



# FINAL POSITION PAPER

## Profitability measures for electricity and gas network businesses

December 2019

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## Shortened Form

Shortened Form	Extended Form
ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
Benchmark gearing ratio	The benchmark ratio of the value of debt to total capital (currently 60 per cent) set in the rate of return instrument.
CCP	Consumer Challenge Panel
Core regulated services	Standard Control Services for electricity distribution network service providers; Prescribed Transmission Services for electricity transmission network service providers; Haulage Reference Services for gas distribution pipeline service providers; and Reference Services for transmission pipeline service providers.
EBIT	Earnings before interest and tax
ECA	Energy Consumers Australia
ENA	Energy Networks Australia
Gearing	The ratio of the value of debt to total capital.
Income statement	Statement of profit or loss and other comprehensive income of the service provider. Also known as the statement of financial performance.
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
Network service provider or NSP	In the electricity sector the network service provider is the regulated network service provider (as defined under the NEL). For the gas sector, the network service provider is the scheme pipeline service provider (as defined

	in the NGL).
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NPAT	Net profit after tax
RAB	Regulatory Asset Base
Regulatory accounting information	Financial information that has been prepared in accordance with regulatory rules. Regulatory accounting information is to be prepared for the Network Service Provider and the core regulated services of the Network Service Provider.
RII	Regulatory Information Instrument
RIN	Regulatory Information Notice
RIO	Regulatory Information Order
RoA	Return on Assets
RoE	Return on Equity
RoRE	Return on Regulated Equity
SAPN et al.	Joint submission from SAPN, CitiPower, Powercor, Australian Gas Infrastructure Group, United Energy
Statutory accounting information	Financial information that has been prepared in accordance with the Corporations Act, including relevant accounting standards. Statutory accounting information is to be prepared for the Service Provider.
WACC	Weighted Average Cost of Capital

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## About Us

We, the Australian Energy Regulator (AER), work to make all Australian energy consumers better off, now and in the future. We are the independent regulator of energy network service providers (NSPs) in all jurisdictions in Australia except for Western Australia. We set the revenue requirements these NSPs can recover from customers using their networks.

The National Electricity Law and Rules (NEL and NER) and the National Gas Law and Rules (NGL and NGR) provide the regulatory framework which govern the NSPs. Our role is guided by the National Electricity and Gas Objectives (NEO and NGO).

NEO:<sup>1</sup>

...to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

NGO:<sup>2</sup>

...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

The decisions we make and the actions we take affect a wide range of individuals, businesses and organisations. Effective and meaningful engagement with stakeholders across all our functions is essential to fulfilling our role, and it provides stakeholders with an opportunity to inform and influence what we do. Engaging with those affected by our work helps us make better decisions, provides greater transparency and predictability, and builds trust and confidence in the regulatory regime. This is reflected in our Stakeholder Engagement Framework and in the consultation process we have followed in this review.<sup>3</sup>

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<sup>1</sup> NEL, s. 7.

<sup>2</sup> NGL, s. 23.

<sup>3</sup> AER, *Revised stakeholder engagement framework*, September 2017.

# 1 Overview

This report sets out the final positions we have reached from our review into measures of profitability. These will allow us to report and compare the returns of the electricity and gas network service providers (NSPs) we regulate. In particular, the review has sought to identify measures of profitability that would allow comparison of:

- expected returns of a NSP relative to its actual returns;<sup>4</sup>
- returns between NSPs in the same sector; and
- returns between the NSPs and other regulated/unregulated industries.

In this final position paper, we:

- specify which profitability measures we will report on, and why
- set out what we have learned about the measures through our review, their individual strengths and limitations, relevant comparators and important contextual information
- specify the data we will need to calculate these measures
- where there are gaps in the data we currently have available, we will:
  - specify and define the additional data that we will request from NSPs, and
  - give guidance on how this data is to be provided, and on supporting information to make the derivation of that data more transparent.

We will begin collecting data from the NSPs in early 2020. We expect to commence reporting on NSP results and our analysis of those results in mid-2020.

## 1.1 The purpose of this review

One of our roles is to report on the performance of the NSPs we regulate, including:

- electricity distribution and transmission networks, and
- scheme gas distribution and transmission pipelines subject to full regulation under chapter 3 of the NGL.

This is an important task in an incentive-based regulatory framework. At its simplest, this model of regulation is designed to promote the long-term interests of energy consumers through a repeat cycle of three steps:

1. Determining the NSPs' revenue allowances based on the best available information, recognising that the NSPs can outperform (underperform) those targets and keep (lose) some of the benefits.
2. Collecting accurate and reliable data on the NSPs' performance against those targets.
3. Using that information to inform future revenue setting processes, sharing the benefits of network efficiency gains with customers.

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<sup>4</sup> Note, for the purposes of this paper, we use the terms returns and profits interchangeably.

Network performance reporting is an important part of this second step. We expect that these profitability measures will complement our existing network performance reporting suite of metrics, including data on operational and reliability performance against benchmarks.

Done effectively, network performance reporting should assist all stakeholders, including the AER, to:

- more comprehensively understand the overall performance of NSPs against our revenue allowances
- form a better understanding of ultimate returns to investors in networks over time
- quantify the impacts of NSP performance and/or regulatory decisions on ultimate returns, and
- having regard to this information, to make better regulatory decisions.

In particular, our view is that reporting on profitability measures will contribute to achievement of the NEO and the NGO by making the NSPs' returns and their drivers transparent. The information should assist us and stakeholders as an additional source of information with which to review the overall effectiveness of the regulatory regime. This reporting should also assist stakeholders in making submissions on NSPs' regulatory proposals and to other regulatory processes. However, we do not expect profitability measures to be a direct input to individual regulatory determinations.

## 1.2 Profitability in the regulatory framework

The regulatory framework is designed to compensate NSPs in expectation for efficiently incurred costs (such as operating expenditure, depreciation, interest on debt and tax) and to provide them with an expected profit margin in line with the required return in the market for an investment of similar risk. The expected profit margin, if set an appropriate level, should attract efficient investment. This is the role that the allowed return on equity plays.

We expect NSPs' actual outcomes to differ from the forecasts and benchmarks we set. The revenue requirement is not a guaranteed return, as the NSPs actual returns are determined in part by whether they outperform or underperform against these forecasts and benchmarks. There are many potential drivers of this outperformance and underperformance, not all of which are within the control of the NSPs—for example, where revenue smoothing for a given year results in a difference between the sum of building block allowances (unsmoothed revenue) and target revenue (smoothed revenue). Where NSPs face these risks, they are compensated accordingly through the return on equity.

This type of regulatory framework is often described as an incentive-based framework. In general, the inherent incentives in this regime encourage NSPs to outperform the forecasts and be financially rewarded through higher returns. The opposite occurs if the NSPs underperform against the forecast.

The regulatory framework also includes targeted incentive schemes to improve efficiency and reliability, which are fundamental parts of the NEO and NGO. Consumers should ultimately benefit from improved efficiency through lower regulated prices. Under these schemes, if an NSP is able to deliver its services at a lower cost than forecast, these lower



costs of delivery should ultimately result in lower forecasts (holding other things constant) at the next revenue determination. By this process, both consumers and the NSP share the benefits of efficiency gains over time.

Through the combination of inherent and targeted incentives in the regime, network regulation seeks to align the commercial goals of the NSPs to the NEO and NGO.

### **1.3 Publication of the profitability measures**

We intend to publish the profitability measure outcomes within NSP annual performance reports along with other performance metrics. In the interest of transparency, supporting analysis and underlying data for each of the measures will also be made publicly available.

In some cases, there are variations in how we can report on the measures, such as being inclusive or exclusive on incentive scheme outcomes. This includes options such as:

- inclusive or exclusive of incentive scheme outcome impacts
- inclusive or exclusive of the effects of annual indexation of the RAB (use of regulatory depreciation or nominal depreciation in determining the RAB value),
- calculation of the return on regulated equity using benchmark or actual gearing; and
- whether to treat National Tax Equivalent Regime (NTER) payments similar to a dividend payment (and therefore apply a 0% tax rate) or a tax payment (apply a 30% tax rate).

Rather than specifying a single preferred interpretation, we will publish our reporting in a form where stakeholders can easily view results under the different permutations. This approach will allow stakeholders, including the AER, a further range of comparisons to be undertaken with each calculation basis highlighting different aspects of the NSPs profitability.

Along with reporting the measures, we will also publish explanatory material to provide guidance on how the measures are constructed and the key factors to be taken into consideration when interpreting and using the measure outcomes. Throughout this review, in collaboration with our profitability measures review working group, we have developed explanatory notes to this effect for each of the measures. We will publish these guides to the measures when we begin reporting.

### **1.4 Timeline of the review**

This final position paper is the culmination of over two years of analysis and engagement by NSPs, industry representatives, consumers, consumer representatives, technical experts and us.

This review began with our engagement of McGrathNicol to undertake a scoping study to identify measures of profitability, and the data requirements underpinning them, that could be applied to the NSPs for reporting purposes. Following this, we published a discussion paper setting out the profitability measures identified by McGrathNicol and the data

requirements to calculate those measures.<sup>5</sup> We sought stakeholder views on the identified measures and the data required to support them.

In April 2018, we published a draft position paper providing our preliminary views on the profitability measures we intend to report. The draft position paper took into consideration and responded to the stakeholder views put forward in response to our discussion paper.

We sought feedback on the draft position paper via written submissions and a public forum. As part of this feedback it was suggested that we establish a working group to work through issues raised by stakeholders in forming our final positions. We took up this suggestion and the working group first met on 27 August 2018 to discuss the calculation of the return on assets (regulatory) profitability measure. On 10 September 2018, we published return on assets ratios which reflected the outcomes of this first meeting.

Since initial publication, we have begun to report return on assets ratios as part of our NSP annual performance reporting. The most recent round of ratios were published as part of the 2019 electricity transmission and distribution electricity NSP performance data reports.<sup>6</sup>

Toward the end of 2018, the AER undertook a specific review into our approaches for setting regulatory tax, and developed a binding rate of return instrument. The analysis in these reviews has assisted us in reaching our final positions. Having completed those reviews, we recommenced the profitability measures review in April 2019.

In May 2019, we engaged PricewaterhouseCoopers (PwC) to provide advice on approaches to derive interest and tax expenses from corporate groups to NSPs for determining the return on regulatory equity measure.<sup>7</sup> We published this advice and sought stakeholder feedback.

The working group continued to meet regularly between June and October 2019 for more detailed development of methodology and data requirements.

## 1.5 How did stakeholders contribute to this review?

We have sought stakeholder engagement throughout this review. This reflects our view that effective and meaningful engagement with stakeholders is essential to fulfilling our role, and it provides stakeholders with an opportunity to inform and influence what we do. Engaging with those affected by our work helps us make better decisions, provides greater transparency and predictability, and builds trust and confidence in the regulatory regime.

We would like to acknowledge the important role stakeholders played in the development of the profitability measures set out in this final positions paper. Stakeholder submissions have been influential in reaching our views on the measures on which we should report, and on the most informative means to calculate and report on those measures.

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<sup>5</sup> AER Discussion Paper, *Profitability measures for regulated gas and electricity network businesses*, November 2017.

<sup>6</sup> Since 2018, the AER has published network performance data for the electricity transmission and gas NSPs. The transmission network performance data 2006-2018 report was published in July 2019 and the distribution network performance data 2006-2018 report was published in August 2019. Available on the AER website.

<sup>7</sup> PwC, *Australian Energy Regulator: Profitability Measures Review – Advice on the allocation of interest and tax expense*, June 2019.

We presented issues raised in stakeholder submissions to our working group, made up of industry and consumer representatives (Table 1.1), who engaged in collaborative discussion of the issues and focused on pragmatic solutions.

**Table 1.1 Working group representatives**

Industry representatives	Consumer representatives
<ul style="list-style-type: none"> <li>Australian Gas Infrastructure Group</li> </ul>	<ul style="list-style-type: none"> <li>Consumer Challenge Panel</li> </ul>
<ul style="list-style-type: none"> <li>Energy Networks Australia</li> </ul>	<ul style="list-style-type: none"> <li>Energy Consumers Association</li> </ul>
<ul style="list-style-type: none"> <li>Essential Energy</li> </ul>	<ul style="list-style-type: none"> <li>Major Energy Users</li> </ul>

Both industry and consumer participants in the working group indicated that this collaborative approach was productive:

Australian Gas Infrastructure Group:<sup>8</sup>

We feel that these working groups are working very well, with a high degree of genuine engagement on the part of all concerned. We commend the AER, and the other working group stakeholders, for the spirit in which the dialogue has evolved

Consumer Challenge Panel 18:<sup>9</sup>

...CCP18 is participating in a number of workshops with the AER, network representatives and consumer representatives. We welcome the cooperative approach being taken by all parties as we seek to develop the detailed implementation methodologies for the agreed measures.

The development of profitability measures will be ongoing, and measures refined in consultation with stakeholders once data becomes available. We encourage stakeholders to continue their engagement through our profitability and performance reporting process, and contribute to its ongoing refinement over time.

## The profitability measures review working group

To engage on the issues raised by stakeholders, the working group met in person on four occasions and a further occasion via teleconference (Table 1.2). The main focuses of these meetings were the:

- suitability of the profitability measures on which we intend to report
- methodologies to calculate the measures

<sup>8</sup> Australian Gas Infrastructure Group, *Allocation of interest and tax expenses for the return on equity (regulatory) profitability measure*, 22 August 2019, p. 2.

<sup>9</sup> Consumer Challenge Panel 18, *Submission on PwC's advice on the allocation of tax and interest expenses*, 23 August 2019, p. 2.

- data requirements and refinement of the instructions for data collection to ensure consistency in reporting these measures, and
- explanatory material to accompany the measures to:
  - provide guidance to stakeholders on how the measures have been calculated and
  - factors that should be considered when interpreting the measure.

For each meeting, we developed discussion papers which were provided to the working group in advance of the meeting. The papers set out the key issues to be discussed, views put forward by stakeholders and our preliminary positions. To this end, the working group provided a useful and broadly representative forum to test our analysis and preliminary views before making our final decision. In the interest of transparency, we have published the summary notes of these meetings alongside this final positions paper.

**Table 1.2 Working group meetings and issues discussed**

Meeting date	Issues discussed
27 August 2018	The approach to determining the return on assets (regulatory) measure.
26 June 2019	Guidance on the use of the measures; inclusion of incentive scheme impacts in the measures (where applicable); the method to determine the earnings per customer measure.
8 August 2019	The approach to determining the RAB multiples measure, further discussion on the earnings per customer measure; editorial changes to the return on assets (regulatory) explanatory note.
13 September 2019	The approach to determining the return on equity (regulatory) measure and in particular PwC's advice on the approach to derive interest and tax expenses from corporate groups to NSPs.
15 October 2019	Use of regulatory or nominal straight-line depreciation in calculating profitability measures; Further discussion of actual tax expenses.

## 2 Our Final Position

Our final position is to report on four profitability measures based on regulatory accounting information. These measures are consistent with the four regulatory accounting based measures outlined in our draft position paper.<sup>10</sup>

Table 2.1 sets out the profitability measures that we will report on, how the measures will be calculated, the sectors for which we will calculate the measures, and our views on the comparators against which the measures should be considered.

**Table 2.1 Final position on profitability measures**

Measure	Calculation	Sector coverage	Recommended comparators
Return on Assets (Regulatory)	Regulatory earnings before interest and tax (EBIT) / regulatory asset base (RAB), where Regulatory EBIT is for core regulated services and the RAB for core regulated services.	All NSPs	<ul style="list-style-type: none"> <li>Pre-tax real/nominal weighted average cost of capital (WACC) allowed in NSPs' regulatory decisions.<sup>11</sup></li> <li>Regulatory returns of other NSPs.</li> <li>Regulatory returns of Australian and international regulated businesses where the RAB is valued on a reasonably consistent basis to that of the NSP.</li> </ul>
Return on Equity (Regulatory)	Regulatory NPAT / Regulated Equity, where Regulatory NPAT is for core regulated services, and Regulatory equity is determined by applying the benchmark gearing ratio to the RAB for core regulated services.	All NSPs	<ul style="list-style-type: none"> <li>Post-tax real/nominal return on equity allowed in a NSP's regulatory determination.<sup>12</sup></li> <li>Regulatory returns of other NSPs.</li> <li>Regulatory returns of Australian and international regulated businesses where the RAB is valued on a reasonably consistent basis, and the debt to equity mix is similar to the service providers.</li> </ul>
EBIT per customer (Regulatory)	Regulatory EBIT / Total customer numbers.  Where Regulatory EBIT and customer numbers are for core regulated services.	<ul style="list-style-type: none"> <li>Electricity: Distribution and transmission</li> <li>Gas: Distribution only</li> </ul>	<ul style="list-style-type: none"> <li>Previous EBIT per customer outcomes for the NSP.</li> </ul>

<sup>10</sup> AER, *Draft Position: Profitability measures for regulated gas and electricity network businesses*, April 2018, p. 3.

<sup>11</sup> The relevant comparator will depend on whether the measure is generated based on regulatory depreciation or nominal straight-line depreciation.

<sup>12</sup> Note that this component of the WACC is not updated annually but is fixed for the regulatory period.

RAB multiples	Enterprise Value / RAB, where Enterprise Value is the total market value of the NSP as determined by reference to a sale value or the value of the company's shares (where listed).	All NSPs	<ul style="list-style-type: none"> <li>Theoretical benchmark (subject to a series of conditions, we would expect RAB multiples to be 1)</li> <li>Transactions/valuations of other NSPs.</li> <li>Possibly transactions/valuations of other regulated business outside of the sector that have a similar level of risk and capital intensity.</li> </ul>
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Source: AER analysis

Compared to our draft position, we have made the following changes in our final position:

- At this time, we will only report on the regulatory profitability measures. We need to further consider the reporting of statutory measures. We discuss this further in section 3.
- We will report the EBIT per customer for electricity distribution and transmission NSPs as well as gas distribution NSPs. We will not report the measure for gas transmission NSPs. We discuss this further in the attachment on measures and technical issues.
- We have expanded the set of options that stakeholders will be able to choose in viewing results, to include treatment of returns from annual indexation, use of benchmark or annual gearing for calculation of the RoRE measure and choice of applicable tax rate for certain ownership structures.

Our detailed analysis is set out in our separate attachment on measures and technical issues, published alongside this final position paper.

## 2.1 Reaching our final position

The process we went through in reaching of final position is set out above in section 1.4 and 1.6. As noted, through this process we worked collaboratively with stakeholders to address the views they put forward.

When considering specific profitability measures and how to implement them, we have been guided by the set of assessment criteria that McGrathNicol identified in its 2017 advice to us, being that:

- The measure is based on clear concepts and able to be calculated consistently over time
- The measure can be calculated without the need for manipulation of data or assumptions
- The measure is generally accepted and easily understood by those without a financial background
- The measure is suited to the characteristics of the industry (e.g. capital intensive, long lived assets, regulated revenue and returns, etc.)
- The measure can be used to compare across the sector and with other businesses in the broader economy.<sup>13</sup>

<sup>13</sup> McGrathNicol, *Final report: Review of measures of financial performance that could be applied to the electricity and gas businesses the AER regulates*, 15 June 2017, p. 15.

As noted in our draft position paper, we supported stakeholder views that criterion 2 should be given less weight if the benefits of obtaining a more appropriate comparison outweighs the loss of simplicity from using unadjusted data.<sup>14</sup>

This final position paper sets out how we have addressed the implementation issues raised by stakeholders, and our approach to collecting and reporting the necessary data to support the reporting on the profitability measures in future NSP annual performance reports.

This final position paper should be read in conjunction with our draft position paper, released on 27 April 2018.<sup>15</sup> The draft position paper set out the profitability measures we proposed to report on, the rationale for choosing these measures, the data necessary to report these measures, and our response to stakeholders' initial views on these measures.

## 2.2 Reporting on a suite of measures

Through this review, we have sought to identify suitable profitability measures that allow us to report and compare the:

- expected returns of a NSP relative to its actual returns
- returns between NSPs in the same sector, and
- returns between the NSPs and other regulated/unregulated industries.

We consider that this objective is best achieved through reporting on the suite of profitability measures we have identified rather than reliance on a single measure. The different measures will allow a broader range of comparisons to be undertaken, with each measure highlighting different aspects of profitability. This provides a more comprehensive assessment of the drivers of a NSP's profit outcomes, and mitigates the limitations of any individual measure.

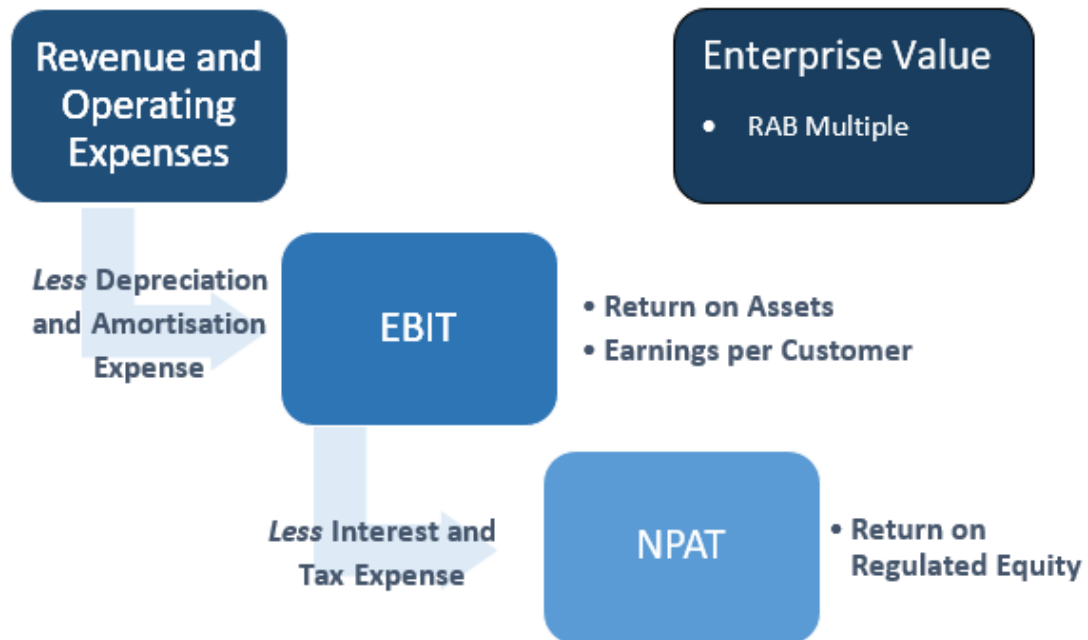
Other than RAB multiples, which is a forward-looking, market-based measure, the other measures ('the accounting measures') on which we will report follow a sequential path from revenues down to the ultimate profits available to equity holders (Figure 2.1). In combination, the range of measures highlight different levels of profitability and drivers of returns.

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<sup>14</sup> AER, *Draft Position: Profitability measures for regulated gas and electricity network businesses*, 27 April 2018, pp. 2-3.

<sup>15</sup> AER, *Draft Position: Profitability measures for regulated gas and electricity network businesses*, 27 April 2018.

**Figure 2.1 Interaction between the regulatory profitability measures**



Source: AER analysis

Each of these measures has strengths and limitations and gives different insights into network profitability. Therefore, it is important for stakeholders when interpreting the measure outcomes to engage with the guidance provided on the appropriate comparators for each measure, how the measures are constructed and the factors that should be taken into consideration when interpreting the measures.



### 3 Measures based on statutory accounting

We will report initially on profitability measures based on regulatory accounting (regulatory measures). We will reconsider the potential introduction of measures based on statutory accounting (statutory measures) in late-2021 following two annual cycles of data collection and reporting on the regulatory profitability measures.

We expect there are valuable insights that will be gained from reporting the regulatory measures which will assist in the possible development of measures based on statutory accounts.

Amongst the objectives of this review, we set out to develop measures which would facilitate comparisons of the NSPs' returns against the returns of companies outside the building block revenue framework. We recognise that consumer stakeholders have emphasised the importance of this objective.<sup>16</sup> To meet this objective, our draft position paper identified two profitability measures based on statutory accounting information we intended to report on:

- return on assets (statutory), and
- return on equity (statutory).<sup>17</sup>

As emphasised in consumer stakeholder submissions, these statutory measures would complement the regulatory measures by providing transparency on how the NSPs' returns under the regulatory regime compare against similar unregulated businesses (capital intensive, long term investment) operating in competitive markets.<sup>18</sup> Statutory measures also provide a different perspective to analyse the NSPs performance against the operation of the incentive based regulatory framework.

On balance our view is that:

- The regulatory measures, in particular the return on regulated equity, will allow a more comprehensive comparison of the NSPs' actual profitability against our expected returns than has been previously available.
- Once we start collecting data and reporting on profitability measures, we expect that we may need to refine our approaches over time. We consider it advantageous to refine one set of measures initially, before introducing a second.
- Through our work so far we have identified a number of issues that arise when reporting on a statutory basis. In our view, these require further consideration before we consider implementation of those measures. For example, Australian accounting standards do not include guidance for preparing intra-company allocations on a 'carve-out' basis and that

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<sup>16</sup> CCP18, *Submission to the AER on its Profitability Measures Position Paper*, 30 May 2018, p.5; ECA, *Submission to profitability draft positions paper*, 12 June 2018, pp.2–3.

<sup>17</sup> AER, *Draft Position: Profitability measures for regulated gas and electricity network businesses*, April 2018, p. 3.

<sup>18</sup> CCP18, *Submission to the AER on its Profitability Measures Position Paper*, 30 May 2018, p.5; ECA, *Submission to profitability draft positions paper*, 12 June 2018, pp.2–3.

there is therefore a risk of diversity in application of those allocations.<sup>19</sup> We will reconsider development of statutory measures in 2020-21.

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<sup>19</sup> PwC, *Australian Energy Regulator: Profitability Measures Review—Allocation of tax and interest expense*, June 2019, pp. 34-35.

## 4 Data requirements and next steps

Much of the data that we need to report on profitability measures is already available. However, some of the measures require development of new or more precisely defined data. In particular, to calculate the return on regulated equity, we will require NSPs to report annually on actual interest expense and tax expense arising from the provision of core regulatory services. A review of our current data collection identified that this information has not been reported consistently across NSPs operating in the electricity and gas sectors, and in some cases not at all.

We recognise that requesting new types of data will result in some additional costs for the NSPs, especially in the initial request where we will seek historical data to allow a consistent time series with our RoA data that we have already published. Nonetheless, in our view, collecting this data is important to allow a comprehensive comparison of actual and allowed returns for regulated networks. As part of our broader network performance reporting toolkit, this additional information will assist our regulatory decision making, stakeholder confidence in the framework and the evolution of the regulatory framework over time. As such, our view is that the benefits of the new data requirements are likely to exceed the costs incurred in producing them.

Our data collection will be undertaken through a staged process that will be initiated through an information request and later finalised through the development of a formal regulatory information instrument.<sup>20</sup>

The remainder of this section outlines:

- the information requirements for our suite of measures
- data collection processes, and
- next steps to facilitate the reporting of profitability measures.

Through these steps we expect to complete our first round of reporting on the profitability measures in mid-2020.

### 4.1 Data requirements

Table 4.1 sets out each of the profitability measure on which we will report, the information requirements that we currently have at our disposal and the new information requirements we will need to develop in consultation with NSPs.

**Table 4.1 Profitability measures current and new information requirements**

Measure	Input	Approach to measure input	Information requirement electricity	Information requirement gas
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<sup>20</sup> NEL, s.28(1); NGL, s.42(1).

<b>Return on assets</b>	Regulatory EBIT	Revenue excluding capital contributions and interest income less  Expenditure excluding finance charges and impairment losses	Annual RIN income statement	Annual RIN income statement
	Regulatory asset base	Opening regulatory asset base	Roll forward model & EB RIN assets	Roll forward model
<b>EBIT per customer</b>	Regulatory EBIT	Revenue excluding capital contributions and interest income less  Expenditure excluding finance charges and impairment losses	Annual RIN income statement	Annual RIN income statement <sup>1</sup>
	Customer numbers	Distribution – Total customer numbers reported  Transmission – Total connection points plus distribution customers served by TNSP in NEM region <sup>2</sup>	Economic benchmarking RIN	Annual RIN (EBIT per customer will not be reported for Gas transmission pipelines)
<b>Return on regulated equity</b>	NPAT	EBIT less interest and tax expense	Annual RIN income statement	Annual RIN income statement
	Interest expense	Specific allocation having regard to use of funds	New information request	New information request
	Tax expense	Permanent capital adjustments	RAB depreciation less TAB depreciation	RAB depreciation less TAB depreciation
		Non-deductible interest expense	New information request	New information request

		Prior year return adjustments	New information request	New information request
		Tax rates: statutory or blended	New information request	New information request
<b>RAB multiples</b>	Transaction multiples	Market transaction value/RAB	AER database	AER database
	Trading multiples	Enterprise value/RAB	AER database	AER database

Source: AER analysis.

1. We expect to recommence annual reporting for gas pipeline subject to full regulation in 2020. In consultation with NSP we agreed the initial annual reporting RINs will request information back cast to the regulatory year 2011. This will provide us with a consistent data set to align our profitability reporting with the regulated electricity NSPs.

2. We will not be reporting on EBIT per customer for gas transmission pipelines. The approach we developed for electricity transmission networks is not applicable to gas transmission pipelines. This is because gas distribution pipelines exempt from reporting requirements limits the customer number data available to determine the total customer numbers under this approach.

## 4.2 Our current data collection processes

The main formal mechanism available to us to collect information is through Regulatory Information Instruments (RII). The NEL and NGL authorise us to serve a RII on a service provider to provide and maintain information if we consider it reasonably necessary for the performance or exercise of our functions or powers.<sup>21</sup> In considering whether it is reasonably necessary to serve a RII on a regulated business we must have regard to the matters to be addressed by the service of the instrument and the likely costs that may be incurred by an efficient service provider in complying with the instrument.<sup>22</sup>

### Electricity

We currently collect data from electricity distribution and transmission NSPs, via regulatory information notices (RINs). We also gather financial and expenditure information from electricity transmission NSPs annually in response to our *Electricity Transmission Information Guideline (Version 2)*.<sup>23</sup> We developed these instruments in line with the development of our regulatory tool kit to inform our assessment of an NSP's efficient costs in providing regulated services.<sup>24</sup> This data meets most of our data requirements for preparation of NSP performance reports.<sup>25</sup> The data required for metrics such as EBIT, RAB, and customer numbers are already available for electricity sector NSPs.

<sup>21</sup> NEL, s.28F; NGL, s. 48. A RII can be either a regulatory information notice (RIN) or a regulatory information order (RIO).

<sup>22</sup> NEL, s.28F(2); NGL, s. 48(2).

<sup>23</sup> This guideline can be found on the AER's website. Available at <<https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/information-guideline-2015.>>

<sup>24</sup> For example, refer to the AER's Better Regulation reform program. Available at: <<https://www.aer.gov.au/networks-pipelines/better-regulation>>

<sup>25</sup> NEL, s.15(1)(ea); NGL, s.27(1)(f).

However, our current data collection does not provide us with the information we need to estimate RoRE, or most measures for regulated gas NSPs.

## Gas

We are currently developing new regulatory information instruments for gas distribution and transmission NSPs subject to full regulation. Our current data collection for gas distribution and transmission pipelines is limited to reset RINs that were developed to inform arrangement determinations. The reset RINs were not developed with profitability reporting or performance reporting in mind. However, we will shortly reissue annual reporting RINs to recommence data collection for gas distribution and transmission pipelines consistent with annual reporting for electricity sector. As with the electricity data, any additional data not collected via the annual gas RINs will initially be collected using an information request.

### 4.3 Next steps

Our aim is to report on the full suite of profitability measures in our network performance reports in mid-2020.

In order to meet this aim, the initial information request will require service providers to provide historical data from 2013–14 (2014) to 2018-19 (2019).<sup>26</sup> We intend to commence these information requests in February 2020. We are requesting the historical data to allow consideration of trends, since we expect some amount of year to year variability within and between NSP results as a result of the natural functioning of the building block revenue framework.

The initial information request will allow NSPs to present data on a best endeavours basis.<sup>27</sup> This allows us to commence collecting the information initially using a simpler process compared to development of a formal regulatory information instrument. This approach will provide us with a small sample of historical data to work through, allowing us to review the data and work through areas of interest with stakeholders. We expect this process will allow the development a robust set of information requirements before their inclusion in a formal legislative instrument, such as a RIN.

Further, our request for information will be a public process. We intend to publish all information provided, unless specific requests for information to be treated confidential are received. Any claims for confidentiality should be made in accordance with the AER's Confidentiality Guideline, as if that Guideline applied to the information being provided.

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<sup>26</sup> Victorian NSPs report on a calendar year basis. Therefore, we will request historical data back to 2014 for this group of NSPs.

<sup>27</sup> Information provided on a "best endeavours" basis will require an explanation why it was not possible for the subject of the request to use actual information in responding to the request. The explanation should include a description of the approach used and/or assumptions made in preparing the "best endeavours" basis, and why the approach was chosen. In addition the assurance requirements are planned to take the form of a statutory declaration signed by a responsible officer.