probability of total failure, and to reduce adoption and stranding risk, relative to a typical seed-stage venture.*¹¹

46. However, the *Draft Report*:
- (a) Contains no analysis and provides no estimate of what IPART considers the (lower) risk of failure to be; and
 - (b) Performs no analysis of the failure risk that is implied by its various rate of return scenarios or any assessment of whether those implied failure probabilities are reasonable.
47. This also falls well short of the usual standard of regulatory decisions.
48. In relation to the ex ante probability of failure early in the life of this venture, the PEXA submission notes that:
- (a) Several Australian State governments had previously tried to set up eConveyancing platforms and failed, such as NECO (The National Electronic Conveyancing Office) in NSW and EVC (Electronic Conveyancing Victoria) in Victoria. EVC succeeded in creating a functional platform but was unable to drive market take-up and only ever conducted one transaction;¹²
 - (b) It was clear that industry participation in eConveyancing would be optional. ARNECC's consultation paper from July 2012 notes that *"...the decision to participate will be up to the individual member of the conveyancing industry. There is no present intention to make participation in National Electronic Conveyancing mandatory or to remove paper-based conveyancing."* Consequently, any emerging ELNO would itself need to create the market and drive adoption by demonstrating efficiencies and benefits to enough market participants to create critical mass. It could not expect regulatory support or mandates to create the market or drive adoption;¹³ and
 - (c) Several years after PEXA's platform gained widespread acceptance in Australia, no other country has implemented an eConveyancing platform – apart from PEXA's growing efforts in the United Kingdom to which investors are not yet ascribing significant value in PEXA's market valuation, given the risks as to whether the platform will become widely adopted.¹⁴
49. The PEXA submission also includes a summary of the development lifecycle, reproduced in Table 1 below.

¹¹ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 76.

¹² PEXA, May 2026, *PEXA submission to IPART Methodology Paper*, p. 21.

¹³ PEXA, May 2026, *PEXA submission to IPART Methodology Paper*, p. 21.

¹⁴ PEXA, May 2026, *PEXA submission to IPART Methodology Paper*, p. 21.

Table 1: PEXA development lifecycle

Year	PEXA's net cash flow (mill)	Mandates*	Share price (non-listed)	Market penetration	Phase
FY2011	-\$6		\$1.00	0%	Start up
FY2012	-\$37		\$1.22 -1.50	0%	
FY2013	-\$76		\$1.50 - \$2.80	0%	
FY2014	-\$ 120			0%	Solution build and market education
FY2015	-\$174		\$3.15	2%	
FY2016	-\$223		\$4.79	9%	
FY2017	-\$286		\$ 5.00	23%	Scale and gradual mandates
FY2018	-\$334	Refi: VIC, NSW, SA, WA Transfers: VIC	\$ 5.00	48%	
FY2019	-\$341	Transfers: NSW, WA	\$ 12.00 (privatisation)	68%	

Source: PEXA, May 2026, PEXA submission to IPART Methodology Paper, Table 3, pp. 21-22.

50. Table 1 shows that in the start-up phase of the development lifecycle:
- (a) Relatively small investments were made, largely to fund platform development;
 - (b) There were (obviously) no revenues or mandates as there was no fully developed, tested and certified platform; and
 - (c) The value of each share (which reflects the probability weighted average of the success and failure outcomes) was a small fraction of the price that was ultimately paid on privatisation.
51. Moreover, there are very strong network effects in ventures like the platform that was being developed by PEXA. Even if the technology is robust and the platform works well, it only has real value if it becomes the dominant mechanism for conveyancing transactions. For these types of platforms, once a critical mass of participants has adopted the platform it becomes costly and inconvenient for a participant to not also adopt the dominant platform. When both sides to a transaction are using the PEXA platform, the transaction completes seamlessly. But where one party does not use the PEXA platform, settlement requires PEXA *plus* another platform or a physical settlement exchange to occur. And it is not until a platform becomes the dominant mechanism that its use would become mandated. There is, of course, a risk that PEXA would *not* become the dominant platform – as has been the experience in Tasmania, the UK and everywhere else in the world. And as was the case with previous attempts to establish eConveyancing platforms in Australia.
52. The above features are all indicative of a material risk of failure during that early start-up phase and the *Draft Report* does not dispute that PEXA's investors faced higher risk during that early start-up phase:

*We agree that PEXA Exchange faced greater risk in its formative years than it does today, and that its risk profile changed over time.*¹⁵

¹⁵ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 76.

53. In this regard, I note that Figure 2 shows that the implied failure probability in the first year of PEXA's development is:
 - (a) 35% in the PEXA submission; and
 - (b) 23% in the highest scenario developed by IPART.
54. That is, the analysis and conclusions in the *Draft Report* imply that IPART considers that, in the first year of PEXA's development:
 - (a) A 1 in 3 chance of failure is so unreasonable as to be rejected outright; but
 - (b) A 1 in 4 chance of failure is sufficiently reasonable to be included among the scenarios considered.
55. However, the *Draft Report* contains no calculations or analysis or reasoning to support any conclusions about the reasonableness of any failure probabilities. There is certainly no analysis to explain why the 'reasonableness' line would be drawn so precisely – somewhere between a 1 in 3 and a 1 in 4 chance of failure.
56. The only 'analysis' in the *Draft Report* is a conjecture that the involvement of government and major banks might indicate a relatively lower probability of failure. However, history is replete with examples of new ventures that failed despite having government backing and bank funding. Moreover, direct evidence on this point is available in relation to eConveyancing start-ups. Two attempts prior to PEXA had failed, both of which involved government support and bank funding. And even if government backing and bank funding *does* reduce the probability of failure below what it otherwise would have been, the *Draft Report* does not explain why, in light of those factors, a 1 in 4 probability of failure would be considered to be reasonable and a 1 in 3 probability would not.

3.4 The scenarios considered in the Draft Report

57. IPART has explained that the that the rate of return paths that were considered in the *Draft Report* explains were developed as follows:

*Even so, we have tested the cross-check under multiple rate-of-return paths, including several that apply an elevated return in the early years, declining linearly to the regulatory WACC as the platform became established. This reflects the greater risk of the formative years without importing portfolio-level venture capital returns that are not appropriate to a single investment.*¹⁶
58. That is, there is no indication that there is any analysis or evidence underpinning the various return paths other than that some begin with an "elevated" return to reflect "greater" risk. But what is the level of risk? And how much higher must the return be to properly account for that risk?
59. In my view, the return paths in the *Draft Decision* contribute nothing beyond showing that, under the RCM, a lower return path will produce a lower starting RAB. But that is already obvious.

¹⁶ IPART, July 2026, *Draft Report: Electronic Lodgment Network Operator service fees*, p. 76.