AUSTRALIAN ENERGY COUNCIL

3 July 2021

General Manager, Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Submitted electronically at:

Dear ,

Rate of return and cashflows in a low interest environment.

The Australian Energy Council (AEC) welcomes the consultation opportunity in the Australian Energy Regulator (AER) working paper 'Rate of return and cashflows in a low interest environment'.

The AEC is the industry body representing 22 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The working paper, alongside the separate papers submitted by NERA and Frontier Economics, consolidates a range of views and expert opinion on the matters at hand. In our response, the AEC accepts their assessment that overseas regulators are currently setting return on equity allowances that are materially higher than those set by the AER. However, evidence that Australian regulated network service providers ability to raise capital is impacted in a manner that requires a similar regulatory response to overseas was not visible to us. And whilst return on debt has declined significantly, so have the costs of securing debt.

To some extent these issues on financability have already been recently exercised. The AEMC rule change process rejected the proposal to bring forward TNSP cash flows in order to improve financeability metrics, concluding that the regulatory framework does not create a barrier to financing large projects. We query whether regulated network service providers ability to raise capital is impacted in a manner that requires a regulatory response. We also note that evidence of any such impacts or outcomes were not presented during the AEMC's recent process.

Whilst the exploration of the impacts on financability of the current market are well thought, we remain concerned that the NSP's have not provided:

- Evidence they cannot efficiently raise capital.
- Evidence their capital structures are sufficiently constrained to make regulatory investments unfinanceable.
- Evidence they have been unable to manage their capital structure and cash flows to maintain investment grade credit ratings.
- Evidence they are unable to raise capital in the current low risk free rate environment.

Changing the regulatory model to reflect what may well turn out to be short term effects requires careful investigation, and an incorrect decision by the AER could have serious consequences on

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the long term interests of consumers. We support the AER view that at this stage they are not minded to make changes to address dynamic financability scenarios.

As the AER notes, the NSPs' actual financeability is substantially impacted by the practices and choices made by the NSPs. They engage in a range of practices specific to managing their own operations. This includes adopting individual financing and capital structure decisions to accommodate circumstances and management choices.

We would question if there is a single AER regulated NSP that is actually geared at or below the assumed 60% debt to RAB. This 60% debt to RAB, and a 10-year term structure with 10% of debt refinanced annually, are the assumptions that underpin the AER's cost of debt allowance. But if NSPs choose to leverage their assets more aggressively, that's their business. Arguments put forward by the NSPs in the consultation could in our view lead to the 'cherry picking' of the regulatory model for higher returns. Now the case for change appears to be supported by the hypothesis that the cost of debt allowance is too low, and this is making the NSP businesses financially unsustainable. The AER is prudent to require more validation of this claim.

The AEC also supports the AER's view that the AER should not use measures of financeability directly when setting the rate of return. In turn we agree with the AER that they should not adjust the return on equity or the parameters that inform return on equity in proportion to movements in any financeability measures. We also agree with the AER that changes to estimating depreciation are unwarranted in order to address financeability issues.

Broadly we support the AER's apparent conclusions that:

- Financeability should be principally managed by the regulated firms;
- The financing challenges NSPs face on large investments is not unique. Any capital-intensive long-lived asset enterprise will face comparable challenges in the current market;
- In response, regulated firms can vary their capital structures to meet need, and;
- Change to the regulatory model is not required.

Any questions about this submission should be addressed to [redacted] by email to [redacted], or by telephone on [redacted].

Yours sincerely,

[redacted]
Networks and Distributed Energy Resources Policy Manager
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