

Independent Panel questions to the AER

Date of correspondence 24 -28 August 2018

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

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

1. Questions from Independent panel re prior review processes

Further to your conversation with one of our panel members, could you please advise on the following:

- i. Did the judgements in the judicial reviews of the AER's Cost of Debt Trailing Average approach discuss the choice between a 10 versus a shorter term (eg 5 years) for the risk free rate and/or the term of the cost of equity?
- ii. If so, could AER refer us to where that is discussed?

AER response

Please note this answer interprets the question to be referring to appeals to the Australian Competition Tribunal (ACT) of the AER determinations made under the 2013 AER Rate of return guidelines and any subsequent appeals of these ACT decisions to the Full Federal Court of Australia (FFC). Therefore, in responding to this question we have not considered appeals of any earlier AER determinations (pre the 2013 Rate of return guidelines) and what the ACT may have considered in prior appeals.

To the best of our knowledge neither the ACT who reviewed the appealed AER's decisions on the trailing average under merits review, or the FFC who reviewed the Tribunal's decisions that were appealed, discussed in any substantive way the choice between a 10 year term and a shorter term in relation to the risk free rate and/or the term of the cost of equity (or debt). However, the ACT decisions that considered debt transition did comment that term was not in dispute (references are provided below). We will also provide all the ACT and FFC decisions for the Independent panel to consider if they wish to do so.

[Background on ACT and FFC appeal processes](#)

[Background to ACT appeals of AER determinations post the 2013 Rate of return guidelines](#)

The transition to the trailing average introduced post the 2013 Rate of return guidelines has been appealed under merits review in three sets of reviews before the ACT.

The three sets of Australian Competition Tribunal reviews of AER decisions were:

1. Appeals in relation to 2015 decisions by the AER for the NSW electricity distributors (Ausgrid, Endeavour Energy and Essential Energy), the NSW gas distributor (Jemena Gas Networks), and the Act electricity distributor (ActewAGL electricity distribution). The ACT decisions in these appeals are:
 - o Applications by Public Interest Advocacy Centre Ltd and Ausgrid [2016] ACompT 1 ("the PIAC Ausgrid decision")

- Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy [2016] ACompT 2
 - Applications by Public Interest Advocacy Centre Ltd and Essential Energy [2016] ACompT 3
 - Application by ActewAGL Distribution [2016] ACompT 4
 - Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT 5 (“the JGN decision”)
2. An appeal in relation to the 2015 decision by the AER for the SA electricity distributor (SA Power Networks). The ACT decision in this appeal is:
- Application by SA Power Networks [2016] ACompT 11 (“the SAPN decision”)
3. Appeals in relation to the 2016 decisions by the AER for VIC electricity distributors (Jemena electricity networks, AusNet services, CitiPower, Powercor, United Energy) and by the ACT gas distributor (ActewAGL Gas distribution). We note that in these cases AusNet Services, CitiPower, Powercor and United Energy all withdrew their grounds of review prior to the Tribunal decision being handed down and therefore the decision (as it related to the trailing average) only related to the grounds of review on the trailing average of Jemena Electricity Networks and ActewAGL Gas Distribution. The ACT decisions in these appeals are:
- Application by ActewAGL Distribution [2017] ACompT 2 (“the ActewAGL Distribution decision”)
 - Application by AusNet Electricity Services Pty Ltd [2017] ACompT 3
 - Applications by CitiPower Pty Ltd and Powercor Australia Ltd [2017] ACompT 4

Background FFC appeals post the 2013 Rate of return guidelines

The AER appealed the decisions of the ACT to set aside AER determinations in relation to the first set of tribunal decisions above on a number of grounds (including in relation to debt transition). SAPN appealed the ACT decision that upheld the AER determination for SAPN on a number of grounds (including in relation to debt transition).

The FFC decisions related to the first set of Tribunal decisions appealed by the AER are:

- Australian Energy Regulator v Australian Competition Tribunal (No 2) [2017] FCAFC 79
- Australian Energy Regulator v Australian Competition Tribunal (No 3) [2017] FCAFC 80

The FFC decision related to the SAPN ACT appeal is:

- SA Power Networks v Australian Competition Tribunal (No 2) [2018] FCAFC 3

Answer to the Question part a) – ACT merits review decisions post the 2013 Rate of return guidelines

In relation to the most recent (third) set of Tribunal decisions, the debt transition issue was only discussed in the 2017 ACompT 2 decision for ActewAGL Distribution. This decision also involved Jemena Electricity Networks, the only other service provider in this set of ACT appeals that continued an appeal on the AER’s debt transition decision. In this decision (the 2017 ACompT 2 decision for ActewAGL Distribution), the ACT did not discuss the choice between a 10 year term and a shorter term (eg 5 years) in relation to the risk free rate and/or

the term of the cost of equity (or debt), other than to note the term adopted by the AER and that this was not in dispute between the parties.¹

In relation to the SAPN decision (the 2016 ACompT 11 decision), the ACT did not discuss the choice between a 10 year term and a shorter term in relation to the risk free rate and/or the term of the cost of equity (or debt), other than to note the term adopted and that this was not in dispute between the parties.² However, the ACT did comment that firms might have used shorter term debt at times when the DRP was perceived to be unusually or temporarily high to avoid locking in that high level of DRP.³

The lead decision in the first set of ACT decisions is the PIAC Ausgrid decision (the 2016 ACompT 1 decision). This contains the reasoning in relation to the return on capital for the Endeavour Energy, Essential Energy and ActewAGL Distribution decisions which cross reference it. In this decision there is also no substantive consideration of the choice between a 10 versus a shorter term for the risk free rate and/or the term of the cost of equity (or debt), other than to note the term adopted and that this was not in dispute between the parties.⁴

As JGN was not advocating for the same outcome in relation to debt as the NSW distributors and ActewAGL distribution, the ACT decision for JGN while picking up reasoning from the Ausgrid decision also contains additional discussion in relation to debt transition. However, this decision does not consider the choice between a 10 versus a shorter term for the risk free rate and/or the term of the cost of equity (or debt).

Answer to the Question – FFC judicial review of ACT decisions that reviewed AER decisions post the 2013 Rate of return guidelines

In none of the three Full Federal Court decisions listed above (Australian Energy Regulator v Australian Competition Tribunal (No 2) [2017] FCAFC 79, Australian Energy Regulator v Australian Competition Tribunal (No 3) [2017] FCAFC 80, and SA Power Networks v Australian Competition Tribunal (No 2) [2018] FCAFC 3) did the Full Court discuss the choice between a 10 year term and a shorter term in relation to the risk free rate and/or the term of the cost of equity (or debt), other than to note the term adopted.⁵

2. Questions from independent panel re prior questions

In addition, when AER staff spoke to a member of the independent panel about the above question (where the panel member was requested to provide the question in writing) two clarifying oral questions were asked (and answered) in relation to answers previously provided:

- 1) In relation to prior answer 4 of 22 August [that stated]:

“The Draft Guidelines requires any averaging period to be kept confidential after the averaging period has concluded (see Draft Guidelines Clause 17).”

Does the AER have any concerns with making averaging periods public after they have finished?

No, although the AER has never published averaging periods (once completed) in relation to determination made under the 2013 Rate of return guidelines (even though the 2013 Guideline only indicated averaging periods would be kept confidential until they had

¹ At para [60]

² At paras [203]-[204]

³ At para [253]

⁴ At paras [667], [876]

⁵ see Australian Energy Regulator v Australian Competition Tribunal (No 2) [2017] FCAFC 79 at para 399 and SA Power Networks v Australian Competition Tribunal (No 2) [2018] FCAFC 3 at para 73.

passed). The reason for not publishing average periods once complete has been some service providers have used the same averaging periods from year to year and disclosure of prior periods could disclose future periods due to this practice.

2) In relation to prior answer 5 of 22 August [that stated]:

“The AER has the power to collect the information it requires to fulfil its regulatory obligations. Therefore, assuming it was relevant to determining the appropriate benchmark term of debt and this was relevant to determining the return on debt, the AER could ask the SPs for this information. The AER could then analyse it itself or have Chairmont or another consultant analyse it.”

Does the AER have any concerns with collecting this data?

No, although the AER always considers any regulatory burden/cost on service providers when determining what information to require service providers to provide.