

**AER Draft Decision – ActewAGL
Consumer Challenge Panel
Response**

Pre- Determination Conference

9/12/2014

Presentation Overview

Section 1: Context

Section 2: Key Themes

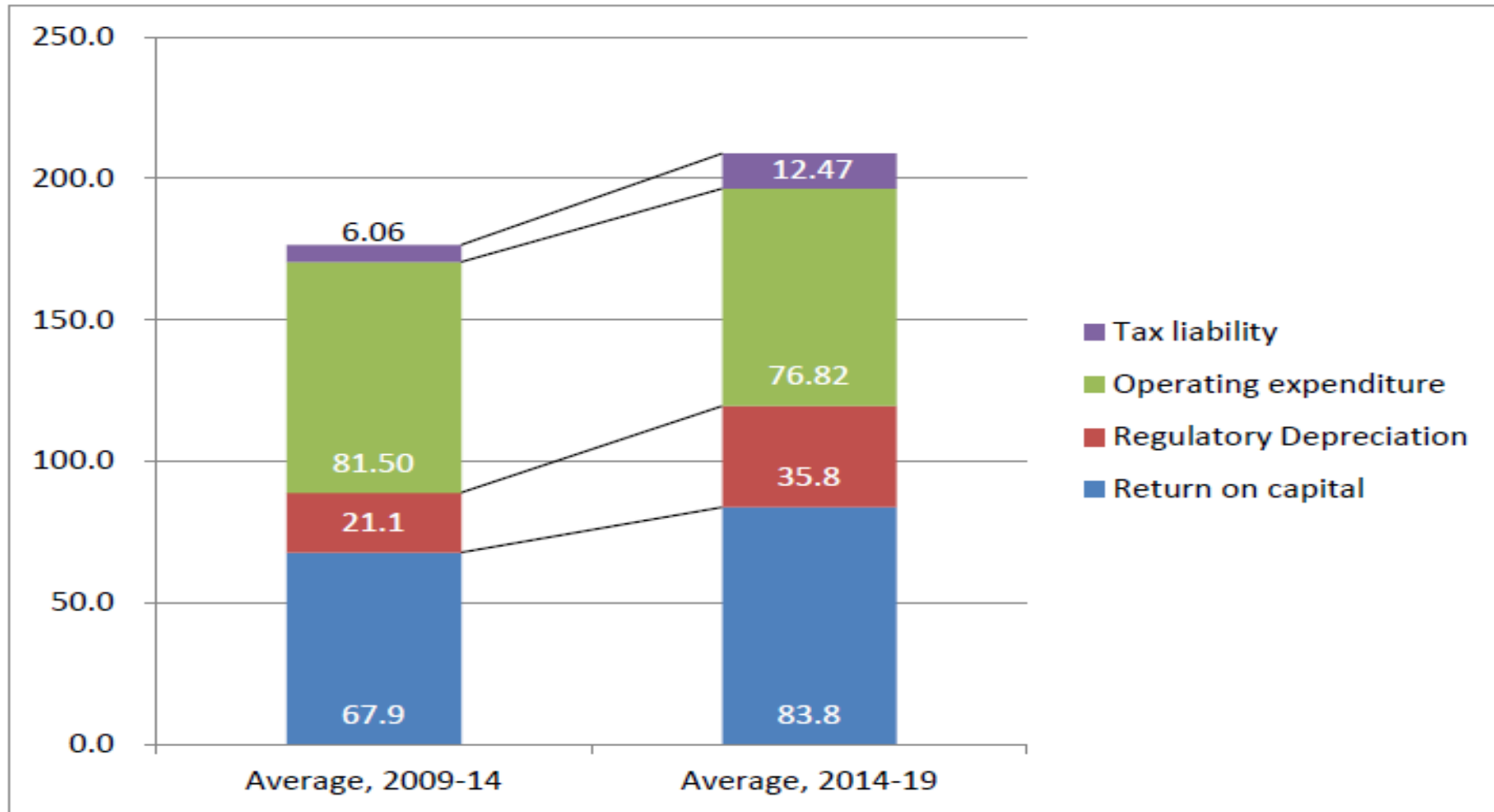
- Rate of Return
- Benchmarking and Efficiency
- Falling Demand
- Consumer Engagement

Section 2: Specifics

- Rate of Return
- RAB
- Oxex
- Capex
- Transition Period

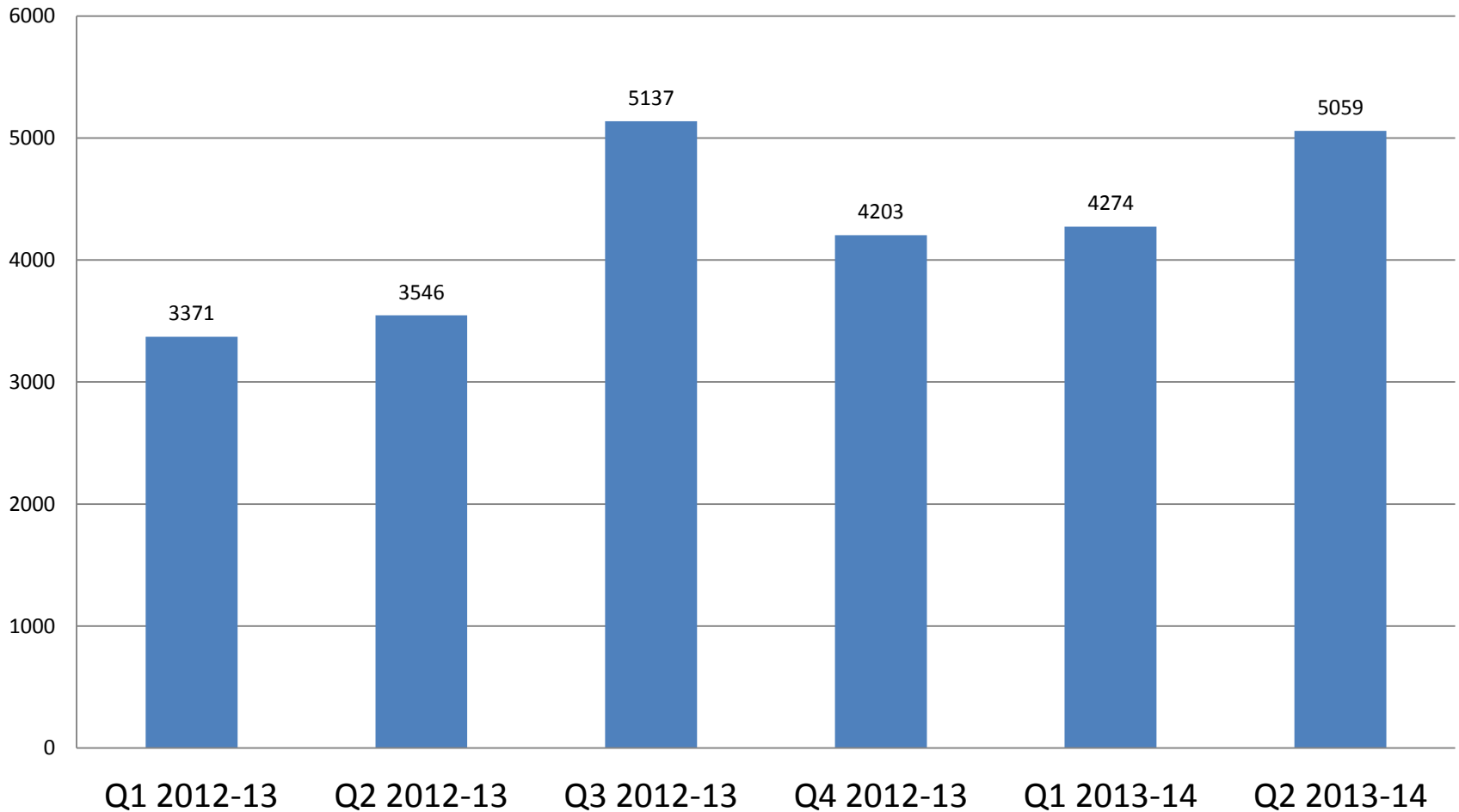
Context: 2009-14 cf 2014-19

Figure 0.5 Comparison of ActewAGL Distribution annual revenue requirement 2009-14 and 2014-19



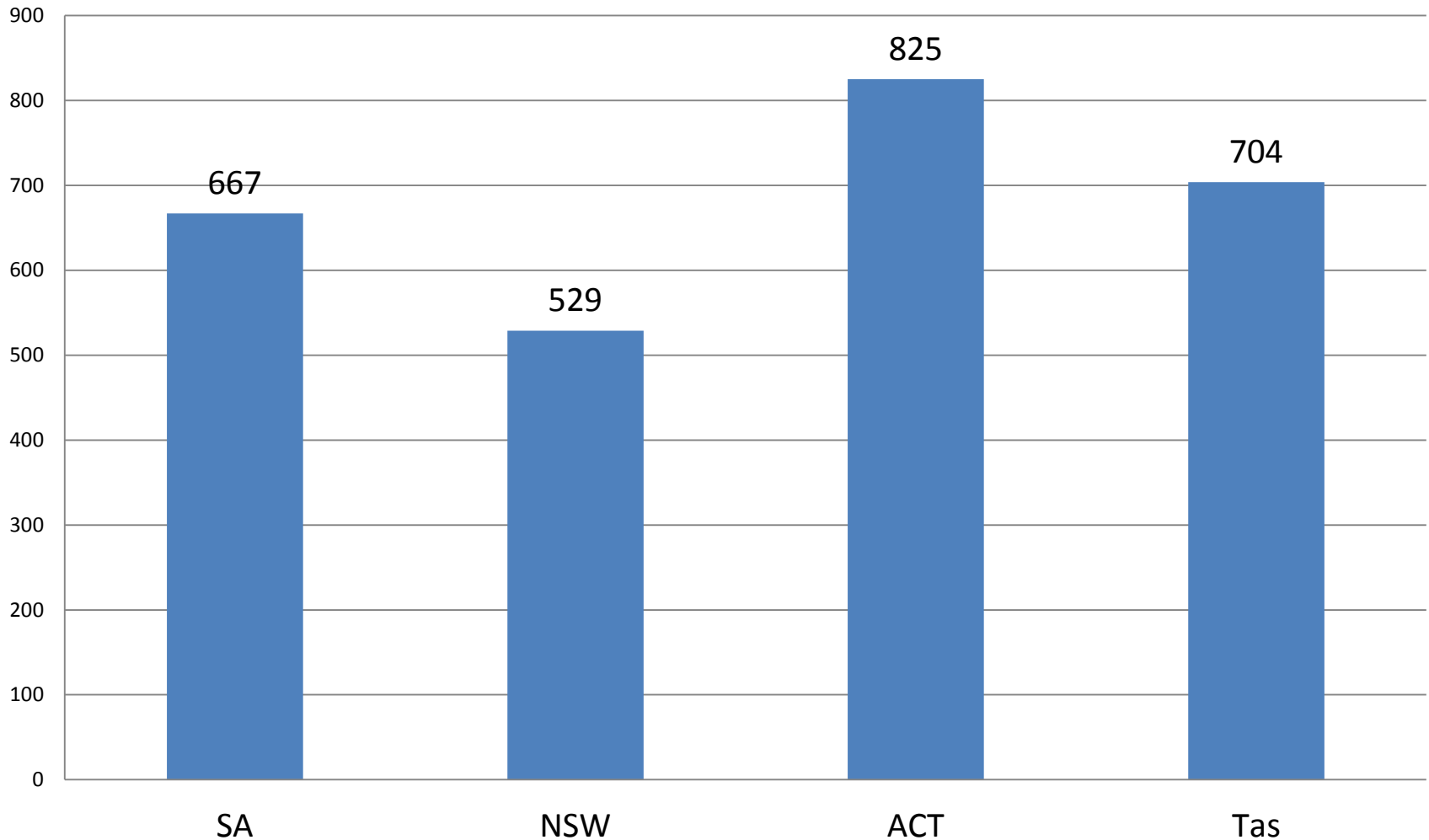
Impact?

Electricity customers with debt, ACT, by quarter





Impact

Average Debt of Households with Electricity Debt, \$, 2013-14

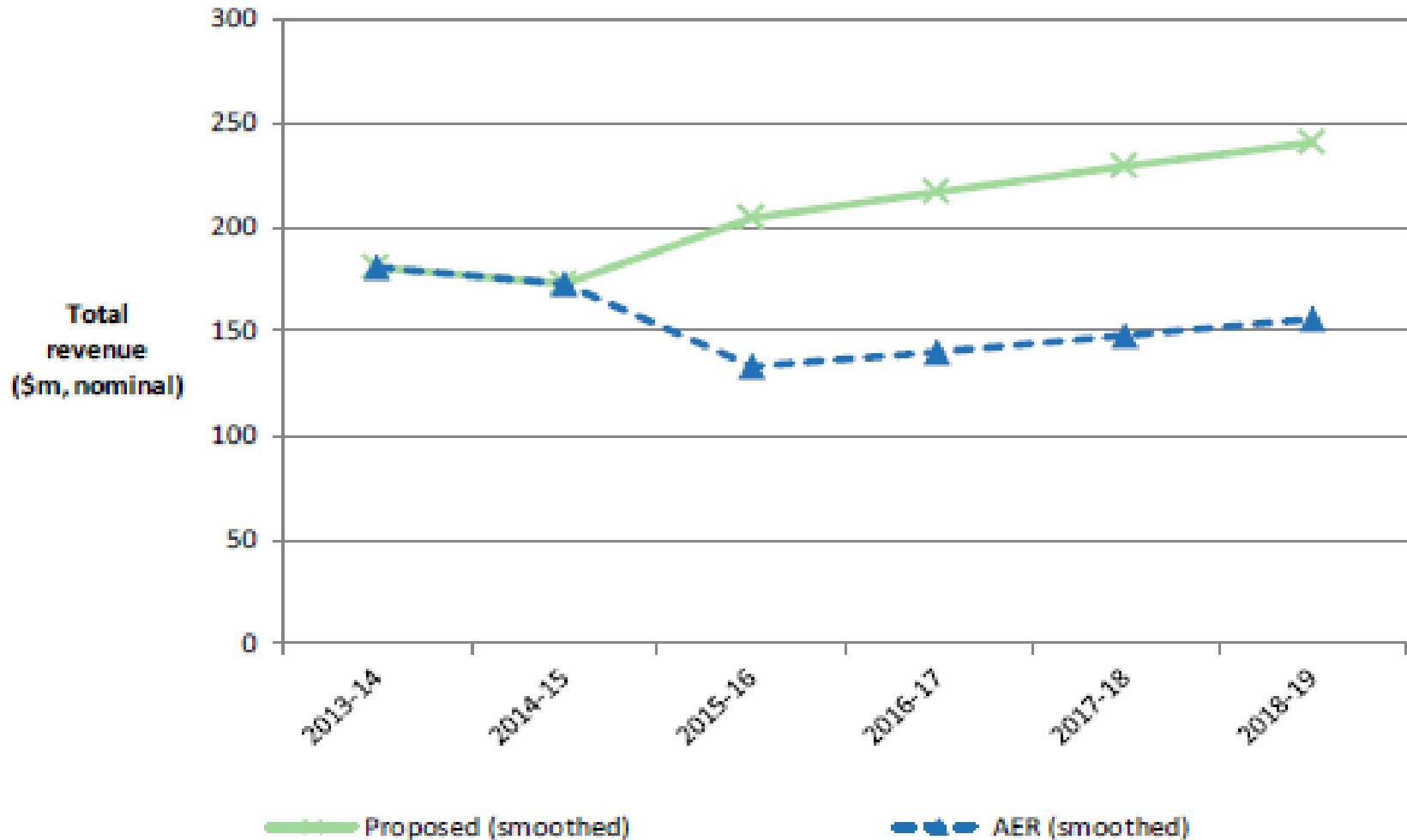


Key Draft Decisions

	ActewAGL Bid	AER DD
Rate of Return	8.99	6.88
Opex	\$383.5m	\$222.6
Capex	\$372.2	\$244.2
Ave Bill Impact	 \$118pa	 \$182pa

Revenues, ACT, 2014-19 – Proposed and DD

Figure 7.3 AER's draft decision on expected revenues compared with ActewAGL's proposed expected revenues for 2014-19 – distribution and transmission (\$ million, nominal)

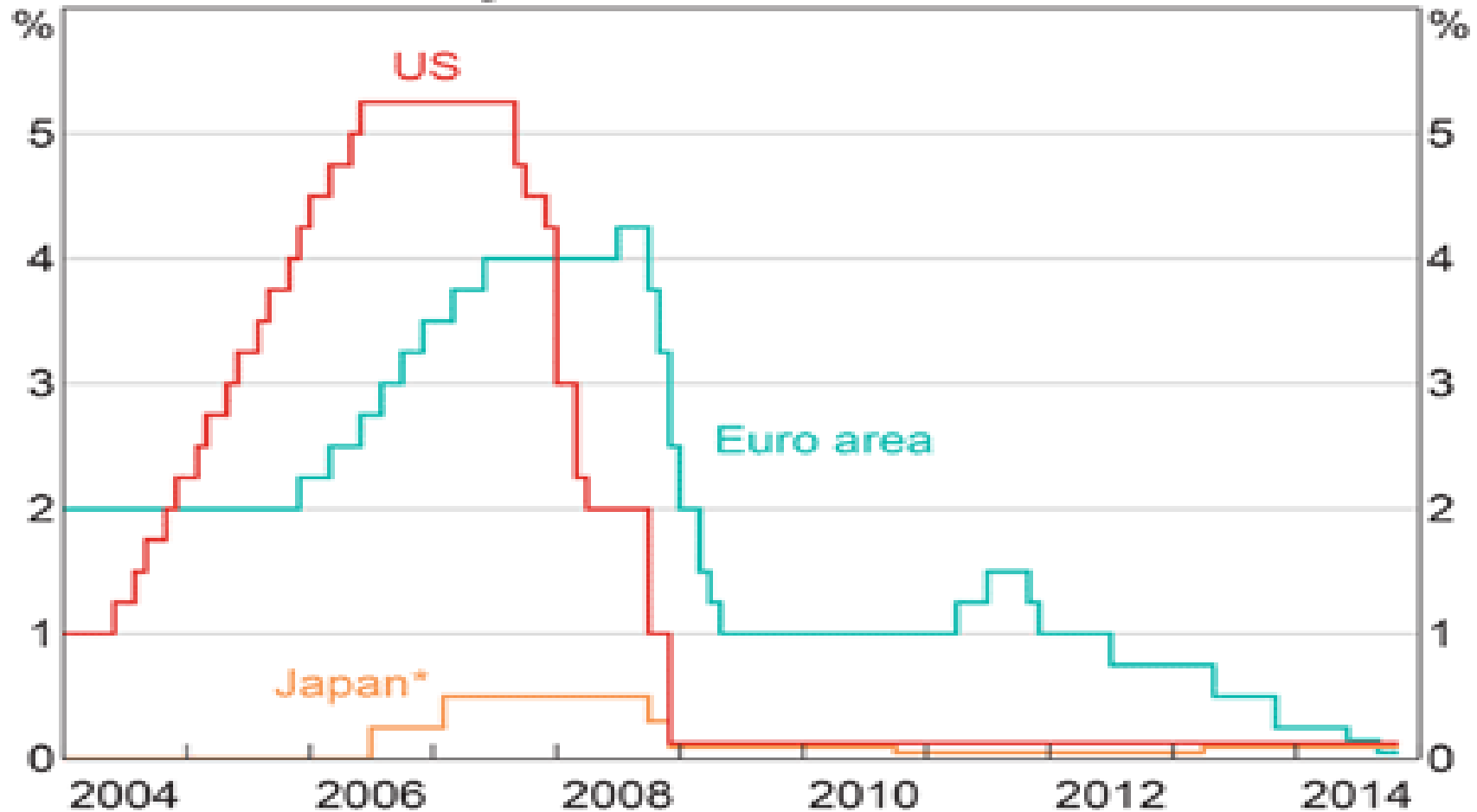


Draft Determination Key Themes: 1

- Much of the reduction from ActewAGL proposal is due to lower Risk Free Rate.
- Not reasonable to expect that the next regulatory period will lock in financial parameters from the GFC.

Interest Rates GFC and Now

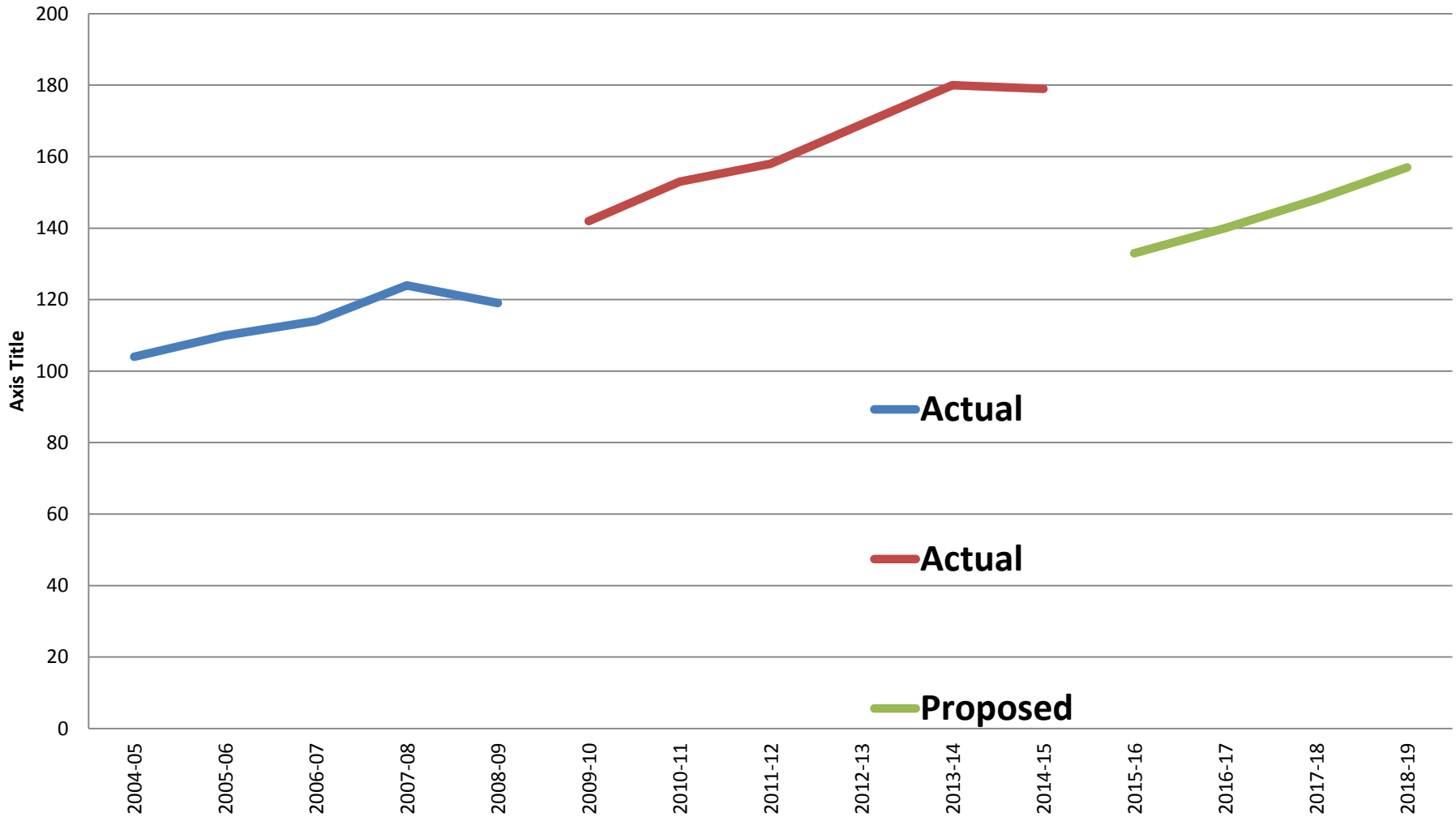
Policy Interest Rates – G3



* Since April 2013, the Bank of Japan's main operating target has been the money base

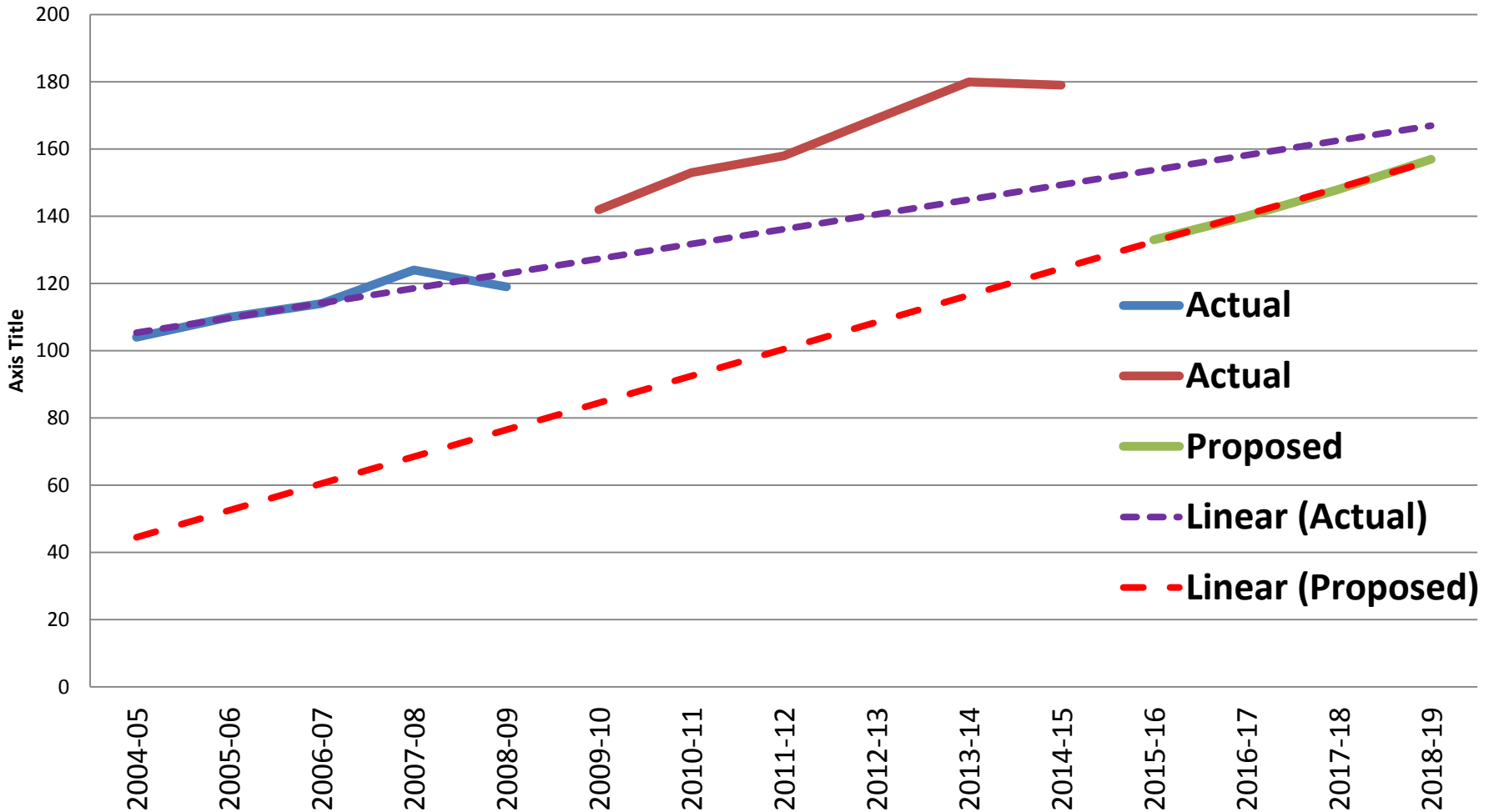
Source: central banks

ActewAGL: Total Revenue: 3 Reg Periods



Convergence?

ActewAGL Total revenue: 3 Reg Periods plus trends.



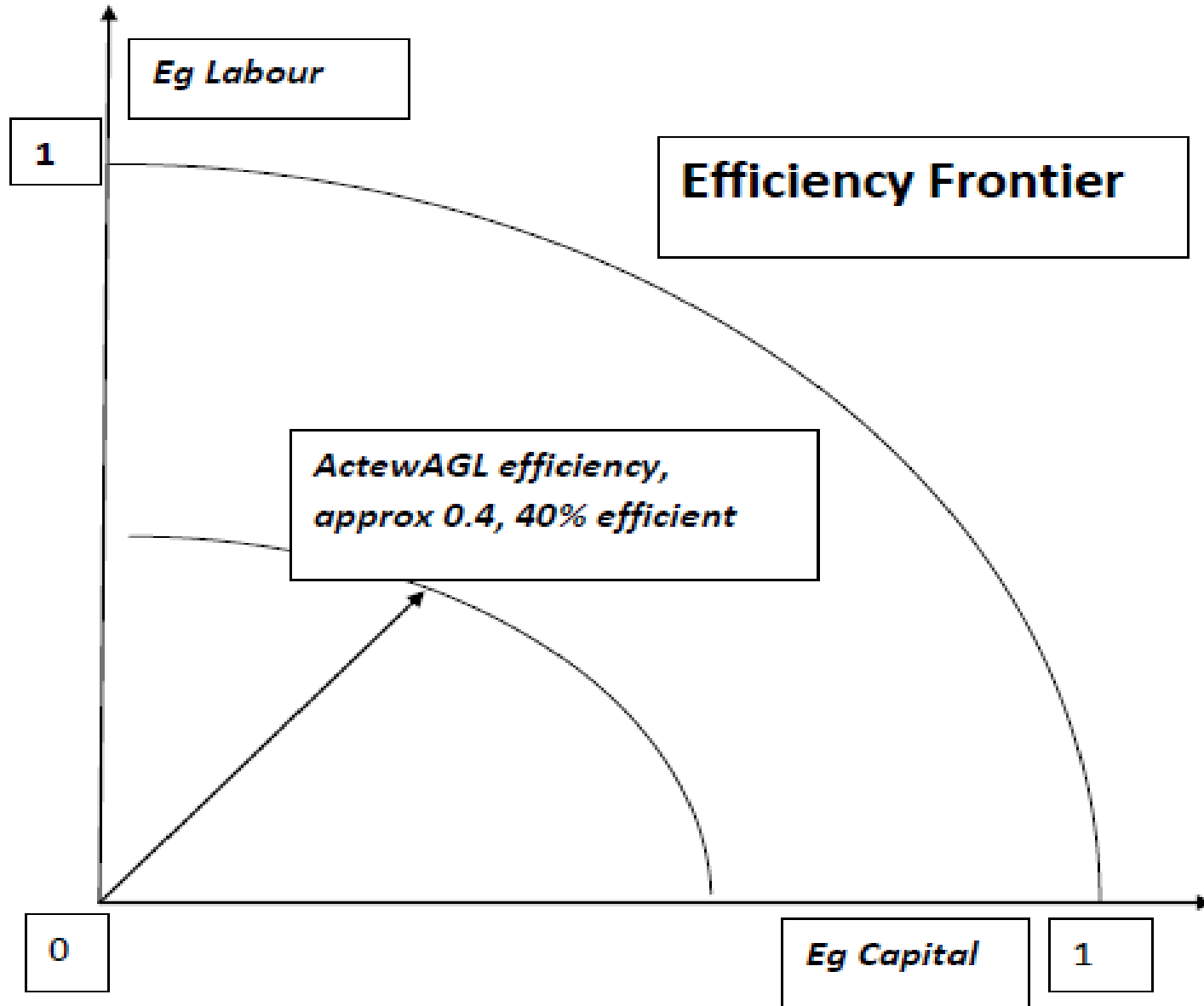
**Draft Determination, 2015 – 19 is
returning to the ‘natural’ order for
ActewAGL**

**The 2009-14 determination was
heavily influenced by the GFC – so
this period not an appropriate
starting point for 2015-19**

Draft Determination Key Themes: 2

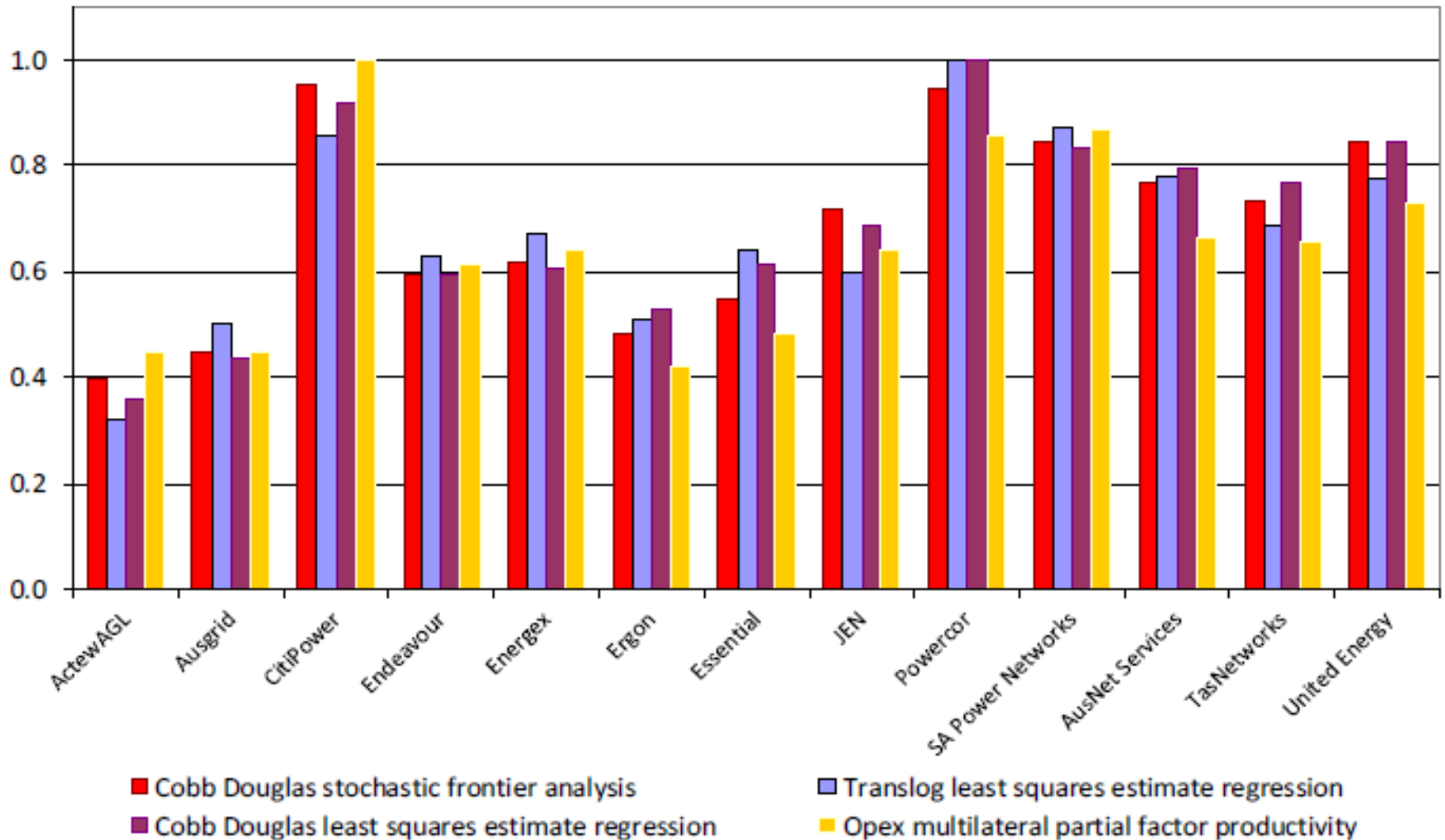
- Benchmarking report is useful and uses data from the businesses. Benchmarking has been promoted as an important guide to regulatory determinations, eg Productivity Commission 2012

Efficiency



Economic Efficiency: 4 approaches

Figure 8.6 Econometric modelling and opex MPFP results



**ActewAGL is considerable distance
from the 'efficiency frontier',
compared with Australian distribution
businesses**



Draft Determination Key Themes: 3

- Demand is falling, so not reasonable to expect capex and opex to increase. Indeed, consumers who can have been voting with their feet about electricity prices and looking to leave / reduce network dependence, ie through going to PV.

Draft Determination Key Themes: 4

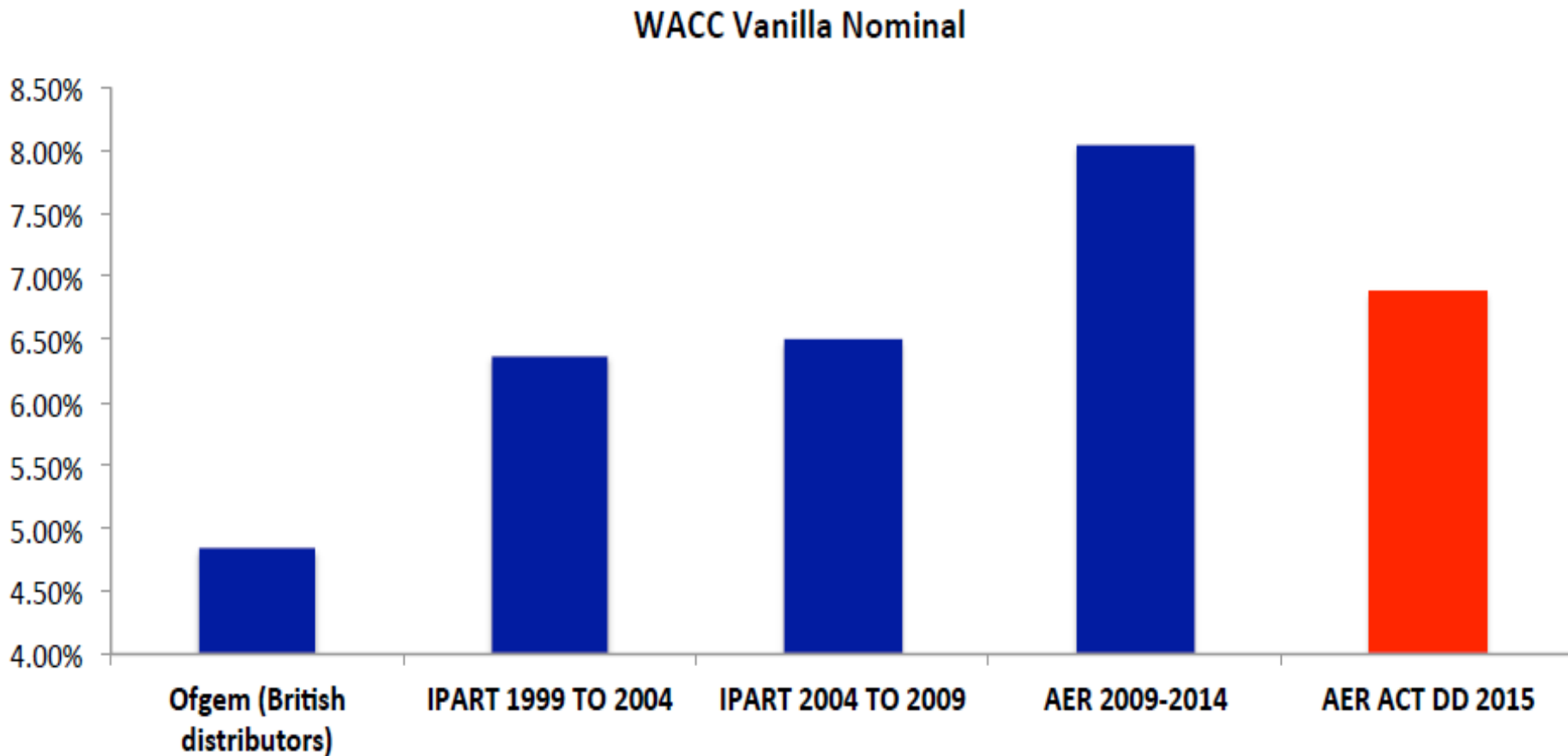
- Consumer Engagement didn't justify increases

Key Draft Decisions

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Specific aspects of Draft Determination

WACC: some progress still higher than IPART and even more so Ofgem. Why ?

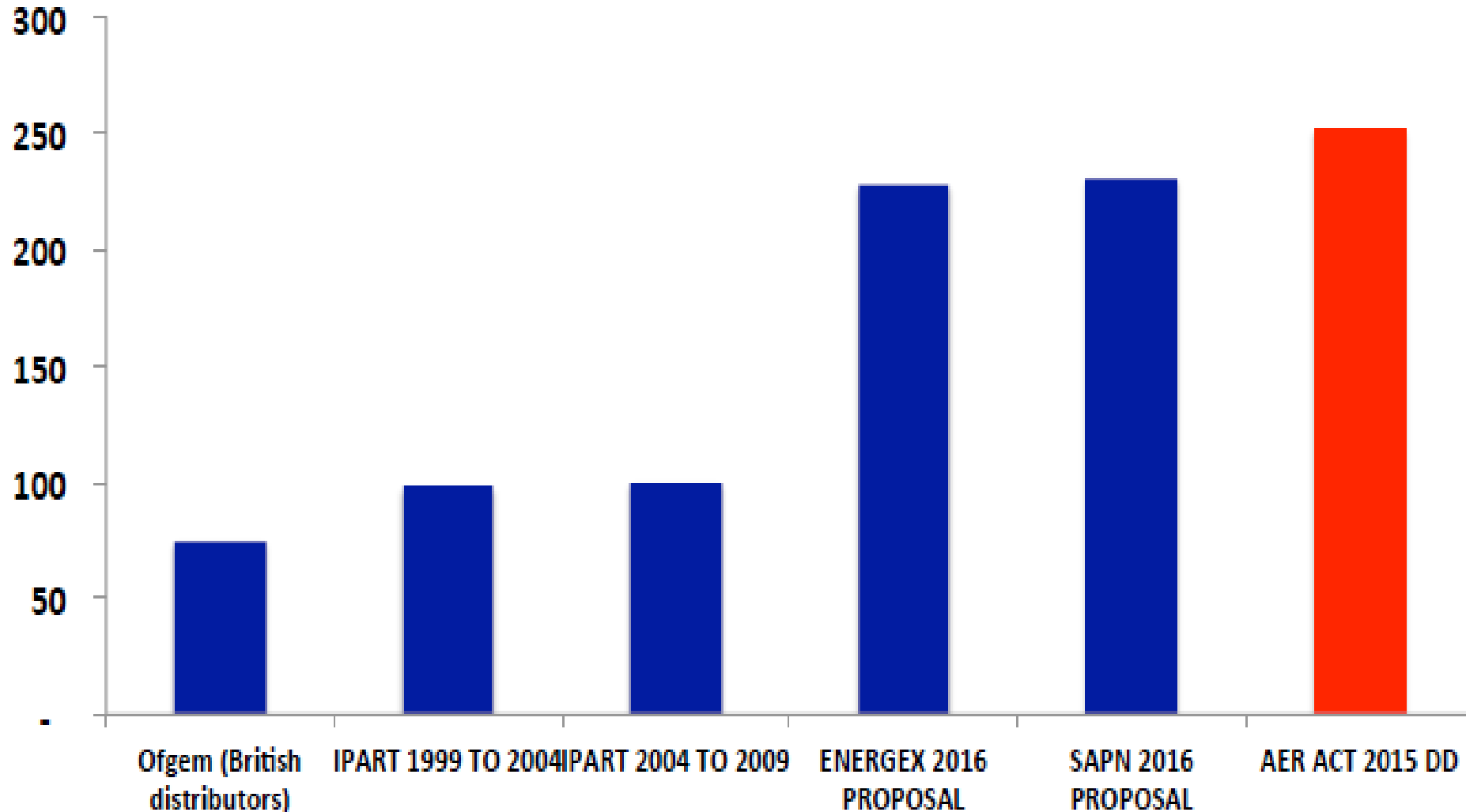


* All Australian decisions rebased to use consistent 2014 Risk Free Rate

DD Debt allowance is particularly problematic

Basis points

Debt Margin (nominal debt less nominal RFR)



Still Room for Lower Rate of Return

Return on Equity

- Market Risk Premium 6.5%
- Equity Beta 0.7

Could be lower

Return on Debt

- Gamma (imputation credits) 0.4 (from 0.5)
Tax allowances higher than actual tax paid
- Debt Margin: about 150 basis points too high

Regulated Asset Base (RAB)

- RAB 2009 -10: \$598.7m
- RAB 2018-19: \$935.8m:

57% increase in a decade with declining demand.

OPEX

We agree:

- Wrong Base Year (2012-13)
- Step changes proposed are discretionary business decisions.

Need to move to more efficient operations as per benchmarking report. We note “30% allowance for operating environment differences” and benchmarked against 75%+ efficient firms. Generous, from a consumer perspective

CAPEX

We agree with:

- Lack of examination of alternative options for major Capex proposals
- Full Repex proposal “overstated”

Draft Determination Capex revision is ‘About right.’

Transitions

The AER has asked about Transitions or “Glide Path.”

We think about the issue of transition from three perspectives: efficiency, equity and financing ability.

- Efficiency: arguments for or against a transition of whatever (debt, opex etc.) are not strong either way
- Equity: there can be no doubt that it is unreasonable to ask consumers to pay for management’s failures
- Financing Ability: Substantial revenue over recent periods means no issue here.

No strong argument for a transition that effectively gives ActewAGL (and other db’s) more revenue.

Summary of key points

- From CCP's perspective, AER Draft Determination should set the high water mark for revenues, assets, WACC and expenditure. Compromises have already been made, by consumers, and back-tracking from here would be unwise.
- Allowance for Debt is too high. Calculations that do not reflect actual DNSP borrowing costs (BBB) are flawed. The AER must have regard to actual borrowing costs.
- Opex and capex allowance seem roughly reasonable although some "adjustments" to the benchmarking to narrow the VIC-ACT gap is problematic and needs to be addressed.
- ActewAGL has been shown to accept significant inefficiencies that consumers have been paying for years. Shareholders, not consumers, must bear the consequence of inefficiency.