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Mr Warwick Anderson

General Manager

Australian Energy Regulator

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By email: [redacted]

25 September 2018

Re: Draft Rate of Return Guidelines

AGL Energy (AGL) welcomes this opportunity to provide comments on the Australian Energy Regulator's (AER) Draft Rate of Return Guideline (draft Guideline) that was released for consultation on 10 July 2018.

AGL is one of Australia's leading integrated energy companies with over 3.6 million electricity and gas retail accounts in New South Wales, Victoria, Queensland and South Australia. Changes in network charges generally have no direct commercial impact on an energy retailer such as AGL because usually network charges are passed through to customers in their retail energy prices. However, AGL is highly concerned with network charges because of their impact on addressing customer affordability. Given the increased size of the regulated asset base (RAB) of most of the electricity and gas, distribution and transmission business, the regulated rate of return as determined by the AER's draft Guideline is now the largest single driver of network prices.

AGL participated in the Retailer Reference Group (RRG) conducted by the AER during its the development of its draft Guideline and appreciated the extensive consultation and stakeholder engagement. The process has been transparent, all decisions clearly explained, and stakeholders have been provided many opportunities to raise issue or concerns.

As such, AGL supports the AER's draft Guideline and believes it has achieved a reasonable balance between providing an appropriate rate of return that compensates the regulated businesses for their low-risk capital investments whilst ensuring consumers are not paying inflated network charges.

Although AGL is not able to analyse the AER modelling and quantitative evidence in detail, we would also highlight our support for the submission of the Australian Energy Council (AEC) to this consultation. The AEC represents many competitive energy businesses, including retailers, and has collaborated with its members during its analysis which has landed broadly in support of the findings of the AER.

AGL notes that some of the AER's changes to the rate of return parameters are highly contentious for the regulated network businesses and may be disputed. AGL believes these changes were not only necessary but were greatly overdue and considers that some of the parameter estimates in the draft Guideline remain conservative ie. provide a higher rate of return for networks than required. One of these parameters being the equity beta.

AGL acknowledges that the AER has used appropriate modelling and data sources to derive its estimated range for the equity beta and selected a conservative point estimate as a result. Indeed, AGL supports the AER's subsequent reduction in the Equity Beta.

However, AGL still believes that the cost of equity, which is required to compensate investors for market risks, is higher than appropriate given it is an asset class with such a low risk profile.

The regulatory framework used by the AER to determine network revenue almost completely insulates the network businesses from risks faced by other businesses in competitive markets with:

- revenue caps providing total income surety no matter the changes to volumes;
- use-of -systems revenues and cash flow guaranteed through price pass-through and retailer guarantees;
- interest rates built into operating cost build-ups and reflected in annual price changes; and
- unexpected events covered through the opportunity for further cost pass through applications.

Indeed, investments in network assets could be considered a low risk asset classed with Government bonds which theoretically, can have an equity beta of 0. On face value, AGL considers the AER's use of an Equity Beta estimate of 0.6 as highly conservative.

If you wish any further information, please contact me on [redacted] or Patrick Whish-Wilson on [redacted].

Yours sincerely

[redacted]

Elizabeth Molyneux
GM of Energy Markets Regulation