

Independent Panel questions to the AER

Dates of correspondence: 2-3 August 2018

Correspondence between: Natalia Southern (Chair of Panel), and Esmond Smith (Director – Rate of Return – AER)

*Please note the Panel's requests/comments are in **black** text and the AER's responses in **blue**.*

The Independent Panel (**Panel**) wrote to the AER regarding the following:

1. The independent panel requested a word version of the shortened forms from the Explanatory Response

- Would [the panel] be able to get a word version of the shortened forms from your Explanatory Response for use in [the panel's] report?
- The AER provided the panel with the requested document. See **attachment 1**.

2. The independent panel requested clarification on the distribution rate referred to in page 388 of the 2018 guidelines explanatory statement

- The panel queried whether the distribution rate on pg 388 of 0.88 was the correct rate or whether the rate of 0.83 was the correct rate.

AER Response 0.88 distribution rate

- 0.88 is correct.
- As stated on page 67 of the explanatory statement, we use 0.83 to be internally consistent with our rounded gamma value of 0.5 and our utilisation rate of 0.60. On page 67 we stated:
 - “The estimated distribution rate of the top 20 ASX listed firms from 2000 to 2017 is 0.88. This supports a distribution rate for the BEE of at least 0.88. We consider an efficient service provider¹²⁷ could be expected to be able to maintain a distribution rate of 88 per cent if it elected to do so. We have used 0.83 to be internally consistent with our rounded gamma value of 0.5 and our utilisation rate of 0.60.”
- We also noted the logic for 0.83 in footnote 1482 (that is after the 0.88 figure on page 388 referred to below) where we say:
 - “We note a distribution rate of 0.88 and a utilisation rate of 0.6 give a value of imputation credits of 0.53. This is rounded to 0.5 if we keep one decimal place for the value of imputation credits. To ensure consistency between rate of return parameters given we have used an overall value of imputation credits of 0.5 and a utilisation value of 0.6 (for MRP), this implies a distribution rate of 0.83.”

Attachment 1: Shortened forms

Shortened form	Extended form
2013 Guidelines	refers to AER, <i>Rate of Return Guidelines</i> , December 2013; AER, <i>Rate of Return Guidelines - Explanatory Statement</i> , December 2013; and/or AER, <i>Rate of Return Guidelines - Explanatory Statement - Appendices</i> , December 2013
AER	Australian Energy Regulator
ARORO	allowed rate of return objective
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
CCP16	Sub-panel 16 of the CCP. This sub-panel was established to provide advice on our review of the rate of return Guidelines.
CGS	Commonwealth Government securities
CoAG	council of Australian governments
CRG	consumer reference group
DGM	dividend growth model
DRP	debt risk premium
EICSI	energy infrastructure credit spreads index This is the index developed in: Chairmont, <i>Aggregation of return on debt data report</i> , 28 April 2018.
ERP	equity risk premium
FAB	ATO franking account balance
GDP	gross domestic product
HER	historical excess returns
IRG	investor reference group
LAD	least absolute deviation
legislative objectives	collectively the NEO, NGO, ARORO, and RPPs
MRP	market risk premium
MSE	mean squared error
NEL	national electricity law
NEO	national electricity objective
NER	national electricity rules

Shortened form	Extended form
NGL	national gas law
NGO	national gas objective
NGR	national gas rules
OLS	ordinary least squares
RAB	regulatory asset base
Regulated services	refers to an electricity prescribed transmission service, an electricity distribution direct control service, and/or a gas reference service
Regulatory period	refers to a regulatory control period and/or an access arrangement period
Regulatory year	refers to a year within a regulatory period
RPPs	revenue and pricing principles
RRG	retailer reference group
Service provider	refers to an electricity transmission network service provider, an electricity distribution network service provider, and/or a gas service provider
SLCAPM	Sharpe-Lintner CAPM
WACC	weighted average cost of capital