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RATE OF RETURN
RETAILER REFERENCE GROUP

A consistent and coherent approach to the rate of return framework

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- Retailers are acutely aware of cost of living pressures on consumers, compounded by COVID and the global outlook.
- Retailer increases in bad debt from the COVID response are unlikely to be readily alleviated given the challenging and changing economic outlook. Retailers are doing their best.
- Network costs are unavoidable, and only indirectly influenceable. Networks must get “enough”, efficient costs etc. This cannot be completely decoupled from pressures on consumers, any more than it can pressure on investors.
- Retailers and consumers are relying upon the AER doing an important job.
- To maintain a consistent and coherent approach, there should remain a “high bar to change”.
- Nothing contained in the draft Rate of Return Instrument, nor in the AER’s own analysis, would suggest that it is inconsistent with achievement of the NGO and NEO.

Matching the length of the of the regulatory period to the cost of equity

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- Noted that investors will likely consider that there is a risk that the reset will not in fact replicate the cost of capital that will be faced over future regulatory periods.
- However, the 10-year term for the cost of equity doesn't addresses this risk either.
- A 10-year term is likely to lead to a biased outcome because the task is to *set an efficient return for the next regulatory period* (emphasis added).
- The AEC supports using a term matching the regulatory period.

An expanded role for the Dividend Growth Model in the Market Risk Premium

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- The AER draft is consistent with the 2018 Instrument and a consistent and coherent approach to the rate of return framework.
- The MRP estimate has increased materially under the historical excess return (HER) estimation methodology used in making the 2018 Rate of Return Instrument due to relatively high equity returns post 2017.
- Using HER does not mean an MRP estimate is backward-looking. HER is commonly used by both regulators and market practitioners to inform their estimates of the MRP within a forward-looking rate of return.
- HER method may not be perfect but no evidence ot has had a detrimental impact.
- HER method is the most appropriate for long-lived assets with long-term investors (emphasis added).

NEO, NGO and the long-term interests of consumers

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- Eight regulated network companies have been acquired by private investors since 2006, a process that typically involves a premium for control.
- Market-based evidence suggests that the revenue streams offered by regulated network businesses are attractive to investors.
- Some research suggests that the AER has consistently and materially erred in favour of networks and against customers. Network businesses achieved returns on regulated equity which exceeded forecast returns on equity by approximately 4.2 percentage points on average.
- The AER's approaches may not always promote the most efficient use of network assets nor prevent opportunities to extract monopoly rents.
- But we have no doubt whatsoever that the AER sets a rate of return that attracts investors to the sector.