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Mr Warwick Anderson
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Australian Energy Regulator
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Dear Warwick,

Profitability Measures for Regulated Network Businesses – Draft Position Paper

AusNet Electricity Services Pty Ltd (**AusNet Services**) welcomes the opportunity to make a submission in response to the Australian Energy Regulator's (**AER**) Draft Positions Paper on profitability measures for regulated gas and electricity network businesses. AusNet Services generally supports the AER's Draft Positions and this submission is focused on key remaining areas of concern.

The introduction of profitability reporting may improve transparency in reporting financial returns earned by regulated networks to stakeholders and help to address the concerns raised by some stakeholders regarding perceived excessive profitability in the industry. However, due to their complexity, meaningful comparisons may be limited by the nature of the profitability measures, the unique features of the regulatory framework, and the cost allocation assumptions that will be required to prepare financial statements at the regulatory level.

AusNet Services supports the call for joint technical working groups with the AER and consumer groups to help with developing the framework to provide appropriate and useful profitability metrics.

Relevance and Complexity of Proposed Metrics

The Draft Positions Paper outlines that the AER will report six measures of profitability, which is an increase on the four metrics presented in the Discussion Paper. While these will show different aspects of profitability, some will be more meaningful than others. Consistent with AusNet Services' prior submission into this review, measures 'below' the EBIT level will be less meaningful than those that focus on EBIT, due to the various assumptions that must be made to allocate interest and tax expenses between the regulated networks. The relative merits, and potential applications, of each of the metrics should be clearly set out in the reporting. For example, a description of EBIT could be 'this is the difference between operating revenues and operating expenses. It does not take in to account the financing and tax costs of businesses, and therefore does not represent profit.'

While the proposed metrics are necessarily complex, the accurate communication of these metrics can help generate consistent understanding by all stakeholders. For example, the use of the word 'profit' in the proposed measure of operating profit per customer (regulatory EBIT ÷ total customers) could be misinterpreted as bottom line (i.e. NPAT) profit. Earnings before interest and tax (EBIT) focuses solely on the operations of a business, and only considers revenue and operating expenses, ignoring other variables such as the tax burden or capital

structure of a business. Without a good understanding of financial terminology, it may be misinterpreted as 'bottom line' profit per customer. We suggest that this metric is consistently referred to as 'Earnings before Interest and Tax per customer', and not 'operating profit' or 'earnings' per customer.

In addition, a direct measure of EBIT per customer is not comparable across network businesses as a result of the significantly different profiles of customer types.

For example, AusNet Services' distribution network has seven sub-transmission customers with an average bill of nearly \$530,000. This number is compared to the 680,000 residential customers with an average bill of around \$400. Doubling the number of sub-transmission customers to 14 will have a material impact on EBIT per customer as this change will add \$3.71 million to earnings with only seven additional customers. Compare this to adding an extra seven residential customers, which will only add \$2,800 – a factor of 1325 times.

In relation to publishing RAB multiples, while there are significant limitations to their decomposition and application, if they are to be published it is important that multiples based on both transactions and market values are included. Multiples based on transactions can eliminate some problems with transactions-based multiples, such as the 'winner's curse'.

Proposed Additional Financial Information and Audit Requirements

Ensuring the development of a framework and metrics useful to stakeholders is important in justifying the additional resourcing required by the businesses, the cost of which is ultimately borne by customers. The production of annual balance sheets and income statements for all three networks under AusNet Services amounts to an additional FTE. To help offset some of this additional resourcing, we consider that the complete set of annual RINs should be reviewed and rationalised.

The current description of the audit requirements implies that any financial information needs to be audited. However, financial information that relies on assumptions to allocate expenditures across different networks, for example, can only be estimates, and we request that where financial information is estimated, a review (limited assurance) opinion be obtained.

Please contact Charlotte Eddy, Manager Economic Regulation on [REDACTED] with any questions in relation to this submission.

Sincerely,

[REDACTED]

Tom Hallam
General Manager, Regulation and Network Strategy
AusNet Services