# SUBMISSION

## AER RATE OF RETURN INSTRUMENT

### 19 DECEMBER 2025

## INTRODUCTION

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our members are the engine room of the Australian economy, producing many of the products that households and business use every day including bricks, glass, steel, aluminium, paper, food and beverages. Combined, our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

EUAA members are focussed on making products that meet their own customers' requirements where energy is just one input to the process albeit a critical one. Their expectation is that the energy industry continues to provide energy services that are fit for purpose and consistent with the National Electricity Objectives (NEO) so that our members can continue to provide a fit for purpose product for their customers.

Thank you for the opportunity to make a submission under the AER Rate of Return Instrument (RORI).

At the EUAA, we support the design of rules, legislation and procedures that achieve efficient, cost effective and equitable outcomes for networks, developers and consumers. In the energy sector under most circumstances, this is best achieved through a national approach and a sharp focus on the NEO.

We provide this principles-based submission to the proposed changes to RORI.

It is our contention that the RORI should reflect the degree risk that is being taken by NSPs, which we believe continues to be low given the guaranteed equity returns that monopoly networks enjoy and that a majority of risks are contracted away and ultimately end up being funded by consumers provided the AER deem the costs to be prudent and efficient.

We note that NSP's have progressively sought to push more risk and cost onto consumers including:

- Financeability rule change: that allows NSPs to seek approval for accelerated depreciation, shielding equity investors from short run revenue issues and avoids the need for equity to put more capital "up-front" as happens elsewhere during the earlier "higher-risk" periods of infrastructure projects. This does not materially benefit consumers as we pay a front-loaded return to the NSP. An alternative is that the proposed asset could be built and owned by an alternative NSP while still managed by the host NSP, but this is continually rejected by NSP's.
- Early works Contingent Project Allowance: which also acts as a form of accelerated depreciation and allows NSP's to develop proposals in a lower risk environment. This does benefit consumers provided the final

approval being sought includes AACE class 2 capex estimates, but we rarely see this happening so NSP's use early works as a risk-free development period. This is an example of the trade-off consumers are progressively being asked to make which revolves around more up-front cost (and risk) for consumers in the hope of more accurate cap-ex is provided to the AER for assessment, therefore avoiding ex-post review "surprises".

- Changes to the Capital Expenditure Sharing Scheme (CESS): We already see consumers covering 70% of any cost over-runs through the base CESS, however the "modified" CESS allows the AER to arrive at other sharing arrangements, with a recent AER decision on Marinus Link seeing a modified CESS have consumers cover 95% of the first 10% of any cost over-run[1]. This despite the fact they received early works CPA and "achieved" an AACE Class 2 capex estimate. This is another example of a trade-off consumers are being asked to make.
- Rewiring the Nation funding: Either via debt or equity sees taxpayers wearing a degree of commercial risk.
- Material change in circumstances: Which allows NSPs to "reopen" AER determinations to effectively "reset" the allowed expenditure to include cost over-runs. This can have the effect of reducing the amount of cost over-run covered by CESS and makes the net benefits of the project look much better than they actually are (see next point).
    - The "sunk cost" argument: Which is associated with the above where costs already incurred are proposed not to be included in new net benefits tests and does not pass the pub test. If you exclude these costs from future determinations of net benefits does that mean consumers don't pay for it? No of course not, we will pay all of the costs so all of the costs should be part of the net benefits test and CESS assessment.
- Public Policy: Legislated net zero by 2050, 82% by 2030 and inserting climate change objectives as part of the NEO all provide the underpinning policy environment so political/sovereign risk is virtually nil. There may be timing issues but once approved by the AER then that disappears.

So, where has risk increased for NSP's?

- Workforce availability has become increasing challenging but is manageable by the NSP.
- Material and supply chain constraints.
- Social licence issues will continue to be an area of concern.
- Planning issues, which seems to be a universal issue for the transition to net zero as we fundamentally re-design the NEM.

While we accept these risks are material it is our view is that all of these risks are normal development risks that should be bread and butter for any infrastructure company to deal with. We would argue these risks should be borne by equity given it is within their control.

To the extent there are higher costs associated with these risks they can be passed onto consumers via the regulatory regime, provided they are judged as prudent and efficient by the AER. These risks are also outside of any control or influence of the consumer and failure to manage them is solely the NSP's issue; yet they can still pass on the cost of poor management and/or planning to consumers.

[1] https://www.aer.gov.au/documents/aer-initial-draft-decision-marinus-link-stage-1-part-b-construction-costs-transmission-determination-2025-30

## CHANGES TO THE RATE OF RETURN INSTRUMENT

We understand that the AER has historically used a modified Capital Asset Pricing Model (CAPM) to determine the level of systematic risk (beta) that NSP's are exposed to, and therefore the return for assets that is appropriate. Beta has historically been derived by comparing the share market fluctuations of relevant energy companies listed on the ASX and therefore applied to all NSPs.

This CAPM approach to calculating beta has its pros and cons that creates winners and losers amongst NSPs (i.e. equity investors that receive either more returns or less returns than if they were participating in a true competitive market). These pros and cons include not taking into account jurisdictional policies, asset utilisation, historical expenditure and maintenance and therefore asset condition, debt to equity ratio, borrowing power etc and the impact is different on every NSP.

Historically speaking there have been several relevant energy companies listed on the ASX allowing for beta to be estimated, however currently there is only one semi-relevant energy company (APA Group) listed on the ASX, which makes calculation of beta impossible.

While we have considered the many different models proposed by the AER and the Eligible Experts for calculating beta in the future, we only include in this submission what we consider to be the two extreme models and approach our analysis from a position of principle alongside the intent of the NEO.

## INTERNATIONAL BENCHMARKING

While international benchmarking is utilised by the WEM and NZ regulators to develop beta, the selection of energy markets, businesses and regulations that best represent those in Australia creates a number of issues around overlaying on to the Australian NSPs. While this process would imitate the current process to develop beta, and therefore may be the easiest for the AER to transplant, it carries with it many risks to both consumers and NSPs. At a very high level the two main risks are:

- It does not correct any of the pros and cons of the current development of beta that has led to the risk management rule changes and policies listed in the Introduction that shift risk to consumers.
- It introduces more systematic errors and assumptions into the determination of beta that could be detrimental for both consumers and NSPs.

The AER should not use the logic that "others do it so we should to", but should assess the approach on its individual merits, including identifying all downsides to the approach.

## INDIVIDUAL BESPOKE BETA BASED ON ACTUAL NSP METRICS

While this was proposed by one of the Eligible Experts, we consider this to be the other extreme to the above AER proposed methodology to calculate beta. While this would seem like the "fairest" way to impose the lowest costs on consumers and the "right" returns to equity investors, it is also the easiest methodology for NSPs to "game" and receive a larger return than they are rightfully entitled and therefore pass through inefficient costs to consumers..

Should the AER determine that a model that calculates a bespoke beta for each NSP is the best way forward, this determination would effectively remove the need for all of the other "risk management" rule changes listed in the Introduction. Under these circumstances, we would expect these rule changes would be removed from the NER.

## CONCLUDING REMARKS

While we have chosen the two extreme recommendations to discuss, and only commented from a very high level, the AER's paper and the Eligible Experts report discuss other options that contain varying amounts of these two extremes. We would expect that the risk management rules in the NER (as listed in the Introduction) would therefore be changed in accordance with the actual risk profiles that the NSPs manage whichever model the AER determines to be the best methodology for calculating beta in the RORI.

We see the biggest risks in using the wrong beta are the AER inadvertently increasing consumer costs beyond what is efficient and consumers are able to afford and/or sending NSPs out of business and thus creating uncertainty for consumers connected to that NSP.

We recommend that the AER carefully weighs up the pros and cons of each proposed approach to calculating beta to determine which one best manages the risk of calculating an incorrect beta and that results in the best long-term outcome for consumers, as required by the NEO. This analysis should form part of the next round of consultation allowing feedback from interested stakeholders.

The EUAA welcomes further discussions on issues raised in this submission.

Do not hesitate to be in contact with EUAA Policy Manager Dr Leigh Clemow, should you have any questions.

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