AUSTRALIAN ENERGY REGULATOR

Key Issues and Action Items

DATE: 11 December 2017

TO: AER’s Consumer Reference Group on Rate of Return

CC: Warwick Anderson

SUBJECT: CRG face-to-face workshop

# Progress To Date

* In November the initial 12 CRG members were selected and since 3 others have been added
* Two information sessions were held for members on 30 November and 6 December 2017
* The CRG had a face-to-face workshop with CCP and AER staff members on 11 December 2017.

# Introduction

The AER organised an event for all of the CRG and CCP members to meet face-to-face on the 11 December 2017, in Melbourne. There were presentations from the Energy Networks Australia (ENA) and Australian Pipelines and Gas Association (APGA), Consumer Challenge Panel (CCP) and the AER. The CRG members posed questions and had time to engage with the presenters. From the sessions throughout the day, some key issues began to arise and some next steps were explored.

# Presentations

## ENA and APGA – Garth Crawford and Steve Davies

The ENA and APGA presented on the RoR guideline review, they want the reviewed guideline to be “capable of acceptance” by all stakeholders. They also indicated that they generally accepted the AER approach to the selection of equity models; they intend to focus instead on the data that is used. The ENA also offered to make their consultant from Frontier Economics available to present to the CRG. The ENA is hopeful that it can engage with the CRG more throughout the review process.

## CCP – David Prins

The CCP explained that they exist to challenge the NSPs and AER on proposals. They try to take into account consumer perspectives and some of the decisions in the previous guideline review were influenced by them. The CCP however is not a substitute for consumer engagement, they are a part-time group and they want to encourage other consumer groups and representatives to provide engage with the process.

## The AER – Warwick Anderson

The AER presented on the intentions of the AER with this process, and how the CRG can maximise its influence. The AER noted that the CRG members may wish to nominate individuals to join the independent review panel. The AER also went through the questions of the issues paper.

## The AER – Darryl Biggar

The AER gave a presentation on the potential role of RAB multiples in setting the allowed RoR. The AER noted that both a business’s market value and the value of its RAB multiple are indications of the present value of future cash flows. There are a number of factors that can give rise to differences between the market value of the firms and the RAB value.

# Key Issues

## Gearing

Gearing ratio between debt and equity was raised in the issues paper and was discussed during the meeting. There was discussion around whether the enterprise value or the RAB value is more appropriate for setting a regulatory gearing ratio. Overall, CRG members raised that the absolute amount of businesses’ actual debt is much higher than regulatory allowances due to the gearing ratio being applied to a RAB that is lower than market values. Some CRG members also questioned the role of asset revaluation reserves in the AER’s gearing estimation. The AER indicated that given the amount of discussion, the AER will explore gearing further

## Long-term interests of consumers and the NEO

The CRG members challenged whether the current RoR guidelines are achieving the NEO/NGO and promote the long-term interest of consumers. The AER indicated that it would outline how it sees the current RoR guidelines promoting the long-term interests of consumers (LTIC) and achieving the NEO/NGO. The CRG could put forward their interpretation of the LTIC. This may necessitate the involvement of experts that can also take part in the concurrent expert sessions.

## Beta

The AER sets the Beta in the Capital Asset Pricing Model(CAPM) based on the returns of energy network firms listed on the Australian Stock Exchange. CRG members felt that the Beta should not be based on unregulated firms and that it has been at the higher end of its potential range. As equity beta is likely to be a significant aspect of the guideline review, the CRG members may wish to further explore arguments around Beta.

## Risk

The Australian Pipeline and Gas Association (APGA) suggested that the risk for gas networks and electricity networks are significantly different. The APGA would like to see the higher riskiness of gas networks reflected in their rate of return. CRG members argued that overall the regulation of these entities significantly reduces their risk. The AER is open to seeking an expert report comparing the risk for electricity/gas, transmission/distribution and regulated/unregulated firms.

# Actionable Items

## AER actionable items

The following is a list of documents the AER will produce and provide to the CRG:

* The AER will prepare a sensitivity matrix that will explain how potential changes to components of the rate of return will affect consumer bills
* The AER will prepare a reading guide to assist CRG members with understanding the subject of gearing in the Rate of Return context.

In addition, the AER intends to further consider the following issues:

* how profitability measures can be incorporated in the consideration of the Rate of Return Guideline.
* the different levels of risk for transmission/distribution, gas/electricity and unregulated/regulated firms.
* what is the most appropriate gearing ratio for debt and equity.

Finally, general action items for the AER are listed below:

* facilitating further discussion between the CRG and NSPs.
* how the New Zealand energy regulator accounts for periods of substantial market volatility in their electricity regulation framework.
* introduce deep dive sessions to CRG sessions, so members can elect into smaller groups that will thoroughly examine specific topics.
* further explore the extent the Rate of Return guideline has contributed to the NEO and NGO

## ENA actionable items

* The ENA indicated that they may make one of their consultants available to provide views to the CRG.
* The ENA indicated that they would be open to engaging with the CRG outside of the AER organised sessions.
* The ENA indicated that they would look into whether there is scope to provide historical financial data to CRG members, to support profitability analysis.

## CRG actionable items

* The CRG indicated that it would be beneficial to begin considering which topics will require the assistance of an expert consultant
* The CRG indicated that there may be limited ECA funding available to appoint an expert. The CRG would benefit from considering other avenues they could use to find funding to appoint additional experts.
* The CRG indicated they would consider potential nominees for the independent panel review and would make their confidential nomination to the AER.
* The CRG could provide valuable input on the LTIC. It could be useful to seek a consultants view. The LTIC will likely be an important determining factor in the overall RoR process.

# Next steps

The AER and CRG will have another in-person meeting on the 23rd and 24th of January 2018, in Canberra. Other than that, there will be the monthly meetings every month over the VCU. More details will be provided on the face-to-face session and monthly meetings as they near.