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Consumer Challenge Panel

CCP Sub-Panel CCP11

12 September 2017

To: Australian Energy Regulator (AER) Board

Ct: Lynley Jorgensen and Adam Young, Co-ordination Directors, Victorian Gas Access Arrangement Review (GAAR)

Dear Paula,

Victorian Gas Access Arrangement Review (GAAR) for APA VTS

Please find attached our advice in relation to the above Access Arrangement Review.

Kind regards,

Chris Fitz-Nead

Consumer
Challenge
Panel

Final Advice to the Australian Energy Regulator (AER)

Consumer Challenge Panel Sub-Panel CCP11

Response to the AER's Draft Decisions and the Revised Proposal from APA VTS for a revenue reset / access arrangement for the period 2018 to 2022

Sub-Panel CCP11

David Prins

Bev Hughson

Robyn Robinson

Chris Fitz-Nead

12 September 2017

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EXECUTIVE SUMMARY

CCP11 has considered the AER's Draft Decision and the Revised Proposal of APA VTS (the Network Service Provider or NSP) in light of the objective of the CCP, which is to:

- Advise the AER on whether the network businesses' proposals are in the long term interests of consumers; and
- Advise the AER on the effectiveness of network businesses' engagement activities with their customers and how this is reflected in the development of their proposals.

In this Executive Summary, we summarise CCP11's key observations, and our remaining material concerns regarding the proposed Access Arrangement for APA VTS for 2018-2022.

A. CONSUMER ENGAGEMENT

In our advice on APA's initial access arrangement proposal for 2018 to 2022, CCP11 commented that APA had not yet developed an effective consumer engagement (CE) plan to inform its access arrangement proposal, nor undertaken any meaningful steps to enact such a plan. Since that time, CCP11 has seen no evidence of further development of the CE Plan, or the implementation of a planned suite of CE activities.

Rather, APA has asserted "*that the AER's (and consumer panel's) expectation of public consultation on gas transmission business proposals is unrealistic and would ultimately be a waste of time and resources*".

CCP11 challenges this assertion. APA's role is to provide gas transportation services for the benefit of residential, small business, and industrial customers located in Victoria and potentially elsewhere. Ultimately, it is these customers who provide a significant proportion of APA's revenue. It is important therefore that APA understands and responds to the needs of these customers, as well as to the needs of the 25 direct customers of the business.

Overall, CCP11 considers that APA's engagement with its Victorian end-use consumers has been inadequate and ineffective.

APA claims to engage closely with its direct customers and shippers. However, CCP11 has not been presented with evidence to support that claim. Some direct customers and shippers have questioned APA's commitment to proceed with major investments once the expenditure allowance has been approved by the AER. This does not point to the existence of a successful stakeholder engagement program with these customers.

B. LONG TERM INTEREST OF CONSUMERS

There were several issues in APA's initial proposal which in CCP11's view showed or raised the prospect that the proposal was not in the long term interest of consumers. In its Draft Decision, the AER has considered matters raised by the CCP11 Advice to the AER dated 3 March 2017. APA has further considered its position, and has formulated its Revised Proposal in light of the AER's Draft Decision, submissions on its initial proposal, and other matters that have arisen since its initial proposal.

Many of CCP11's previous substantive concerns have been addressed by the AER's Draft Decision and the NSP's Revised Proposal. These are reviewed, and remaining concerns considered in the Advice section of this paper.

CCP11's key observations and remaining material concerns are summarised in this Executive Summary.

1. Demand Forecasts

CCP11 has no outstanding issues on APA VTS demand forecasts.

2. Capital Expenditure

In its initial Advice, CCP11 expressed serious concern as to who would be paying for the substantial expansion capital investment in the VTS over the current and next access arrangement periods (which is associated with the VNI, the SWP and, after our initial Advice, the WORM). Some of this expansion capital is in part for the benefit of Victorian gas consumers and some (the VNI expansion) is of no present or foreseeable benefit to Victorian gas consumers. CCP11's concern was that the beneficiaries of the investment should now and into the future pay for these assets, and Victorian gas consumers should only contribute when, and to the extent that, they benefit from these assets.

In its Draft Decision, the AER verified and determined that tariffs in the 2018 to 2022 period will recover the cost of this expansion capital from the parties benefiting. CCP11's remaining concern for the long term interests of consumers is how, over the 55-year regulatory asset life of these assets and the ensuing ten or eleven access arrangement reviews, will the principle of the beneficiary paying for these assets be maintained?

3. Operating Expenditure

Although AER's Draft Decision accepted APA's forecast operation expenditure (opex), it did not include any opex changes proposed by APA. APA accepted the AER draft decision on forecast opex.

CCP11 is satisfied that the Draft Decision has addressed all of the operating expenditure issues raised in relation to the 2018 to 2022 access arrangement period. We continue to have concerns regarding the appropriate allocation of operating costs associated with assets developed to benefit interstate shippers of gas in future access arrangement periods, potentially for 50+ years.

4. Rate of Return, Inflation & Gamma

APA's initial proposal on the rate of return, inflation and gamma included significant variations from the AER's 2013 Rate of Return Guideline (Guideline). In particular, APA proposed:

- an equity beta of 0.8 compared to the AER's Guideline of 0.7;
- a market risk premium (MRP) of 7.76% compared to the AER's Guideline of 6.5%;
- rejection of the AER's transition approach to moving to the trailing average for the return on debt;
- an annual update of forecast expected inflation with actual inflation (lagged) in the Post Tax Revenue Model (PTRM); and
- a value of gamma of 0.25 compared to the AER's Guideline value of 0.4.

CCP11’s initial advice was not to accept these proposed variations from the AER’s 2013 Guideline. Consistent with the advice of CCP11, the AER rejected these variations in its Draft Decision, concluding that there was insufficient information provided by APA to support these significant variations. The AER also adopted the recent decision of the Full Federal Court (May 2017) to define the benchmark efficient entity (BEE) taking into account comparative risk, rather than by reference to a regulated or unregulated business.

Unlike the Victorian gas distribution businesses, APA has not accepted the AER’s Draft Decision on rate of return, with the exception of the value of gamma, although APA considers that gamma is still open for further discussion. APA provided limited new evidence to support its Revised Proposal.

Having reviewed APA’s Revised Proposal, CCP11’s submission supports the AER’s Draft Decision, including the AER’s ongoing assessment of the BEE and other components of the rate of return, inflation and gamma. CCP11 highlights that APA is proposing major changes to how the AER should assess the return on equity and inflation. For example, APA proposes a different approach to calculating the MRP and major changes to the way inflation flows through the AER’s revenue models. In addition, APA’s claims rest on analyses of short-term market data and data trends, an approach that is inconsistent with the AER’s approach to adopt a long-term (10-year) forecast horizon in estimating the rate of return and inflation.

Further, APA provides no evidence that it has consulted with either consumer or industry stakeholders, or has plans to do so. We consider that APA overall has shown considerable disregard for consultation in general. This approach is out of step with the developments in the industry, and it does not help improve understanding of and garner support for their proposed changes.

Considering all the matters raised above, CCP11 recommends that the AER does not accept the Revised Proposal by APA with respect to the rate of return and inflation.

5. Tariffs

The principle of ‘user pays’ has been agreed by the AER and APA as being the appropriate basis for setting tariffs. This view should be maintained, and carried into the AER’s Final Decision. It is the view of CCP11 that the current tariff proposal from APA in its Revised Proposal seems the best option to meet this principle. It appears to be fair, simple to apply, and with low risk of gaming. If other options are proposed in the current consultation, they will need to be considered on their merits, and measured taking into account how well they meet the ‘user pays’ principle.

6. Access Arrangement

In its Draft Decision, the AER deleted two definitions of cost pass through events which addressed CCP11 concerns. The AER contended that the proposed Carbon Cost Event and New Gas Market Structure Development Event were not required, as existing pass through events would adequately address the matters of concern. APA’s Revised Proposal puts forward reasons for the definitions to be included in the access arrangement and seeks their reinstatement with minor amendments. Having considered APA’s Revised Proposal, CCP11 remains concerned with the inclusion of the definitions in the access arrangement.

BACKGROUND

- This advice was prepared as agreed between sub-panel CCP11 working on the APA VTS (the NSP) access arrangement, and Lynley Jorgensen and Adam Young, Co-ordination Directors for the Victorian Gas Access Arrangements Review (Vic GAAR).
- CCP11 was established in September 2016.
- On 16 November 2016, CCP11 met in Melbourne with APA to discuss its consumer engagement processes, the key elements of its proposal (i.e. high-level drivers, priorities, issues and challenges for the business and how these issues were reflected in the proposal), and its key consumer issues.
- CCP11 arranged a forum in Melbourne on 5 December 2016 to meet with consumer representatives. CCP11 invited all parties who had been involved in consumer engagement with each network business in the Vic GAAR process. Three people attended the forum. Separately, members of CCP11 met with several other consumer representatives.
- On 1 February 2017, CCP11 participated in the Public Forum convened by the AER in Melbourne. This Public Forum was primarily an opportunity for engagement with the network businesses, with limited attendance by consumer representatives.
- CCP11 has held regular meetings with the Co-ordination Directors since September 2016.
- Meetings have been held with most of the AER specialist teams involved in the Vic GAAR. These meetings have provided an opportunity for CCP11 to increase their understanding of some of the technical issues involved, as well as for the Panel and AER officers to exchange view on issues associated with the Vic GAAR proposals.
- CCP11 submitted an Advice to the AER on 3 March 2017 in which it considered the effectiveness of the NSP's consumer engagement as well as issues which appeared not to be in the long term interests of consumers. CCP11 also met with the Board of the AER on 17 March 2017 to discuss its advice.
- On 20 April 2017, the NSP provided the AER with a supplement to its initial proposal, in the form of what it called a business case for completion of the WORM project as a matter of priority in the coming 2018-22 period rather than in a later access arrangement period. APA provided a further supporting document on 15 May 2017.
- The AER asked CCP11 to provide advice on APA's business case for the WORM in the 2018-22 access arrangement period. This was provided on 6 June 2017.
- CCP11 has considered the AER's July 2017 Draft Decision (and supporting material) on the APA's access arrangement proposal, and has held discussions with AER officers on particular matters.
- CCP11 has considered the APA's August 2017 Revised Proposal, and has held discussions with AER officers on particular matters.
- CCP11 attended a 'round table' convened by the AER on 31 August 2017 with representatives of APA, VTS shippers, the owners of the Iona storage facility and AEMO, to discuss tariffs and capital costs associated with the proposed WORM project.

ADVICE

A. Consumer Engagement

The effectiveness of network businesses' engagement activities with their customers and how this is reflected in the development of the network businesses' proposals

In our advice on APA's initial access arrangement proposal for 2018 to 2022, CCP11 commented that APA had not yet developed an effective consumer engagement (CE) plan to inform its access arrangement proposal, nor undertaken any meaningful steps to enact such a plan.[1] CCP11 expressed concern that there was little time left for consumers to undertake meaningful engagement with APA, and recommended that APA take a much more proactive approach to developing and implementing its CE plan.[2]

The AER in its Draft Decision considered that other than a brief discussion in its proposal,[3] APA had not provided evidence that it undertook engagement with its users in developing its access arrangement proposal.[4] In addition, the AER recommended that APA undertake more rigorous engagement from this point, including in the development of its Revised Proposal, to build confidence between APA, AEMO and its users that its proposal addresses their concerns and is supported.[5]

In its initial proposal, APA expressed a commitment to improved consumer engagement:

> *APA envisions that the scope and relevance of engagement will develop over time and in particular become more targeted as end use consumers become more knowledgeable on issues and how they impact on small customers. The next stages of this Consumer Engagement Plan will involve consultation on this document and proposed steps, and, if endorsed, development of communication tools to deliver the suggestions outlined above.*[6]

Notwithstanding this advice and APA's commitment, CCP11 has seen no evidence of further development of the CE Plan, or the implementation of a planned suite of CE activities.

Rather, APA has taken pains in its revised access arrangement proposal to explain its view *that the AER's (and consumer panel's) expectation of public consultation on gas transmission business proposals is unrealistic and would ultimately be a waste of time and resources.*[7]

CCP11 challenges this assertion.

The AER (and the Consumer Challenge Panel) expects that APA will develop and execute a Stakeholder Engagement Plan that properly identifies APA's stakeholders, identifies the issues appropriate for engagement with each group of stakeholders, identifies relevant engagement methods and priorities, and sets timeframes and performance targets for execution of the plan. It is

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[1] CCP11 Response to Proposal from APA VTS for the 2018-22 access arrangement, p.4
[2] CCP11 Response to Proposal from APA VTS for the 2018-22 access arrangement, p.16
[3] APA VTS, *VTS Revision Proposal submission,* 20170103 - Public, pp. 2-3.
[4] AER Draft Decision – APA VTS gas access arrangement – Overview, p.51
[5] AER Draft Decision – APA VTS gas access arrangement – Overview, p.52
[6] APA VTS – 1 – A.4- Consumer Engagement Plan, p.12
[7] APA VTS – Access Arrangement Submission – 14 August 2017, p.8

also expected that APA will undertake stakeholder engagement as an ongoing business-as-usual activity, rather than as one-off events associated with a revenue reset process. As APA has concluded in its Consumer Engagement Plan, *it would appear appropriate to develop differing plans for engagement of direct users of the system compared to end users of gas, particularly small end users.*[8] CCP11 supports that conclusion.

APA's role is to provide gas transportation services for the benefit of residential, small business, and industrial customers located in Victoria and potentially elsewhere.[9] Ultimately, it is these customers who provide a significant proportion of APA's revenue. It is important that APA understands and responds to the needs of these customers, as well as to the needs of the 25 direct customers of the business. This is the intent of the AER's Consumer Engagement Guideline.

APA claims that:

> *Given the minor impact on gas bills this decision has, it is not surprising that APA VTS's efforts to engage with small consumer representatives has not met with enthusiastic interest. APA VTS understands that consumer groups have limited resources and, in the context of the significant energy price rises that are currently occurring that are driven by changing costs in other parts of the energy supply chain, this access arrangement revision process is not one that they have indicated that they are interested in engaging with.*[10]

This contrasts with feedback that CCP11 has received from consumer groups, one of which told us "*yes it is a small amount on the bill, but we still want transparency*", and considered that they had been rebuffed by APA.

As CCP11 has previously noted, there are electricity transmission companies that face similar challenges and have developed effective consumer engagement programs.[11] We recommend that APA consults with such companies to assist in the next stage of development of their CE plan and activities.

Notwithstanding the absence of a formal CE Plan, APA has participated in several ad-hoc stakeholder engagement activities since submitting its initial access arrangement proposal. These activities are outlined below.

- Together with the Victorian gas distribution businesses, APA participated in the AER Public Forum in February 2017 to explain the detail of its initial proposal to stakeholders and to accept any feedback on matters of concern prior to the deadline for lodgement of submissions on the initial proposal.
- Following the release of significant new information by AEMO and the Victorian Government, APA lodged a Supplementary Submission in May 2017, primarily focused on bringing forward development of the Western Outer Ring Main (WORM) Project, and the formulation of related tariffs. The Supplementary Submission is silent on any stakeholder engagement associated with this development. However, in the revised access arrangement proposal, APA explains that it engaged directly with shippers within the VTS, and with the Australian Energy Market Operator

[8] APA VTS – 1 – A.4- Consumer Engagement Plan, p.5
[9] APA VTS – 1 – A.4- Consumer Engagement Plan, p.2
[10] APA VTS – Access Arrangement Submission – 14 August 2017, page 8
[11] CCP11 Response to Proposal from APA VTS for the 2018-22 access arrangement, p.11

(AEMO) on the need for this investment, and its expected impact on tariffs.[12] On 31 August 2017, APA presented the WORM proposal at a 'round table' meeting of key stakeholders organised by the AER.
- APA delivered brief presentations at the 'Winter 2017 – Victorian Gas Operations Outlook Forum in May 2017, and at the AEMO Consumer Forum on 4 August 2017. The purpose of these events was to disseminate information, rather than to seek feedback on proposals.

Overall, CCP11 considers that APA's engagement with its Victorian end-use consumers has been inadequate and ineffective.

APA claims to engage closely with its direct customers and shippers. However, CCP11 has not been presented with evidence to support that claim. Some direct customers and shippers who provided submissions to APA's initial access arrangement proposal raised concerns questioning APA's commitment to proceed with major investments such as the SWP Expansion once the expenditure allowance has been approved by the AER.[13] In our view, this does not point to the existence of a successful stakeholder engagement program with these customers.

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[12] APA VTS Revised Proposal – 14 August 2017, p.9

[13] See for example Lochard Energy – APA Victorian Transmission System Access Arrangement 2018-22 – 8 March 2017, p. 12; and Consortium of Gas Market Participants – Joint Submission to the AER – APA VTS Access arrangement 2018-22 – 3 March 2017, p. 14

B. Long Term Interests of Consumers

Whether the network businesses' proposals are in the long term interests of consumers

1. Demand Forecasts

1.1 CCP11 advice on regulatory proposal

The CCP11 advice to the AER on APA's regulatory proposal commented on the following aspects of APA VTS' demand forecasts:

- Differences between AEMO and APA VTS forecasts for Gas Powered Generation;
- Impacts of the Victorian Renewable Energy Target (VRET) scheme; and
- The basis of APA VTS forecasts for Tariff V residential gas use.

In the short term, based on modelling by Frontier Economics, APA VTS was forecasting higher levels of Gas Fired Generation (GFG) than AEMO was forecasting. The higher APA VTS forecasts were driving significant capex.

There were differences between APA VTS forecasts and Victorian Government forecasts as to the impact that VRET will have on demand forecasts.

CCP11 found it anomalous that ATA VTS had chosen to use distribution business forecasts as the basis for its forecasts for Tariff V residential gas use, rather than AEMO forecasts. AEMO forecasts are more generally used as they are independent of any business.

1.2 The AER's Draft Decision

The AER accepted APA's proposed forecast of GPG demand, and accepted the Tariff V forecast being based on distribution business forecasts.[14]

The AER agreed with its consultant ACIL Allen's view that APA's proposed forecast of GPG is sound. This included consideration of the impacts of VRET.[15]

CCP11 is comfortable that in its Draft Decision the AER adequately addressed the issues that had been raised by CCP11.

1.3 APA VTS Revised Proposal

The APA VTS Revised Proposal accepted the demand forecasts in the AER's Draft Decision and made no further changes.

This leaves no outstanding issues on APA VTS demand forecasts.

[14] AER Draft Decision APA VTS Overview, section 3.3 Forecast Demand
[15] AER Draft Decision APA VTS Attachment 13 – Demand, section 13.4.6 Demand forecasts for gas powered generation

2. Capital Expenditure

2.1 CCP11 advice on regulatory proposal

In its Advice to the AER regarding capital expenditure,[16] CCP11 expressed concern with APA's overspend in the current access arrangement period (2013-2017) on expansion of the Victorian Northern Interconnect (VNI) to export gas from Victoria. The focus of concern was on how over its long regulatory asset life the cost would be recovered from the beneficiaries of the expansion, rather than from Victorian consumers.

With respect to capital expenditure proposed for the 2018-2022 period, CCP11 expressed some concerns with the proposed acquisition of an easement for the prospective Western Outer Ring Main (WORM) and on proposed urban encroachment pipeline protection. It also queried APA's classification of transmission pipeline inspection costs as a capital expense.

CCP11 made the following recommendations to the AER:

- The AER should consider whether the VNI expansion capital expenditure, made for the benefit of shippers moving gas interstate, is prudent and efficient having regard to it being of limited or no benefit to Victorian consumers (and completely unjustified without the shippers taking gas interstate) and there being no certainty that, by its inclusion in the Regulatory Asset Base (RAB), those consumers may not be required to pay for part of it in the future.
- If the VNI expansion capex is accepted, consideration should be given to whether tariffs in the period 2018 to 2022 recover all relevant costs from the shippers taking gas out of Victoria.
- The AER should explore how to ensure, over the regulatory life of the assets, that these costs are recovered from the beneficiaries of that expansion, not from all Victorian gas consumers. This may require changes to regulatory provisions to quarantine these costs so the consumers of gas from the VTS only contribute to the fraction of the VNI expansion costs that benefits them.
- The AER should examine the case made for the early acquisition of the easement for the WORM to evaluate its merit. If the suggested cost savings are robustly supported and there are firm prospects that the WORM will be constructed by 2025 the AER might consider approving the investment. If there is reasonable doubt then the AER might consider options like allowing a pass through event following a firm decision to construct the WORM.
- The AER should consider engaging an expert to review the APA risk assessments associated with the urban encroachment pipeline protection projects. It should also consider the appropriateness of the selection of the more expensive slabbing option for the VNI (on the information supplied, seemingly because of the capacity needs for gas to be delivered to NSW) and if appropriate, treat the extra $1.1 million cost as capital to be recovered, over its regulatory life, from shippers exporting gas.
- The AER should examine pigging and the other items that APA capitalises for regulatory purposes but treats as operating expenses for tax purposes, including looking at how the same expenses have been treated by other transmission pipeline owners and provided for in their Access

[16] Advice to the AER – CCP11 Response to proposal from APA VTS for a revenue reset/access arrangement for the period 2018 to 2022 – 3 March 2017 pp.19-26

Arrangements. If APA's inconsistent treatment is not justified, then these expenses should be treated as operating expenses for regulatory purposes.

2.2 APA's supplementary proposal

On 21 April 2017, APA provided the AER with a supplement to its initial proposal, in the form of what it called a business case for construction of the WORM as a matter of priority in the coming 2018 to 2022 access arrangement period. APA provided a further supporting document on 15 May 2017. APA's change of plan was said to result from new information from AEMO that had not been available when it submitted its initial proposal for 2018 to 2022 period in January 2017. The AER asked CCP11 to provide advice on APA's business case for construction of the WORM in the 2018 to 2022 period. CCP11's advice acknowledged a need for the proposed construction of the WORM in the 2018 to 2022 period and that the prudent and efficient cost would be conforming capital expenditure under the National Gas Rules. CCP11 also demonstrated in its advice that the need for the WORM was driven by several factors other than security of supply for Victorian consumers, including gas powered generation, maintenance arrangements, shipper gas contracts, Iona storage facility filling behaviour and interstate gas and electricity demand. The advice therefore expressed concern that:

- The capital costs should be recovered from the beneficiaries over the long regulatory asset life (and not disproportionately from Victorian gas consumers to the extent that the expansion has not been for their benefit); and
- The capital allowance for construction of the WORM should reflect the prudent and efficient estimated construction cost.[17]

2.3 The AER's Draft Decision

VNI Expansion Capital Expenditure (2012-2017 period)

The AER's Draft Decision accepts the $339.2 million expenditure on the expansion of the VNI, noting:[18]

- APA's positive present value of incremental revenue over the 55 year asset life (assuming 40% straight line capacity utilisation), justifies the capital expenditure and is made on assumptions which are reasonable in the circumstances;
- Independent advice (from Sleeman Consulting) indicates that the estimated capital cost is reasonable, supporting the conclusion that the expenditure is prudent and in accordance with good industry practice;
- APA says the resulting increased gas flows will save Victorian consumers approximately $5 million per year in overheads.

In light of this, CCP11 considers that the AER's acceptance of the cost of the VNI is reasonably based.

[17] Consumer Challenge Panel Advice to the AER regarding a proposal from APA VTS to complete the Western Outer Ring Main (WORM) in the coming 2018-22 Access Arrangement Regulatory Period - 6 June 2017

[18] AER Draft Decision APA VTS access arrangement 2018 to 2022 Attachment 6 – Capital expenditure July 2017 pp. 6.12 - 6.14

The AER also noted that the tariff for the VNI, paid by parties exporting gas to NSW, is designed to recover the VNI expense in the 2018 to 2022 period and in respect of future access arrangement periods the AER commented:

> *We consider where demand or gas volumes on the VNI does not eventuate beyond the 2018-22 access arrangement, and gas is not flowing into Victoria then APA should bear the costs and risk associated with this. That is, other non-NSW customers would not pay for the VNI unrecovered costs (that is, not yet recouped through depreciation).*
>
> *… Our view is that this draft decision can only set revenues and tariffs that pertain to the 2018-22 access arrangement period. During future access arrangements reviews we will again check APA's proposal for costs recovery and associated tariff implications. Forecasts of demand and throughput for the transmission pipeline will also affect our determinations of revenues and tariffs for future access arrangements.*[19]

CCP11 acknowledges that the AER has assessed that in the 2018 to 2022 access arrangement period the cost of the VNI in that period will be recovered from exporters of gas and that Victorian consumers will benefit from these users paying a share of overheads. CCP11 supports the AER's view that APA should bear the costs and risks if future gas flows do not support the VNI, and we acknowledge the limitation on the AER that it is not able to set revenues and tariffs beyond the access arrangement period being considered.

However, CCP11 remains concerned that over the 55 year life of this asset that Victorian users may unreasonably come to meet the expenses of the VNI if for no other reason than the history of its development is lost.

Capital Expenditure in the period 2018 to 2022

In its Draft Decision, the AER has closely examined the proposed capital expenditure, with independent advice, and has made adjustments that result in approval of $215 million of the $256.1 million sought by APA for the 2018 to 2022 period. This includes accepting the $126.7 million expenditure for construction of the WORM, while limiting expenditure on other proposed works.[20]

CCP11 has accepted that the construction of the WORM is required and is consistent with the National Gas Rules. Its concerns regarding the prudency and efficiency of the proposed cost have been considered by the AER and its advisor, Sleeman Consulting, which consideration affirms that the forecast costs are prudent and efficient.[21]

As with the VNI expansion, CCP11 is concerned that the cost of the WORM (which will be added to the RAB and have a regulatory life of 55 years) be recovered fairly from the parties who benefit from the expansion over the full life of the asset. This will include gas consumers in Victoria as well as other parties such as gas fired generation and gas exporters to South Australia. Recognising the importance of the user pays principle, AER has proposed that in the 2018 to 2022 Access Arrangement, gas shipped through the WORM for injection into the Iona storage facility be charged the "cross system tariff" as well as the "refill tariff" noting:

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[19] AER Draft Decision APA VTS access arrangement 2018 to 2022 Attachment 10 – Reference tariff setting July 2017 pp. 10.21 - 10.22

[20] AER Draft Decision APA VTS access arrangement 2018 to 2022 Attachment 6 – Capital expenditure July 2017 pp. 6.6 & 6.21

[21] AER Draft Decision APA VTS access arrangement 2018 to 2022 Attachment 6 – Capital expenditure July 2017 pp. 6.23

> *For its 2018–22 access arrangement APA proposed to continue this charging regime. We consider this could potentially create a distortion where shippers are utilising the low refill tariff to cross-ship and send gas to Adelaide via the SEA Gas pipeline. The concern is these shippers are charged only the refill tariff and no costs for transporting gas across the VTS. Shippers putting gas into storage and re-injecting it back into the VTS during the winter months however are recovering the full cost burden of the SWP through the injection tariff. We consider this has the following implications for cost recovery:*
>
> - *some users of the VTS may not be contributing their share towards the cost of the VTS*
> - *Victorian gas customers may end up subsidizing South Australian customers.*
>
> *One way to address these concerns would be to charge the cross-system tariff and the refill tariff to those users who ship gas from Longford or Culcairn to Iona storage and then on to the Sea Gas pipeline.*[22]

The efficacy of the WORM tariff is discussed in Section 5 below. However, the challenge remains, as with the tariffs covering the VNI expansion, how to ensure that the underlying rationale that directs this user pays principle, is not lost or forgotten in ten or twenty years when tariffs are being set, with the result that Victorian gas consumers then come to pay for a part of this expansion which was never required by their needs alone.

In reaching its Draft Decision the AER has, with independent expert advice, closely considered the proposed pipeline integrity works (slabbing) and concluded:

> *…our position in this draft decision is that the proposed $24.2 million ($2017) for slabbing is not conforming capex. However, we invite APA to respond with an alternative slabbing program that is more consistent with the rate of urban development along the three pipelines over the next 20 years.*[23]

CCP11 considers this to be an appropriately cautious approach in the circumstances subject to further information from APA.

CCP11's concerns regarding the classification of pigging as capital expenditure are allayed with the AER accepting APA's classification with the following comment:

> *… we note that the difference between treating pigging as opex or capex, once it is approved, is not likely to be material, as all expenditure in the building block model is treated symmetrically. Therefore, the overall difference between treating expenditure as capex or opex should be NPV neutral.*[24]

2.4 APA VTS Revised Proposal

APA contests the AER's reduction or rejection of several of the capital projects which constituted the AER's Draft Decision allowing $41.1 million less for capital expenditure in the 2018 to 2022 period than APA sought. APA sets out further justification for the contested projects which the AER will need to consider.

[22] AER Draft Decision APA VTS access arrangement 2018 to 2022 Attachment 10 – Reference Tariff Setting July 2017 p. 10.19
[23] AER Draft Decision APA VTS access arrangement 2018 to 2022 Attachment 6 – Capital expenditure July 2017 pp. 6.27
[24] Ibid. p.6.25

The pipeline protection project (slabbing), which the AER did not accept but invited APA to provide an alternative program has reduced in scope. The largest part of the cost reduction arises because of changes in operating arrangements for the Brooklyn to Corio Pipeline, which allow its pressure to be reduced. Pressure reduction was an alternative to slabbing to reduce the risk from a pipeline strike, so this change saves investment in 7km of slabbing.[25] APA sets out further justification for the remaining reduced program, and CCP11 encourages the AER to undertake further expert review of this, to assess its merit to validate whether an appropriate balance between expenditure and safety is evident.

2.5 Long term risk of expansion capital expenditure

CCP11 notes that APA supports the AER's proposal that parties delivering gas to the Iona storage facility for subsequent export to South Australia pay the "cross system" tariff as well as the low "refill tariff", but has identified practical problems with implementing the AER proposal and has suggested an alternative. CCP11 supports APA's aim with its 2018 to 2022 tariff proposal to ensure a 'user pays' approach for the WORM investment as well as with the VNI expansion costs. This is discussed further in Section 5 – Tariffs, below.[26]

However, addressing the fair recovery of expansion capital expenditure in the 2018 to 2022 period is a small fraction of this issue raised by CCP11 in its initial advice to the AER. The expansion capital of concern is:

- Expansion of the VNI in the 2012-2017 period for the sole purpose of facilitating a major increase in gas moving from Victoria to NSW and Queensland;
- Expansion of the SWP in the 2012-2017 period, in part to support gas moving to South Australia; and
- Completion of the WORM in 2018-2022, in part to support gas moving to South Australia and to supply gas fired power generation for the benefit of electricity users in Victoria and South Australia.

Assuming no material changes in the regulatory framework, the cost of these investments may remain in the RAB and continue to be recovered through tariffs that will be set in up to ten more access arrangement reviews, through to the second half of this century. Over this long term, there is a real risk that Victorian gas consumers may come to be the parties who pay for a large part of these investments in capacity expansion that were only partially or not at all for their benefit. This may occur just because the reasons for the original expansion and the basis of current tariffs are lost or forgotten. It is acknowledged that in a changing gas market, some of this investment may come to be for the benefit of Victorian consumers (such as if gas comes to be imported to Victoria from South Australia or NSW), and it would be then entirely appropriate for the relevant benefit to be recovered from Victorian consumers through future tariffs.

CCP11 is not aware of any mechanism in the regulatory framework that would preserve the reasons for particular capital investments and the rationale for tariff structuring. There may be existing options: could it be captured in the access arrangement; perhaps the AER has a data base to preserve such knowledge that is incorporated into its access arrangement review process so that future

[25] Victorian transmission system access arrangement proposal – submission in response to draft decision 14 August 2017, p.45
[26] Ibid. p.103

personnel access and use the information. It is important to the long term interests of consumers that future tariff setting apportions the RAB for relevant assets to the beneficiaries of those assets. If in the future the parties for whom the investment was made no longer use the asset, and the asset is not then needed for the benefit of Victorian consumers, the value in the RAB should be removed (partially or fully, depending on the extent of the remaining benefit to consumers).

CCP11 recommends that the AER explore options on this matter, and implement a plan to ensure that, over the long term, tariffs continue to be set in order to recover the capital costs of these major expansions from the beneficiaries.

3. Operating Expenditure

In its initial regulatory proposal, APA proposed an overall small increase in operating expenditure over the next access arrangement period, with reductions in insurance costs and corporate overheads being offset by proposed step and scope changes. CCP11 advised that while the forecast reduction in insurance costs and corporate overheads was welcome, several of the proposed opex changes warranted further scrutiny.[27]

Although AER's Draft Decision accepted APA's forecast opex, it did not include any opex changes proposed by APA.[28] The AER adopted APA's corrected forecast for return on the inventory of linepack and spare pipes, valves and fittings (spares). APA accepted the AER draft decision on forecast opex.

CCP11 also recommended that the AER should ensure that the arrangements put in place in this regulatory determination fully quarantine all the costs (including opex) associated with expenditure to benefit interstate shippers of gas from Victoria into New South Wales. The AER confirmed that only NSW customers would pay for the VNI in the 2018 to 2022 access arrangement (see Section 5 – Tariffs).

CCP11 is satisfied that the draft decision has addressed all of the operating expenditure issues raised in relation to the 2018 to 2022 access arrangement period. We continue to have concerns regarding the appropriate allocation of operating costs associated with assets developed to benefit interstate shippers of gas in future access arrangement periods, potentially for 50+ years.

[27] Advice to the AER – CCP11 Response to proposal from APA VTS for a revenue reset/access arrangement for the period 2018 to 2022 – 3 March 2017, p.29

[28] AER Draft Decision APA VTS gas access arrangement – Attachment 7, p.23

4. Rate of Return and Inflation

4.1 Introduction and summary

The AER's 2013 Rate of Return Guideline (Guideline)[29] set out the AER's preferred approach to calculating a rate of return, the forecast of expected inflation and the value of imputation credits (gamma), in order to best satisfy the National Gas Objective (NGO) and the Revenue and Pricing Principles (RPP),[30] and to achieve the allowed rate of return objectives (ARORO) in the National Gas Rules (NGR).[31] In particular, the Guideline established that:

- The return on equity is be determined by adopting the Sharpe-Lintner CAPM (SL CAPM) as the 'foundation model' supported by other relevant information and models. Specific values were set in the Guideline for the equity beta (**β**= 0.7) and the market risk premium (MRP = 6.5%).
- The return on debt is to be determined using a 10-year trailing average approach along with a period of transition to move from the 'on-the-day' to the trailing average methodology.
- Inflation is modelled on the basis of achieving the best estimate of 10-year average expected inflation. This is measured using the geometric average of the RBA's 2-year forecast of expected inflation and the mid-point of the RBA's target inflation range for the remaining eight years.
- A calculation of the value of imputation credits of 0.4 based on the product of the estimate of the payout ratio (0.7) and the utilisation rate (theta = 0.6) of imputation credits and where theta is derived from domestic equity ownership and tax statistics.

Each component of the rate of return assessment, the AER's approach to inflation and the value of imputation credits has been the subject of multiple appeals by various networks to the Australian Competition Tribunal (Tribunal) and the Full Federal Court (Court). At a broad level, the NSW Tribunal has confirmed the AER's approach to return on equity, but has rejected the AER's approach to the return on debt using a transition and to corporate tax (gamma component). A differently constituted Tribunal (SA Tribunal) confirmed the AER's approach to both debt transition and gamma. The AER has appealed the NSW Tribunal's decision to the Court. In May 2017, the Court confirmed the NSW Tribunal's decisions on transition, but rejected the NSW Tribunal's decision on gamma. SA Power Networks (SAPN) has appealed the SA Tribunal decision, and the Court has reserved its judgement. Further appeals on different matters are pending including the Victorian network's appeal to the Victorian Tribunal.

It is against this complex legal situation that the Victorian gas distribution and transmission businesses submitted their initial proposals in January 2017, and CCP11 responded to these proposals in March 2017. The AER's Draft Decision and the current Revised Proposals by the gas businesses have been made after the Federal Court's decision on the NSW/ACT appeals was published.

In its initial proposal on the rate of return, APA proposed significant variations to the AER's 2013 Guideline with respect to both return on equity and return on debt. With regard to the return on equity, APA proposed a higher market risk premium (MRP) of 7.76% and a higher equity beta of 0.8, with a total return on equity of some 8.45%. In addition, APA proposed that the Guideline approach

[29] AER, Rate of Return Guideline, December 2013; AER, Explanatory Statement, Rate of Return Guideline, December 2013. While the Guideline applies to both electricity and gas distribution, the focus in this submission is on the gas distribution requirements.

[30] The NGO and RPP are set out in the National Gas Law (NGL). Equivalent provisions apply under the NEL.

[31] See NGR r. 87(2). Equivalent obligations are set out in the National Electricity Rules (NER).

of directly estimating the MRP was incorrect and that the MRP should be regarded as the residual once the overall return on equity and the risk free rate were calculated.[32]

APA also proposed an immediate adoption of the trailing average approach to estimating the return on debt, without a transition period. As a result, the proposed return on debt was 7.47%, well above the AER's recent determinations of a return on debt of around 5%. APA adopted all other aspects of the AER's Guideline with respect to the return on debt (e.g. credit rating, data series, averaging periods).

With respect to the estimation of expected inflation, APA proposed updating the AER's forecast of expected inflation with actual inflation (lagged one year) for each year of the regulatory period, paralleling the annual update of the return on debt. In its initial proposal, APA also proposed a value for gamma (imputation credits) of 0.25 compared to the current value adopted by the AER of 0.4.[33]

In its March 2017 advice to the AER, CCP11 made recommendations to the AER that are summarised below:[34]

- The proposal by APA to adopt a higher value for MRP (7.76%) should not be accepted by the AER;
- The AER should not accept APA's proposed methodology for calculating MRP;
- The proposal by APA to adopt a higher equity beta value should not be accepted by the AER;
- The proposal to adopt an immediate transition to the trailing average should not be accepted by the AER; and
- The AER consider the risks and benefits of annual updating of expected inflation with actual inflation (lagged one year). Note, CCP11 provided limited advice on the approach to inflation given that this issue would be addressed in the proposed inflation review.

CCP11 did **not** provide advice on the assessment of gamma on the basis that the Full Federal Court would determine this in its decision on the NSW Tribunal's gamma decision. However, our standard position would be to recommend that the AER's decision should comply with its Guideline rather than with the non-compliant proposals of the networks, unless there was a compelling reason to change the approach, such as evidence that the taxation allowance (including gamma adjustment) was insufficient to cover the tax and imputation obligations of the network businesses. We did not see that evidence provided by APA.

Moreover, the AER's decisions on the rate of return, inflation and gamma do not occur in a vacuum. It is important that these decisions are made within the overall general regulatory approach to the rate of return. Specifically, it should be consistent with the incentive framework, internally consistent and assessed on the basis of investors' expectations for long-term investments in long-term assets.

The assessment of current short-term market indicators must be tempered by the regulatory focus on the long-term underlying trends in expectations in financial markets. In essence, the regulatory framework is seeking to establish the prevailing expectations of investors, while noting that this is equivalent to the prevailing expectations for long-term financial returns on long lived assets. It is not

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[32] APA calculated a return on equity of 10% for the total market and a risk free rate of 2.24%. The MRP was therefore (10%-2.24% = 7.76%).

[33] The AER's Guideline included a value for gamma of 0.5. However, AER updated this in 2014 to 0.4 on the basis of additional material provided to it by its consultants.

[34] See, CCP11 Response to Proposal from APA VTS for the 2018-22 access arrangement 3 March 2017, p.p. 72 & 85. Note, CCP11 did not provide any advice on the value of gamma adopted by the networks although both AusNet and Multinet proposed a value of 0.25 compared to the AER's Guideline figure of 0.4.

about the returns that can be expected in the next year or so. Think pension fund rather than trader. This approach is consistent with the use of 10-year Commonwealth Government Securities (10-yr CGS) and 10-year commercial bonds (10-yr BBB bonds) in the calculation of the return on equity and return on debt respectively.

For this reason, CCP11 was sceptical of much of the evidence provided by the gas networks, including APA, and its consultants, as this was based on analysis of shorter-term market trends. For example, CCP11 considered that the evidence provided in the initial revenue proposal did not support a change in the equity beta/MRP since 2013, despite the various claims that it did. Particularly notable was the network's focus on shorter-term data such as five-year historical equity data or recent trends in dividend growth (as assumed in the Dividend Growth Model). Similarly, we did not accept that it was appropriate to change the AER's approach to inflation at this point in time or to move to replace expected inflation with actual inflation within the regulatory period.

The AER's Draft Decision: The AER did not accept APA's proposals for the rate of return on equity or the return on debt. Nor has the AER accepted APA's proposals on annual updating of expected inflation with actual inflation (lagged) or on the lower 'market-based' value for gamma. The reasons for the AER's Draft Decisions are summarised in sections 4.2 to 4.4 below.

The AER's Draft Decision largely aligns with the views expressed by the CCP11 in its response to APA's initial proposal. We support the AER's decision, albeit noting that some aspects of the AER's decision (and the Guideline on which they are based) have been considered "conservative" by previous CCP sub-groups and consumer groups. However, CCP11 considers that stability and certainty must be priority considerations at this stage, given the ongoing appeals and the pending reviews of inflation and of the Rate of Return Guideline. The AER's reasoning has evolved since the completion of the 2013 Guideline (without changing the fundamental Guideline parameters and approach), and we have given some consideration to these explanations.

APA's Revised Proposal: APA has largely rejected the AER's approach. APA accepted the AER's Draft Decision on the value of gamma, based on the decision of the Full Federal Court that the AER was not in error. Notably, however, APA expects that: "the debate on the valuation of imputation credits will continue, and an estimate of 0.4 [the AER's figure] will be no more than another step along the way".[35]

APA's decision not to accept key aspects of the AER's Draft Decision is in marked contrast to the decisions by the Victorian gas distribution networks. APA's Revised Proposal will be considered in more detail in Section 4.2 and 4.3 below. It is important to highlight that APA's continued pursuit of these claims will serve to further divert resources from consumers, the AER and the business itself.

[35] APA VTS Access Arrangement Revised Proposal, August 2017, p. 94.

Table 4.1 summarises the AER's 2013 Guideline, APA's initial proposal, the AER's Draft Decision and APA's response to the Draft Decision in its Revised Proposal:

Table 4.1: Summary: AER 2013 Guideline, AER's Decision, APA's proposals and CCP11 Response

	AER 2013 Guideline	**APA's Proposal (Jan 2017)**	**AER's Draft Decision (July 2017)**	**APA's Revised Proposal (Aug 2017)**	**CCP11 Response**
Return on Equity					
Modelling framework	SL CAPM foundation model	Adopt SL CAPM except for MRP approach	SL CAPM foundation model	SL CAPM except for MRP approach Adopt	APA's approach not supported
Equity beta	0.7	0.8	0.7	0.8	APA's approach not supported
Market Risk Premium	6.5%	7.76%	6.5%	7.70%	APA's approach not supported
Risk Free Rate	10-yr CGS averaged over 20 BD	Adopt	Adopt	Adopt	Support
Return on debt					
Modelling framework	10-yr trailing average with annual update	Adopt	Adopt	Adopt	Support
Transition	10-yr transition to trailing average	Not accept	Adopt Guideline transition	Not accept	APA's approach not supported
Debt	Average RBA & Bloomberg 10-yr BBB bond series	Adopt	RBA series only	RBA, Bloomberg & Reuters series	Reject proposed changes to series
Expected Inflation					
Modelling Approach	Average of RBA forecast for 2 yrs + mid-point RBA target range fro 8 yrs	Not accepted, propose annual updating of expected inflation with actual inflation + compensation	RBA 2-year forecast and mid-point of target range for 8 years	Not accepted, propose annual updating of expected inflation with actual inflation + compensation	Reject proposed changes to inflation estimation at this stage and compensation
Gamma					

	AER 2013 Guideline	APA's Proposal (Jan 2017)	AER's Draft Decision (July 2017)	APA's Revised Proposal (Aug 2017)	CCP11 Response
Payout ratio	0.7	Adopt	Adopt	Adopt	Support
Utilisation Rate	0.6	0.35	0.6	Adopt	Support

As illustrated in Table 4.2 below, APA's Revised Proposal seeks a rate of return that is significantly above the AER's Draft Decision (WACC of 7.7% versus AER's Draft Decision of 5.75%). APA's Revised Proposal for the rate of return is also significantly greater than the allowance that has been accepted by the Victorian gas distribution businesses. APA provides no explanation as to why APA (assuming it is efficient) requires a greater WACC than the gas distribution businesses.

A key element in evaluating the AER's Draft Decision versus APA's Revised Proposal is to 'sense test' the equity and debt premiums. For example, APA is proposing that investors in long-term assets, subject to regulatory protections, and seeking stable returns would require an equity risk premium of 6.12%, and that debt providers would require a debt premium of 4.23% over the risk free rate?[36]

An important element of the reform of the gas rules in 2012 was to draw attention from the detail to the overall outcomes. For example, APA and its consultants write extensively on equity beta and MRP, but make no attempt to demonstrate why the overall return on equity represents an efficient cost for equity, given the risks of the Victorian regulated gas transmission pipeline and the investment criteria of long-term infrastructure investors. We note here, for instance, that the regulatory framework ensures that across a regulatory period, investors will receive a constant real rate of return. This is discussed further in sections 4.2 and 4.3.

Although APA and the AER estimate the initial expected inflation in the same way, APA's initial proposal and Revised Proposal updates the expected inflation each year with actual inflation (lagged one year). That is, by the end of the regulatory period, APA's inflation will not represent 'expectations' but instead it will be based on realised inflation outcomes. Estimating the components of the rate of return based on prevailing investor expectations, however, is central to the AER's estimation of the return on equity in particular.[37]

Similarly, differences in inflation forecasts will flow through to the underlying value of the real rate of return: the lower the value of inflation in the AER's revenue model, the higher the real rate of return (all other things being equal).[38] A lower gamma figure also translates into higher revenues for the networks. These issues are discussed further in sections 4.3 and 4.4.

The remainder of this submission will respond to aspects of the AER's Draft Decision and APA's response in its Revised Proposal. The AER's Draft Decision raises important points of principle and demonstrates the AER's own evolving view on how to determine a rate of return that best meets the

[36] Equity risk premium = (8.8% - 2.68%), debt risk premium = (6.91% - 2.68%). For details, see Table 4.2 below and Table 6-1 in APA's Revised Proposal.

[37] That is, the AER endeavors to establish a priori, expectations for average 10-year inflation outcomes at the start of the regulatory period.

[38] That is, the nominal rate of return under the WACC is effectively adjusted by deducting the inflation forecast using the Officer formula for converting nominal to real values (and vice versa).

ARORO. This evolution of the AER's thinking also reflects inter alia the analyses set out in the decisions of the various Tribunals and the Full Federal Court. APA has provided a limited amount of additional material to accompany its Revised Proposal.

Summary of recommendations

The AER not accept the rate of return in APA's Revised Proposal, including the return on equity, and the return on debt.

CCP11 also recommends that the AER further develop its atlas of 'real world' financial data with which to benchmark its decisions on the cost of equity and debt.

APA has raised specific issues around the Equity Beta and the MRP. CCP11 encourages the AER to undertake and publish its own update of the Henry equity beta study. CCP11 also encourages the AER to consider what value the Dividend Growth Model (DGM) provides in estimating the long-term MRP.

The AER not accept APA's proposed treatment of inflation. CCP11 welcomes the AER's ongoing investigation into the measurement and application of inflation expectations in the ex-ante revenue forecasts.

The AER accept APA's Revised Proposal for gamma.

CCP11 notes APA's expectation that gamma will continue to be an issue for debate and recommends that the AER continue to collect relevant financial data.

The AER's revised understanding of the benchmark efficient entity (BEE) is important and CCP11 recommends that the AER undertake further investigation into the types of risks of the BEE (whether regulated or not regulated).

4.2 AER's Draft Decision – Rate of Return

4.2.1 Overview of the AER's Draft Decision and APA's Revised Proposal

In its Draft Decision, the AER did not accept most of the key elements of APA's proposal. Given APA's Revised Proposal is little changed from its initial proposal, APA will need to provide significant new supporting evidence for its Revised Proposal.

The AER's Draft Decision determined an allowed rate of return of 5.75% (nominal vanilla) for APA, consistent with its decision on the three Victorian gas distribution businesses. While all three of the gas distribution businesses accepted the AER's rate of return Draft Decision, APA's Revised Proposal specifies a rate of return of 7.7%, more than 2% greater than the rate of return accepted by the other three Victorian gas businesses.

This leaves us to question how APA's Revised Proposal can represent efficient financing and thereby satisfy the requirements in the NGO, RRP and ARORO represents an efficient financing benchmark. It is hard to see that APA's regulated Victorian business experiences greater risk than the gas distribution businesses particularly as APA VTS benefits from a greater diversity of demand across the state and operational risk is reduced in the Victorian Declared Transmission System owing to the unique role of AEMO in operational decisions and supply/demand balancing.

Key components of the AER's Draft Decision & APA's Revised Proposal on the Rate of Return

The AER's determination of a nominal vanilla WACC and APA's response in its Revised Proposal is summarised in Table 4.2 below.[39] A brief summary of CCP11's perspective on the Revised Proposal is also included in Table 4.2. Rows that are highlighted in green represent areas of dispute and which will be considered further in this submission.

Table 4.2: Allowed Rate of Return

	APA Proposed	AER Draft Decision	APA Revised Proposal	CCP11 Comment on Revised Proposal
Risk free rate (nominal	2.24%	2.60%	2.68%	Approach in line with Guideline. Differences due to timing
Equity beta	0.8	0.7	0.8	Do not support APA's analysis
Market Risk Premium	7.76%	6.5%	7.70%	Do not support APA's analysis
Rate of return on equity	8.4%	7.2%	8.8%	APA's proposal implies an equity risk premium of 6.12%, which is not consistent with efficient financing given the risks
Rate of return on debt	7.47%	4.79%	6.91%	APA's proposal implies a debt risk premium of 4.23%, which is not consistent with efficient financing given the risks
Gearing	60%	60%	60%	Approach in line with Guideline
Allowed Rate of Return	**7.8%**	**5.75%**	**7.7%**	**Overall rate of return significantly greater than rate of return accepted by the gas distribution businesses. There does not appear to be any rationale for APA to be allowed a higher rate of return.**

CCP11 has highlighted above, and in our previous submission to the AER, that some of the AER's rate of return parameters have been regarded as conservative, a point highlighted by several CCP subgroups and consumer groups since 2013. In particular, we note that the AER has generally selected point estimates at the top of the empirically derived ranges.

Nevertheless, the discussion that follows is focused on APA's Revised Proposal rather than the AER's Draft Decision. However, before considering these individual elements it is important to explore the more recent developments in the concept of the benchmark efficient entity (BEE). These recent developments highlight the importance of developing a clear understanding of the risks of the regulated businesses and comparator businesses.

4.2.2 Efficient financing costs and the benchmark efficient entity (BEE)

Underpinning the AER's analysis of APA's proposal is its ongoing development of the concept of 'efficient financing costs' as expressed in the ARORO. This includes developing its understanding of the BEE based on the core elements in the ARORO of 'risk', 'similar' and 'reference services'.[40]

[39] APA VTS, Revised Access Arrangement, August 2017, Table 6-1, p. 70.

[40] The ARORO provides for a rate of return commensurate with the *efficient financing costs* of a *benchmark efficient entity* with a *similar degree of risk* as that which applies to the service provider in respect of the provision of *reference services* (see NGR, r. 87(3)).

CCP11 regards the AER's ongoing clarification of the BEE as essential, particularly following the decisions of the NSW Tribunal and the Full Federal Court (Court). While the Court confirmed the Tribunal's view that a BEE cannot be defined by reference to a 'regulated entity' as the AER had done in the past;[41] the Court stressed that the relevant BEE is an entity with a *'similar risk'* for the '*provision of reference services'* (whether regulated or not). [42] The Court has emphasised this distinction throughout its judgement. For example:

> *[537] Thus, in our view,* ***it is not appropriate to characterise the benchmark efficient entity as either regulated or a non-regulated****. The allowed rate of return objective does not do so, and there is no need to do so.* [emphasis added]
>
> …
>
> *[592]…we repeat our conclusion that the allowed rate of return objective in r 6.5.2(c) does not import the characterisation of the benchmark efficient entity as a regulated entity. It does, however,* ***require the benchmark efficient entity to be taken as having a similar degree of risk as that which applies to the particular service provider in the provisions of its standard control services****. As we have remarked, this degree of risk may be affected by the fact that the provision of the services is regulated by price control. [emphasis added]*

The AER's most recent approach is summarised in its Draft Decisions for the Victorian gas businesses, as follows:[43]

> *We adopt the Full Federal Court's decision that a benchmark efficient entity is not necessarily to be characterised as a regulated entity. Therefore in assessing the efficient rate of return* ***we look to comparators that have similar risk characteristics****. Otherwise our allowed rate of return would not achieve the ARORO or the NGO.* (emphasis added)

CCP11 supports the AER's approach following the Court's decision, and its application to the rate of return. We expect that the concepts such as 'similar risks' to the entity providing network services will be an important point for discussion in the review of the AER's Rate of Return Guideline. For instance, as the Court noted, one consideration is whether the BEE should include only those entities subject to some form of price control that in turn can be considered as limiting excess profits but also limiting losses and protecting cash flow and asset values.

APA and its consultant, Frontier Economics (Frontier), appear to have effectively ignored the Court's analysis and decision in its Revised Proposal, even though the Court's judgement was published in May 2017, months before the submission of Revised Proposal. In particular, the Court specifically stated that the BEE could not be construed as an unregulated entity as Frontier claims (based on the NSW Tribunal's wording rather than the higher Court).

As highlighted above, the Court concludes that the central feature of the BEE is the assessment of the similarity of risk facing the businesses, whether regulated or unregulated. In turn, the

[41] In its Draft Decision, the AER states that: "*we previously considered a benchmark efficient entity would be a 'pure play,* ***regulated*** *energy network business operating within Australia*" (see Attachment 3, p. 322). This definition was included in the AER's 2013 Guideline and in all its decisions that followed the publication of the Guideline.

[42] See for instance Federal Court of Australia, *Australian Energy Regulator v Australian Competition Tribunal (no 2)[2017] FCAFC 79*, May 2017, @ [529]-[545]. The Court provides a detailed analysis of both the AER's and the networks' interpretations of the ARORO and the benchmark efficient entity.

[43] AER Draft Decision APA VTS, Attachment 3, p. 3-322.

assessment of what counts for 'similar risk' is not a simple task, and certainly not one addressed by Frontier or by APA in its Revised Proposal.

We assess Frontier's analysis further in the discussion below on the equity beta (a component of the return on equity).

4.2.3 AER's Draft Decision re Return on Equity

In its reasoning on the efficient return on equity, the AER highlighted that the NSW Tribunal has upheld the AER's approach to assessing the return on equity, and has not rejected the parameter values (beta and MRP) that the AER has applied to the NSW businesses and in all its subsequent decisions.[44]

Following the AER's current Draft Decisions on the Victorian gas networks, the three gas distribution businesses have accepted the AER's Draft Decisions on return on equity parameters. However, APA continues to dispute the AER's Draft Decision on the return on equity parameters of equity beta and the MRP.

The AER's Draft Decision, and APA's response with respect to both equity beta and MRP is discussed below. Many of the arguments provided by CCP11 to the AER in response to APA's initial proposal are still relevant to the assessment of APA's Revised Proposal, as there is little new evidence provided by APA in the Revised Proposal other than a report from Frontier that extends its previous analysis.[45]

CCP11's view remains that APA has not established a reasonable case for changing the parameter values for equity beta and MRP set out in the AER's Guideline, and used in AER's Draft Decision.

Behind this view, sits the importance of the general principle of regulatory consistency and predictability based on well accepted, robust and transparent analysis, rooted in sound economic theory and practice. That means that there must be a very good reason for the AER to change its approach and the requirement for evidence of the need for change sits with those proposing change, not those defending the well-established status quo. This reasoning must point to an enduring change and one that is consistent with the expectations of long-term investors who are typically concerned with long-term trends rather than short-term market events.

AER rejects APA's equity beta of 0.8; APA maintains its initial equity beta in its Revised Proposal

Determining the value for equity beta that best meets the ARORO has been a long disputed area between the AER and many of the regulated networks. On the other hand, consumer groups have expressed concern that the AER's view erred on the side of "conservatism".[46]

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[44] For example, see Australian Competition Tribunal, *Applications by Public Interest Advocacy Centre Ltd and Ausgrid [2016] ACompT*, 26 February 2016, @ [813]. (*Ausgrid)*

[45] Frontier Economics, *Updated rate of return parameter estimates, report prepared for APA Group*, August 2017. (Frontier, *Updated Rate of Return Estimates,* August 2017).

[46] For example, the Public Interest Advocacy Centre (PIAC) sought an equity beta of 0.5 during the development of the Rate of Return Guideline and raised this same issue with the NSW Tribunal (See for example *Ausgrid*, @ [681-700] and [1211]). The NSW Tribunal quotes from the PIAC's submission to the AER's Draft Decisions as follows: *"For instance, PIAC previously advised the AER that the equity beta set out in the Guideline (0.7) was overly conservative and did not recognise the extent to which the economic risks sat with consumers rather than the networks".* PIAC also argued that the 2014 Henry report, which was produced after the completion of the Guideline provided improved statistical reliability than the 2008-2009 Henry studies relied upon by the AER in its Guideline and the AER should have provided more weight to the updated Henry study (Ibid @ [777-778].

In its assessment of the equity beta, the AER has relied in the first instance on the empirical studies by Professor O. Henry (Henry) in 2008-09 and in 2014 using a range of statistical techniques. The AER states in the Draft Decision that it has repeated the Henry 2014 study using data up to 2017, and found results that are very similar to the 2014 Henry study.

While most networks, including the Victorian gas distribution businesses in their Revised Proposals, have now accepted the AER's Draft Decisions of an equity beta 0.7, APA has persisted in its claim for a higher equity beta. The AER's Draft Decision on APA VTS provides detailed reasoning for its decision and in our view, APA has provided little additional information that should cause the AER to restate its Draft Decision.

The following sections respond to Frontier's August 2017 paper that forms part of APA's Revised Proposal as this report represents the bulk of the limited new information provided by APA.

The AER's approach to beta

Frontier characterises the AER's approach to the calculation of equity beta as follows:[47]

> *Thus the AER's approach is to begin with its "best empirical estimate" of 0.5 from domestic comparators and then* ***apply an uplift to 0.7*** *on the basis of a number of other considerations.*

These "other considerations" are listed as including "international estimates", considerations of the "Black CAPM" and ''investor certainty". Frontier then argues that the AER fails to quantify how much of the uplift from 0.5 to 0.7 is due to each of the three factors, or whether any of these three factors is more or less important than others.[48] Frontier then proceeds to address some of these factors by reference to equity beta estimates by the Economic Regulatory Authority of Western Australia (ERA), Frontier's 'updated' analysis of equity beta and Frontier's analysis of 'comparator' domestic firms.

These factors are considered below. Importantly, however, it is a mischaracterisation of the AER's approach to describe the selection of the top of the equity beta range as some sort of "uplift".

The AER began with an empirically derived equity beta average of 0.5 within a range of 0.4 to 0.7 from the Henry studies. The AER states that by selecting a point at the top of the empirical range it was not using a specific "uplift" for each of the 'considerations' as these were not quantifiable. Rather these considerations provided a "directional guide to selecting a point within the range. For instance, the AER states:[49]

> *Our consideration of the theory of the Black CAPM and international estimates (which we give less consideration) suggest a point estimate towards the upper range. These considerations along with our consideration of investor certainty lead us to set a point estimate of 0.7.*

The AER goes on to state that:[50]

> *We do not consider that the theory of the Black CAPM can reliably support a specific uplift or that it implies that the Sharpe-Lintner CAPM produces biased return on equity estimates.*

The Tribunal also noted the "considerable" support in other consumer submissions to the AER for a lower equity beta. See, for example Ibid, @ [785].

[47] Frontier, *Updated Rate of Return Estimates,* August 2017, paragraph 8, p. 3.

[48] Ibid, paragraph 39-40, p.p. 10-11.

[49] AER Draft Decision APA VTS, Attachment 3, p. 3-187.

[50] Ibid, p. 3-299.

…We consider it open to us to consider the theory underlying the Black CAPM in informing our equity beta. However, we consider the practical application of the Black CAPM produces unreliable empirical estimates.

Thus, it is wrong to conclude that the AER is now required to add some specific "uplift" to the new empirical estimate of 0.7 (claimed by Frontier). Importantly, the AER was entitled to use its discretion to select a point estimate within the observed range, an outcome confirmed in the NSW Tribunal's Ausgrid decision. Even if a new empirical range is established (and we would question this), the AER remains entitled to use its discretion. It is not 'bound' in some-way to add an uplift.

ERA's updated beta estimates

Frontier and APA have cited the ERA's Final Determination in the Dampier to Bunbury Pipeline (DBP)[51] in which the ERA adopted an equity beta of 0.7 as "the best current best statistical estimate". Notably, the ERA did not make further adjustments ('uplift'). Frontier and APA then argue that, for consistency, the AER should now adopt 0.7 as the best statistical estimate then add some quantity to reflect the other considerations that the AER had referred to in its decision to select the top of the range. They suggest that 0.8 should be the lowest equity beta consistent with the AER's approach.

This issue was raised in APA's initial proposal. In its advice to the AER, CCP11 disputed the conclusions that were drawn by Frontier and APA on several grounds.[52] In the first instance, CCP11 noted that the ERA had observed that the theory of the Black CAPM is difficult to put into practice and that "properly framed" there is no low beta bias and an adjustment to the SL CAPM is not required.[53] It would seem, therefore, that Frontier and the APA are selectively using the ERA's analysis. First they are wanting to use the ERA 2016 decision as a basis for increasing the equity beta, but then want to challenge the AER's approach on the basis that it is not accommodating the alleged 'low beta bias' which the ERA claims does not exist if the issue is "properly framed". This contradiction is not discussed in the Frontier August 2017 paper.

Secondly, CCP11 noted that the ERA study had used five years of data and the results were therefore not comparable with the AER/Henry analysis that used 10 years of data. The more limited data set also raises questions about the statistical reliability of the 5-year data and its sensitivity to one off or short-term events. Moreover, the AER's 10-year assessment of regression data was theoretically preferable as it was consistent with the AER's approach that takes a longer-term perspective than the ERA. That is, the ERA relies on 5-year CGS yields and 5-year commercial bond yields to derive the rate of return, where the AER uses 10-year bonds and 10-year commercial bond yields. While – perhaps – the equity beta is higher than observed for the 10-year data set used by the AER, the risk free rate will be lower reflecting the lower yields on 5-year bonds. Again, Frontier or APA does not discuss this in the paper and Revised Proposal.

Moreover, it is important to note, as CCP11 highlighted in its Advice in March 2017, that Frontier's earlier report to APA and others, stated that it was preferable on the basis of statistical reliability to use 10-years of data. Frontier's 10-year analysis indicated an equity beta range of 0.52 to 0.57, an

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[51] ERA, *Final Decision on Proposed Revisions to the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline 2016-2020*. [ERA, *Final Decision, DBP Pipeline*, June 2016]

[52] See, CCP11 Response to Proposal from APA VTS for the 2018-22 access arrangement, 3 March, 2017.
And Beverley Hughson, *"APA VTS: Supplementary advice on APA VTS's proposed return on equity"*, 22 March 2017.

[53] ERA, *Final Decision, DBP Pipeline, June 2016*, Appendix 4. Referenced in the CCP11 3 March 2017 submission, p. 32. Also cited in the supplementary submission, dated 22 March, p.p. 22 – 23.

outcome that is consistent with Henry's 2014 best statistical estimate of 0.5. In Frontier's August 2017 update, Frontier reiterates its preference for longer data series:[54]

> *Our view is that a five-year period is generally insufficient to provide sufficient statistical precision, so we consider estimates from longer (ten year) periods.*

Frontier also concluded that:[55]

> *The general pattern of results is that the 10-year estimates are lower than the 5-year estimates … Expanding the sample period to ten years includes data from prior to the Guideline and has the effect of reducing the equity beta estimates. This observation leads us to examine a series of rolling beta estimates …*

It is clear from this that Frontier's observations support an empirical equity beta within the AER's longer-term (10 year) regulatory framework that is similar to Henry's studies. However, Frontier then draw a different conclusion, that is: "This [the 10-year result] suggests that the correlation between stock returns and market returns (for the four sample firms) has increased markedly over the last five years."[56]

Frontier then claims to test this assumption through the "rolling beta estimates". The next section will touch on Frontier's claim that the market returns has "increased markedly".

Frontiers' updated analysis of equity beta - the observed beta estimates over the past five years

Frontier claims to have undertaken the same analysis as Henry, but updating it for more recent market stock data and focussed on the four firms that are now currently trading in the market. Frontier also states that it has adopted the same approach to de-lever and re-lever the market returns of each of the firm to adjust to the BEE criteria of 60% gearing. On the basis of the last five years using weekly data, Frontier states that it has found a mean estimate for the equity beta of 0.67, and excluding one company (DUET), which has the lowest raw and re-levered beta, the average equity beta of the remaining 3 companies is 0.79.[57] Frontier's results are summarised in Table 4.3 below. The 'adjustment factor' represents the adjustment due to de-levering/re-levering to 60% gearing ratio.

Table 4.3:

Statistic	APA	AST	DUE	SKI	Equally-Weighted Portfolio	Value-Weighted Portfolio
Average gearing	0.50	0.58	0.64	0.28	0.50	0.52
Adjustment factor	1.24	1.04	0.90	1.80	1.24	1.20
Raw beta	0.64	0.66	0.36	0.49	0.58	0.69
Re-levered beta	0.80	0.68	0.33	0.89	0.71	0.83
Standard error	0.09	0.08	0.09	0.12	0.07	0.09
Confidence interval upper bound	0.97	0.84	0.50	1.12	0.85	1.01
Confidence interval lower bound	0.62	0.52	0.15	0.66	0.58	0.65
R^2	0.20	0.21	0.05	0.11	0.25	0.21
Observations	260	260	260	260	260	260

Source: Datastream, Frontier Economics calculations. Five years to beginning of May 2017

54 Fr
55 Ibi
56 Ibi
57 Ibi

Frontier's 5-year updated beta analysis, weekly data, four firms

Source: Frontier, *Updated Rate of Return Estimates* August 2017, Table 1, paragraph 61, p. 17.

There are many questions that can be raised about Frontier's new analysis, some of which are summarised below. Some of the comments below relate to one of the listed firms (APA). While there has not been the opportunity to investigate the other companies in the same level of detail, the APA observations raise questions that might be further investigated by the AER in its Final Decision.

- Gearing ratios: Frontier states that the average gearing for APA is 0.5. However, in the recent annual report from APA, APA states that its debt portfolio has a broad spread of maturities with an average maturity of drawn debt of 7.5 years as at 20 June 2017. It further states that APA's gearing of 67.4% is marginally higher than the 66.4% at June 2016,[58] while gearing at 30 June 2015 was reported as 63.4%.[59]

  This would imply a very substantial increase in APA's gearing (to achieve an average of 0.5 in the three financial years 2012-2014), yet other data suggests that there has been little change in APA's credit rating[60] or its ability to fund substantial (and arguably higher risk) growth in unregulated gas pipelines, gas processing plants, wind and solar farms.

  APA also highlights in its most recent report that is able to: "deliver superior securityholder value year after year, regardless of market cycles,"[61] and points to a TSR compound annual growth rate (CAGR) averaging some 18.2% per annum over 17 years.

  Overall, it is very difficult to reconcile the actual reports from APA with a view from the Frontier analysis that somehow APA's systematic risk has increased. Certainly, the share market does not seem fazed by the post 2014 APA gearing, nor do the rating agencies.

- De-levering/re-levering: While this is a standard technique for comparing businesses, there are issues around the process that require careful consideration, and we note that the AER has undertaken such work although has made few conclusions as a result. Certainly, over a fairly narrow range of raw beta estimates, it might be expected that the re-levered estimates do not necessarily involve a straight-line relationship in the real world. For infrastructure businesses in particular, there may well be a wider range of gearing that is tolerated by the market without impacting on its perceived systematic risk.

  As highlighted also by Partington and Satchell (June 2017),[62] it may be the choice of gearing assumptions that is driving the observed increases in re-levered beta rather than a fundamental change in risk. The updated Frontier report (August 2017) increases APA's equity beta estimate

[58] See https://www.apa.com.au/globalassets/documents/annual-reports/2017-annual-reports/20170823-apa--fy17-results-asx-release.pdf

[59] APT Pipelines Limited, *Annual Report for the financial year ended 30 June 2016*, Section 5.1, p. 2. The report also states on page 53 that that it targets gearing in a range of 65% to 68% (gearing = net debt to net debt plus equity)

[60] APT Annual Report (Ibid) states it has a credit rating of BBB long-term corporate credit rating (outlook stable) from S&P in June and last confirmed on 19 March 2016; and Baa2 long-term corporate credit rating (outlook Stable) from Moody's in April 2010 and last confirmed on 15 April 2016. This strongly suggests that the rating agencies did not see any change in investor risk for APA over the period 2010 to 2016.

[61] See: https://www.apa.com.au/investors/adding-value-at-apa/

[62] See Partington and Satchell, *Report to the AER: Discussion of submissions on the cost of equity*, 8 June 2017, p. 10.

to 0.8 from 0.71 in its previous report. This is a rather rapid increase in market perceptions over the course of 8 months (if that is the only reason for the increase).

- Removing DUET from the analysis:[63] In a small sample it is a highly questionable practice to remove data points and of particular concern when the removal happens to support the Frontier hypothesis of an increase in equity beta. It could be equally argued that Frontier should remove SKI from the set as their gearing ratio sits well below the others, resulting in an adjustment factor of 1.8, considerably greater than the other three. This in turn results in a re-levered beta that is well above the other three (0.89). Leaving SKI out of the analysis results in a beta of 0.6 well within the Henry and AER range. In addition, removing one company (whether DUET or SKI) reduces the number of data points even further, changing the statistical properties of the reported results.

Overall, CCP11 agrees with the AER that the total of this evidence does not provide a sound basis to change from a value for equity beta set out in the Guideline. However, Frontier also looks at the rolling average and results from comparator studies. We consider these below.

Frontier's rolling average results

Frontier points to its analysis of rolling beta estimates for the 5-year blocks of data based on their portfolio results (see Table 1 above). Frontier concludes that: "there is an obvious increase in the portfolio beta estimates as data from 2014, 2015, 2016 and 2017 is introduced, replacing older data from 2007-2008".[64] Frontier further claims that this is consistent with the notion that the relationship between domestic comparator returns and market returns has become stronger in the years since the 2013 Rate of Return Guideline.[65]

The AER and its consultants have critiqued Frontier's 2016 analysis of the rolling 5-year average, and the associated claim that this is a basis for updating the equity beta. For example, Partington and Satchell advise that there is no statistical test for a significant change in beta, or for a 'structural shift'. The advisors also conclude that it is not at all clear that the five-year estimates represent a recent increase in beta relative to the more reliable 10-year estimates.[66]

CCP11 considers the AER and its advisors' arguments on this and the problems with the reliability of five-year data are reasonable and consistent with CCP11s own comments in March. We have carefully considered APA's response to the Draft Decision in its Revised Proposal and overall, find its reasoning rather confusing and even contradictory in places, particularly its comments that it has not relied on Frontier's 5-year assessment or the CEG and ERA studies, but rather states that it has used these studies simply as support for its claim for an increase in the equity beta.[67]

APA then posits two arguments. The first appears to be a claim that the AER previously allowed an equity beta of 0.8 for APA's 2013-2017 determination, although we note that this determination was made before the Guideline came into effect. The AER has responded that since that time, further

[63] We recognise that Frontier has removed DUET for the purpose of illustration that an equity beta of 0.7 is low, but Frontier has retained DUET in the overall portfolio results.

[64] Frontier, *Updated Rate of Return Estimates,* August 2017, paragraph 66, p. 20.

[65] Ibid, paragraph 70, p. 21.

[66] See Partington and Satchell, *Report to the AER: Discussion of submissions on the cost of equity*, 8 June 2017.

[67] *APA VTS Access Arrangement Revised Proposal*, August 2014, p.p. 72- 78. APA responds to each of the 8 reasons provided by the AER when rejecting APA's proposed equity beta of 0.8.

work on equity beta has provided greater precision and confidence in the estimates. However, APA then proceeds to argue that the AER should continue with the equity beta of 0.8. APA states: [68]

> *If the AER concluded, in 2013, that, in view of that imprecision, the relative riskiness – the beta –for the VTS [APA VTS] was 0.8, then, in the absence of evidenced that betas have fallen, there is no reason for now adopting a value of 0.7. An estimate of 0.8 remains the best estimate in the circumstances.*

It appears that APA is stating that the extensive consultation processes involved in developing the 2013 Guideline, and the subsequent analyses by Henry and the AER regarding equity beta, are irrelevant. What counts to APA are the AER's decisions made prior to the 2012-13 consultation and research programs. This seems to be a strange argument and one that the AER should not indulge.

Having said that the AER has to prove that there has been a decline in equity beta since pre-Guideline days, APA also argues that Henry's studies no long represent prevailing conditions and therefore are of little relevance. The AER claims that it has updated the Henry study using data up to 2017 and found similar results to Henry's 2014 study. It would be useful for the AER to publish this later study before the Final Decision.

APA also continues to point to Frontier's analysis of equity betas for "large transport infrastructure firms". Frontier has indicated that these firms provide appropriate comparators for assessing the equity beta. However, as noted above, Frontier's selection is underpinned by the claim that the comparator firms must <u>be unregulated BEEs</u>. For this reason, Frontier sets out its selection criteria for 'comparator' firms as follows:[69]

(a) Ownership of very long-lived, tangible, infrastructure assets;
(b) Capital intensive businesses;
(c) Provision of an access services to customers that provides a relatively stable series of cash flows;
(d) Listed on the ASX.

This list is clearly not consistent with the Court's ruling that comparator firms can be regulated or unregulated, the key element being that they face a similar degree of risk. Neither APA nor Frontier have acknowledged the clear statement of the Court in May 2017when considering the selection criteria for the comparator firms. To reiterate our earlier comments on the BEE, the Court concluded: [70]

> *[538] …To the extent that the Tribunal concluded, positively, that, for the purposes of the allowed rate of return objective, the benchmark efficient entity must be fixed with the character of an unregulated entity – and there is some suggestion that it might have done so (see, for example, [914]), although this is not entirely clear –* ***we would respectfully consider that particular conclusion, if reached, to be erroneous****. … under the allowed rate of return objective, for the benchmark efficient entity* ***is to be taken as having a similar degree of risk as that which applies to the service provider in question.***

The AER, therefore, correctly concluded in the Draft Decision that:[71]

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[68] Ibid, p. 75.
[69] Frontier, *APA VTS, Rate of return parameters update*, 16 August 2017.
[70] Federal Court of Australia, *Australian Energy Regulator v Australian Competition Tribunal (no 2)[2017] FCAFC 79*, May 2017 @ 534-535 & 538.
[71] AER Draft Decision APA VTS, Attachment 3, p. 3-79.

> *We do not consider that the re-levered equity betas of unregulated transport-related infrastructure firms can be used to inform the equity beta of a benchmark efficient entity with a similar level of risk as APA in providing the reference services. … Partington and Satchell also advised that unregulated transport-related infrastructure be given 'negligible weight'.*

While the AER is correct in its comments on Frontier's comparative beta analysis, APA also seems to be implying that it is up to the AER to establish whether each business does not have comparable risks.[72] CCP11 does not consider this the responsibility of the AER; it is the business proposing a change from the Guideline that needs to demonstrate that the comparator firms show a similar degree of [systematic] risk. APA has not done so.

AER rejects the proposed higher MRP

The AER did not accept APA's initial proposal for a higher MRP allowance (7.76%) and adopted the MRP of 6.5% that was set out in its 2013 Guideline and confirmed in subsequent electricity and gas revenue determinations. The AER's Draft Decision was consistent with the CCP11's recommendations to not accept APA's initial proposal on the MRP.

However, in APA's Revised Proposal, it has again proposed a higher value for the MRP of 7.7% given a risk free rate of 2.68% and APA's updated assessment of the total market return on equity of 10.38% (i.e. 10.38%-2.68% = 7.7%). In adopting this figure for the MRP, APA rejects many of the components of the AER's Draft Decision.

The AER's Draft Decision on the MRP, and APA's reasons for rejecting the AER's Draft Decision are summarised below. However, before considering the specific arguments raised by APA, there are some general comments to be made:

- The NSW Tribunal found no error in the AER's approach to, and parameter for the MRP;
- There has been considerable material provided by the networks prior to and after the Tribunal's decision, which has been considered by the AER in its current Draft Decision;
- There is no substantive new material provided in APA's Revised Proposal regarding the MRP, beyond the August 2017 update by Frontier.

While the AER makes no claim for a constant MRP, there should also be a very good reason to change from the Guideline figure of 6.5%, particularly in terms of assessing the investors' perception of long term market risk. That means that the methods to assess the MRP must be transparent, predictable, robust, and relevant to the long-term perspective of the AER's regulatory framework. From a consumer's perspective, it should also 'make sense' in that the MRP is reasonably consistent with other observed events in the economy, particularly in what the AER calls "conditioning variables".

When the AER increased the MRP from 6.0% to 6.5%, it was persuaded that there was a level of volatility in the economy that was consistent with a MRP that was higher than the long-term historical trend. What we see in practice in the four years since 2013 is *remarkable stability in conditioning variables at least <u>relative</u> to longer-term historical observations.* This stability includes

[72] For example, APA states at p. 76: "The AER comments that the risk characteristics of the [Auckland] airport would be very different to those of the benchmark efficient entity, for example due to demand risk. This is not immediately obvious (but is not examined further in the Draft Decision). The implication here is that the AER has to examine each business in whatever comparator list a business puts forward, even if the selection criteria is narrow (transport) and misplaced (selecting only unregulated businesses).

interest rates, GDP growth, PE ratios, bond spreads, wages growth, inflation and the volatility index (VIX 200). For example, the VIX ASX index has remained below the 'normal' level of about 20% for some time.[73] As Partington and Satchell noted in June 2017:[74]

> *Relative to the evidence of history and the evidence of surveys this [APA's MRP of 7.76%] is a relatively high market risk premium. It seems an unlikely outcome to have a relatively high market risk premium when market volatility is particularly low.*

Moreover, some measures point to improved conditions for investment as seen in the RBA's assessment of banks' non-performing domestic assets[75], and the recent NAB survey of business conditions and business confidence (Figure 4.1).[76]

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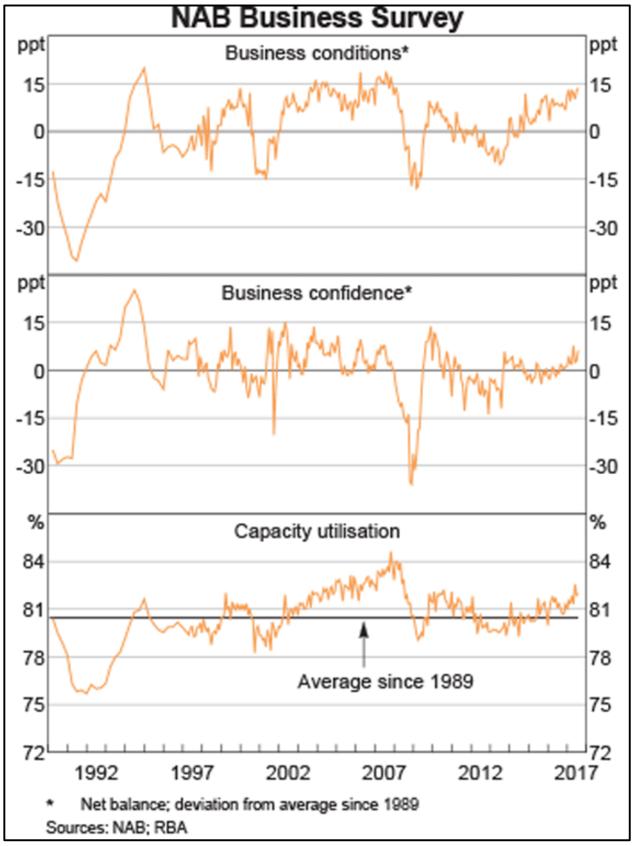
[73] Excluding one brief period (Nov 2016) where the VIX/ASX 200 has been slightly above 20 (3-9 November 2016), the index has remained below 15 for most of the last year. As at 8 September, the index was 13.42. See e.g. https://au.finance.yahoo.com/

[74] Partington and Satchell, *Report to the AER, Discussion of Submissions on the Cost of Equity*, 8 June 2017, p. 47.

[75] The RBA's September 2017 updates indicate a significant decline since 2012 in bank's non-performing loans.

[76] NAB Business Survey charts, http://www.rba.gov.au/chart-pack/business-sector.html (accessed 08.08.17)

Figure 4.1: NAB Survey of Business Conditions and Confidence (September 2017).



In its most recent Statement on Monetary Policy Decision, RBA Governor Lowe stated:[77]

> *The recent data have been consistent with the Bank's expectation that growth in the Australian Economy will gradually pick up over the coming year. The decline in mining investment will soon run its course. The outlook for non-mining investment has improved recently and reported business conditions are at a high level.*

The question then is whether APA has provided sufficient evidence in its initial proposal and its Revised Proposal to justify its claim that expectations for market risk (as measured in the MRP) have increased, noting the stability and even improvements in general measures of the economy and investment. In making its case, APA appears to rely on Frontier's DGM analysis, including the updated August 2017 analysis.

Frontier's update, however, does not provide substantive new evidence on the MRP. Therefore, we do not intend to replicate the AER's arguments set out in the Draft Decision, but do acknowledge that the AER, and its consultants Partington and Satchell, have devoted considerable attention to both APA's and Frontier's contentions and has found them wanting on theoretical and statistical grounds. The AER's arguments, and those of its consultants, suggest that there is insufficient reliable and robust evidence to change the MRP from 6.5%. CCP11 agrees with this conclusion.

A summary of APA's main arguments against the AER's Draft Decision is provided below along with a brief commentary on these arguments.

[77] RBA Media Release, Statement by Philip Lowe, Governor: Monetary Policy Decision, No 2017-18, 5 September 2017. http://www.rba.gov.au/media-releases/2017/mr-17-18.html (accessed 08.09.17).

APA states in its Revised Proposal:

- APA is not relying on the theory or practice of the Wright CAPM model.[78] That is, APA's approach makes no assumptions about the relationship between the risk free rate and the MRP, the MRP 'falls out' of the calculation of the other two parameters (risk free rate and the prevailing expected market returns).
- The AER and its advisors (Partington and Satchell) rely on the argument that "it is the risk premium that determines the market portfolio, and that defend this claim by stating that practitioners tend to treat the MRP as the exogenous variable to the CAPM instead of the return on the market as suggested by APA VTS".[79] APA states that the AER's argument is irrelevant and "do not address the conceptual and theoretical foundations of the SL CAPM". [80]
- The expected return on the Australian market can, in principle, be estimated using averaging of past values and/or the dividend growth model (DGM).[81] However, APA states that averaging of past values cannot be used within the regulatory framework as: "**Those [historical] data are not expectations data"**.[82] APA then states that: "**Only the dividend growth model** can provide forward looking estimate of expected return required for the application of the SL CAPM". [83] [emphasis added]
- Frontier has provided an updated estimate of the expected return on market parameters, which claims to be based on the AER's DGM models set out in the 2013 Guideline. Frontier estimated a MRP of around 7.7% assuming an annual dividend growth rate of 4.6%.[84]
- APA has relied on the Frontier's updated DGM model to derive the MRP and market return on equity set out in its Revised Proposal. APA has not relied on or referred to the other data considered by Frontier.

The proper construction of the SL CAPM

APA again raises this issue as noted above. APA argues that whether or not its construction is widely used by practitioners is not relevant as, in APA's view, practitioners use "an incorrectly estimated single factor model for which there is little or no theoretical or empirical support".[85] APA also claims that the AER's consultants, Partington and Satchell do not address the conceptual and theoretical foundations for the SL CAPM, or the way in which APA applies the SL CAPM other than to say "practitioners do it differently".[86]

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[78] Simplistically, the Wright CAPM model proposes that there return on equity is relatively stable, and therefore there is an inverse relationship between risk free rate and MRP.
[79] Ibid, p. 78-79.
[80] Ibid, p.79.
[81] Ibid, p. 80.
[82] Ibid, p. 80-81.
[83] Ibid, p. 81.
[84] See Ibid, p. 81. The MRP estimates are taken from Frontier, *Updated Rate of Return Estimates,* August 2017, Table 3, Table 6, paragraph 89, p. 27. Frontier estimated two values for the MRP of 7.7% (2-stage model) and 7.72% (3-stage model) that it claims are based on the AER's DGM models. CCP11 is not in a position to confirm this but notes that in its latest report, Frontier does not make the NERA correction for dividend yield (consistent with the AER's approach). Frontier also states that "it adopts a theta of 0.6 which is consistent with a gamma of 0.25", it is not clear if this is an editorial error, however, theta of 0.6 is consistent with the AER's approach. (see paragraph 87, p. 26).
[85] Ibid, p. 79.
[86] Ibid.

However, the AER's consultants do go further than suggested by APA. The consultants state that either the MRP or the market return on equity could be regarded as the exogenous variable, but if it is to be the market return on equity then it would be required to establish that the expected return on equity is a "stationary process", and to consider the standard error of the return on the market estimates. APA does not appear to have demonstrated these statistical requirements, nor has it asked Frontier to do so.

Moreover, in estimating the market return on equity as the exogenous variable, APA relies on the long run average of past values (in the absence of "expectation data"). As such, APA faces the same issue that faces those who measure MRP as an exogenous variable (such as the AER and "most practitioners") – yet APA explicitly rejected the historical assessment of the MRP, stating that it does not provide information on the prevailing market conditions.[87] That is, it would seem that APA criticises the AER's reliance on historical data to derive the MRP, but then uses the historical data to derive the return on equity.

If APA had significant concerns about the proper construction of the SL CAPM, then this is a topic that should have been raised during the Guideline process and/or APA would need to have demonstrated more detailed statistical analysis (as suggested by Partington and Satchall). In our view, APA would also need to demonstrate it has undertaken an extensive consultation process with the AER, consumers and other stakeholders on the issue. There is no evidence that APA has done so.

APA's proposed interpretation of the SL CAPM would, if adopted by the AER, be relevant to all stakeholders. The AER could not have one interpretation of the SL CAPM (a fundamental feature of the AER's methodology) for its decisions on APA and another for its other network decisions. On the other hand, it would be entirely inappropriate for the AER to put aside its existing well-established methodology that has been endorsed by the Tribunal, and is well understood and accepted by practitioners and other stakeholders.

This is not how regulatory processes do or should work. By necessity, regulatory processes should change cautiously and following extensive consultation with multiple experts and stakeholders to establish that a change is preferable and consistent with the NGO, NGL and ARORO.

APA's reliance on the DGM update by Frontier

As a general comment, CCP11 notes that Frontier's paper includes an assessment of a wider range of material than APA relies on when it proposes and MRP of 7.7%. Frontier's paper refers to historical excess returns, 2 and 3-stage DGMs, Wright CAPM, survey data, and reports from independent experts. On the basis of all these reports Frontier states that: our proposed estimate [of MRP] is at least 7.0%" and that this estimate is "conservative".[88] However, Frontier does not make a specific recommendation for a point estimate of the MRP.

However, as noted above, APA's Revised Proposal appears to consider only the results of Frontier's August DGM study. APA explicitly rejects the use of historical data analysis on which the AER has placed most reliance. It also states that it has not relied on other data (such as decisions by other regulators), it has simply referred to this data in support of its proposal.

[87] See Partington and Satchell, *Report to the AER, Discussion of the estimate of the return on equity*, April 2017, p.p. 42 - 46.
[88] Frontier, *Updated Rate of Return Estimates,* August 2017, paragraph 120, p. 38.

Moreover, APA adopts the DGM without acknowledgement of the weaknesses of the DGM, particularly with respect to nominating a point estimate of the MRP. Nor has APA attempted to justify its selection of input parameters from the range provided by Frontier. For example, APA has selected Frontier's mid-point forecast assumption of a 4.6% growth in annual dividends, from the range provided by Frontier. [89] APA provides no justification for this selection, although many would question whether this is a sustainable figure for average annual growth over a 10-year period given it exceeds long-term forecasts of GDP growth (3%-3.5% per annum[90]).[91] Such a 'big' claim would require substantially more evidence than APA has provided in its initial proposal or its Revised Proposal. APA's case would be stronger if it had openly and transparently investigated a range of scenarios.

Other independent forecasters provide different forecasts for dividend growth rates. International experts such as Fenebris.com have suggested a dividend growth of 2.4% for the Australian market and an implied MRP of 4.4% as at July 17.[92] This represents a significant decline in the MRP from 6.48% observed by Fenebris for July 2012 using the same DGM. Partington and Satchell highlighted the Fenebris reports[93] as evidence that we are not only seeing different MRPs <u>using the DGM</u> approach, we are also seeing different trends in the MRP over time, notionally produced by the same (or similar) general DGM specifications, but with different input assumptions.

This sensitivity of the DGM, in both absolute and trends terms, to what are certainly very arguable input assumptions about future growth, makes the DGM unsuitable in the regulatory context for determining a <u>point estimate</u> of the DGM, as APA appears to have done in its Revised Proposal.

Even the AER's use of the DGM as a so-called "directional" indicator (within the range defined by the historical analysis) has become increasingly questionable given the observations above. Moreover, there does not appear to be an agreed theory to underpin any consistent relationship between dividend payout ratios, business earnings and general economic growth. There are many observers who note that Australian businesses have recently had what are historically very high payout ratios and that these are occurring at the same time as very low investment by the businesses. For example, in its most recent Economic Insights report, CommSec refers to a "dividend bonanza" and notes that: "A relative reluctance by companies to plough back cash into the business – expansion, renewal, replacement or efficiency measures – also has boosted funds that can be made available as dividends".[94] However, the question arises in this report (and by other commentators) regarding the sustainability of this approach.

For example, Figure 4.2 below points to moderation in the trend for increasing dividends that was seen between 2010 and 2014.

[89] Ibid, Table 6, paragraph 89, p. 27. Frontier used the same mid-point as the AER but not the same range of growth forecasts in its scenario.
[90] Based on RBA forecasts as of August 2017.
[91] It is possible for dividends to grow above GDP growth for short-medium terms if costs are cut and/or capital investment for growth or efficiency is significantly reduced. However, these factors are time limiting.
[92] See report at http://www.market-risk-premia.com/au.html updated to 31.07.17, accessed 08.09.17.
[93] See for instance, Partington & Satchell, *Discussion of estimates of the return on equity*, April 2017, p. 26.
[94] CommSec, "*Economic Insights, Dividend bonanza: $26 billion to be paid out"*, 8 September 2017, p. 3.

Figure 4.2: Proportion of companies lifting or maintain dividends 2010-2012.

Source: CommSec, "*Economic Insights, Dividend bonanza: $26 billion to be paid out*", 8 September 2017, p.2.

CommSec also highlights in the same report that:[95]

> *It is clear that dividends remain in vogue. But as has been apparent for the last few reporting periods, there is an ongoing re-assessment by companies about just blindly paying a dividend at all costs. More companies see value in investing in their businesses…*
>
> *Companies are also more actively weighing up pay-out options, notably whether dividend payments should be maintained, let alone increased over time. There still needs to be adequate cash maintained for reinvestment in the business and applied to new opportunities –entering new markets or engaging in mergers and acquisitions.*

Given this sensitivity to assumptions, and the other weaknesses in the DGM that have been well explained by the AER and its consultants since 2013, CCP11 agrees with the Partington and Satchell that: [96]

> *DGM-based estimates of the MRP in a 10 year horizon context are probably better down-weighted than given more weight … we think it is very unlikely that the DGM will provide a forward looking MRP commensurate with the prevailing conditions in the market for funds. Very different results can be obtained depending on the model used and particularly the assumptions about growth.*

Overall CCP11 supports the AER's reasoning and conclusions in the Draft Decision while noting that the MRP of 6.5% is probably at the high end, given all the data available to the AER. As noted in our Advice in March 2017, CCP11 is particularly sceptical of the value of the DGM within the AER's regulatory framework given the DGM's reliance on expectations about medium to long-term growth in dividends and GDP growth including the growth path in dividends and GDP over time and inflation

[95] Ibid, p. 1 and p. 3. The article also discusses how companies who continue to maintain or lift dividends and not invest in their company's efficiency or growth (particularly in a relatively low growth economy), will see investors looking elsewhere.
[96] Ibid, p.p. 25-26.

estimates. In addition, we note that the DGM has many different model specifications that can lead to different results and with no clear rationale for adopting one model specification over another.[97]

Moreover, we consider that the DGM is overly influenced by, and reflects near term expectations for dividend growth and GDP growth. For example, in its Advice in March 2017, CCP11 referred to comments from the Tribunal that restated the AER's position as follows:[98]

> *In the AER's view, the short term MRP will vary from the long run estimates of MRP at times, but that in order to maintain regulatory consistency, a long-term MRP with a notional ten year investment consistent with the terms of the risk free rate ought to be considered.*

It is little wonder the AER's own analysis using the DGM has identified a wide range of possible (arguable) estimates of the MRP as noted above. In the absence of an objective and independent basis for forecasting the long-term trends and determining the optimal model specification, the CCP11 has considerably more confidence in the simpler and more transparent approach of forecasting long term expectations for the MRP on the basis of observable historical trends.

CCP11 also draws the AER's attention to the conclusions of Partington and Satchell in its April 2017 advice. If the AER is to give any significant weight to the DGM findings (whether part of its assessment of APA's proposal or more broadly), then the AER should consider:[99]

- the effect of different assumptions about the magnitude of the growth rate;
- the output of different DGM models such as the Gordon and Gordon model and the Fenebris model;
- the impact of dividend reinvestment plans;
- the lack of reliability of year by year estimates from the DGM (and, CCP11 would add, the implications for asserting trends in the MRP).

4.2.4 AER's Draft Decision re the return on debt

The three Victorian gas distribution businesses have accepted the AER's Draft Decision to adopt a 10-year trailing average approach to the assessment of the cost of debt with a 10-year transition period. However, APA's Revised Proposal continues to propose a change to the 10-year trailing average **without a transition period.** As a result there is a very significant difference between the AER's Draft Decision and APA's initial proposal and its Revised Proposal and this difference has large impacts on costs to consumers and the investment incentives. The AER Draft Decision proposes an initial return on debt of 4.79% (to be updated annually), while APA's Revised Proposal without transition is 6.91%.[100] APA alleges that its estimate of the rate of return on debt is the estimate that "contributes to the allowed rate of return objective".[101] APA further states that: "If APA VTS is to have a

[97] For example, whether the DGM model will be a two stage or three stage model or some more complicated model specification. In particular, assumptions must be made about when dividend growth rates will converge to the expected 'normal' GDP growth rate.
[98] See, CCP11 Response to Proposal from APA VTS for the 2018-22 access arrangement 3 March 2017, p. 76. The quotation is taken from the Australian Competition Tribunal, *Application by Envestra Limited (No 2)[2012],* ACompT4 @ 136.
[99] Partington and Satchell, *Report to the AER, Discussion on estimates of the return on equity*, April 2007, p. 26.
[100] *APA VTS Access Arrangement Revision Proposal*, August 2017, p. 83. APA's initial proposal was for a return on debt of 7.47% using the same methodology, updated for more recent data on 10-year BBB bond yields.
[101] Ibid.

reasonable opportunity to recover its efficiently incurred costs of financing its pipeline assets, there must be an immediate adoption of a trailing average (without transition)".[102]

The AER has raised important practical difficulties with obtaining a reliable estimate of the 10-year trailing average, including data quality/consistency issues when calculating these costs,[103] and CCP11 considers this is an important assessment, and one we support under the principles of transparency and consistency. We also note, and agree with the AER's concern that the immediate application of the 10-year trailing average would retrospectively remove interest rate risk for which APA has been rewarded under the previous determinations.[104]

It is instructive to summarise some of the AER's other arguments in its Draft Decision, particularly with respect to the transition process as it highlights the principles (e.g. NPV = 0) and the risks that must be carefully considered when changing methodology from one regulatory period to the next. These arguments represent a useful evolution of the AER's thinking on this issue over the last three years.

For example, the AER states that while the 'on-the-day' and the 'trailing average' approach are both allowed under the NGR,[105] and each approach has its own benefits and limitations.[106] For example, the AER argues that continuing the on-the-day approach for estimating the allowed return on debt will achieve the ARORO and the NGO[107] and it was open to the AER to do so. The AER also demonstrates that over the life of the assets, the on-the-day and the trailing average approach "provide equivalent ex-ante compensation over the term of the RAB".[108]

Therefore, it is not the approach to calculating the return on debt per se, that is the issue facing the AER and stakeholders; it is the process of <u>changing from one to another methodology</u> that creates the problem and which the transition process is designed to address. The 2012 amendments to the Gas Rules specifically recognise that while both on the day and trailing average approach are both approaches that can contribute to the ARORO, the AER must also **have regard to any impacts that a change in the methodology could have**.[109]

In particular, moving directly from the on-the-day approach (i.e. the approach adopted in the current regulatory period) to the trailing average approach <u>without a transition arrangement</u> as proposed by APA would violate the NPV=0 principle and would not satisfy the ARORO. As the AER concludes:[110]

> *Given this, **while we adopt a trailing average for this determination, we do not consider this change in methodology would be justified in the absence of a transition**…Our view is supported by our consultants who note that "[a]n immediate switch to the trailing average **immediately gives risk to a regulated allowed return that exceeds the current required return**. Consequently, it immediately gives rise to economic rents and an incentive to overinvest." We agree with our consultants and consider such an outcome would be*

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[102] Ibid, p. 93.
[103] AER Draft Decision APA VTS*,* Attachment 3, p. 3-128-129.
[104] Ibid, p. 3-128. One example is that the relevant benchmark bond series have changed over that period.
[105] See NGR, r. 87 (8)-(12) and particularly (9)-(10).
[106] AER Draft Decision APA VTS, Attachment 3, p. 3-123.
[107] Ibid.
[108] Ibid, p. 3-120.
[109] See NGR, r. 87 (11)(d).
[110] AER Draft Decision APA VTS, Attachment 3, p. 3-123. The AER's embedded quotation is taken from Partington and Satchell, *Report to the AER in relation to the cost of debt*, 9 April 2017, p. 29.

inconsistent with both achieving the ARORO and achieving the National Gas Objective. [emphasis added]

CCP11 supports the evolution of the AER's argument for a 10-year transition period as it is the only approach that will ensure that the process of changing the methodology (which in itself provides a benefit to the networks) produces outcomes in the next regulatory period that are consistent with the best estimate of the ex-ante efficient cost of debt.

Importantly, the existence of a transition process (as set out in the Guideline) was a significant factor in consumer representatives accepting the 10-year trailing average approach during the development of the Guideline in 2013, as the opportunity for significant gaming by the networks **purely** as a function of the change in methodology, was readily apparent at the time.[111]

The AER addresses the same issue in the Draft Decision from a somewhat different perspective:[112]

> *When we [AER] proposed moving to a trailing average in the Guideline, this proposal was contingent on applying a transition so that the value of the firm aligned with previous investor expectations under the on-the-day regime.*

The AER's more recent explanations of why the transition process is preferable in terms of contributing to the ARORO and the NGO (including the above quotation), also addresses the problems created by the legal analyses that underpinned the decisions of the NSW Tribunal and the Federal Court.

The AER's current analysis which seeks to achieve, via the transition process, an NPV=0 position during the change from one methodology to another, gives much greater consideration to the <u>outcomes</u> of the transition/no transition arguments regarding the costs of debt and whether these outcomes are consistent with the ARORO and NGO and whether the outcomes provide the correct signals for efficient investment.

CCP11 agrees with the AER's consultants that the <u>no-transition</u> approach will not deliver an outcome that meets the ARORO; rather it will deliver a cost of debt that (in this instance) is higher than the efficient cost of debt. Moreover, this arises <u>purely as an artefact from the change in methodology</u>. If the trailing average had been in place, for instance, in 2013, then it would be strongly influenced by the lower commercial bond rates prior to the GFC. If the trailing average had been in place in 2008, then APA would not have been granted a rate of return that reflected the 'prevailing costs' that emerged in the GFC. Using the networks' arguments, including APA's Revised Proposal, the AER's decision would nevertheless have been efficient.

If APA were to move straight to the trailing average, consumers would be paying twice for the extreme situation facing APA in 2008-09, the corollary being that APA would be overcompensated for debt in the 2018-22 regulatory period and, therefore, have an incentive to over invest.

So it is hard not to conclude that if the 10-year debt yields were increasing rather than decreasing (as they have since the peak of 2008-09), there would be no dispute from any of the networks about the AER's transition approach, irrespective of their actual debt portfolios.

[111] See for instance, AER, *Explanatory Statement, Rate of Return Guideline*, December 2013, Table I.6,p.p. 197-198 ("Transition to a trailing average"). Consumer groups generally expressed preference for 5-year transition period that would resolve the gaming issue. PIAC noted in its submission that if this 5-year transition was not accepted by the AER, then the AER needed to consider mechanisms that will "reduce the risk of gaming".

[112] AER Draft Decision APA VTS, Attachment 3, p. 3-128.

The fact that the three gas distribution networks (presumably with different portfolios of staggered debt, as suggested in the available annual reports) have adopted a transition approach to assessing their efficient cost of debt in both their initial proposals and Revised Proposals is itself indicative that the ARORO, NGO and the RPP can be satisfied by adopting the transition framework set out in the AER's Guideline. With this in mind, CCP11 has reviewed the actual debt costs reported by APT Pipelines in its Annual Reports since 2012. The 2012 average interest rate (including credit management) applied to drawn down debt was reported as 7.39%. This average interest rate declined progressively over the next five years as follows: 7.35% (2013), 7.12% (2014), 6.76% (2015), 5.64% (2016) and 5.56% (2017).[113]

To reiterate, this is the average interest rate of drawn doubt debt as reported in APT Pipelines Annual Reports, not the marginal interest rate of raising new debt. It is reasonable to suppose given the trend that the marginal rate would be lower again. In addition, APT's annual report does not disaggregate borrowing costs by sector and its asset portfolio is dominated by non-regulated pipelines which are likely to be perceived as higher risk investments. So it is reasonable, if not conclusive, to compare APT's average debt in 16/17 of 5.56%, with APA's claim that the efficient cost of debt that would meet the ARORO and allow APA to recover its costs is 6.91%.

Looked at another way, if the AER allowed 6.91%, when APA's average debt cost is 5.56%, and its marginal debt cost probably lower again, then APA has a clear incentive to invest more than the prudent and efficient capital in the Victorian gas network contrary to the NGO, RPP and ARORO.

4.3 AER's Draft Decision and inflation expectations

The AER had adopted the same methodology for forecasting expected inflation across all its decisions since 2013 including the 2017 Victorian gas distribution and transmission decisions for 2018-22.

Two of the Victorian gas distribution businesses proposed an alternative approach to forecasting inflation, the 'breakeven' approach, which they considered was a better approach to estimating inflation expectations. The AER's Draft Decisions rejected the breakeven approach. The Victorian gas distribution businesses accepted the AER's Draft Decisions on the expected inflation forecast for the purposes of their Revised Proposals.

In contrast, APA accepted the AER's approach to forecasting inflation expectations in its initial proposal and its Revised proposal, at least as a base for estimating inflation at the start of the regulatory period. However, APA proposed an annual update of the forecast inflation for actual inflation (lagged one-year) in the post-tax revenue model (PTRM), in a process similar to the annual updating of the cost of debt in the PTRM. APA argues that in the absence of this annual updating for actual inflation, there will be a risk that the network will under (or over) recover revenues when actual inflation is less (more) than the AER's estimate of expected inflation.

The AER did not accept APA's proposal in its Draft Decision and instead determined an average expected inflation of 2.45%, consistent with its decisions for the Victorian gas distribution businesses, to apply across all years of the PTRM. The AER also did not accept APA's proposal for recovering 'losses' due incurred in the 2013-17 regulatory period as a result of actual inflation being lower than

[113] Extracts from the 12/13, 13/14, 14/15, 15/16, 16/17 Annual Report. Details can be found in the sections headed "Borrowings and finance costs" in each Annual Report. Note there was a small discrepancy re FY 15/16 average borrowing costs between the 16/17 Annual Report (5.78%) and the 15/16 Annual report (5.64%).

forecast inflation. APA proposed to amend the AER's roll-forward model for calculating the capital base over the 2013-17 regulatory period.[114]

The AER's first, but not only concern is that there has been insufficient time to consider all the impacts of such a change including how the risks for service providers and end users may change as a result of the proposed amendments to the PTRM and the roll forward model. The AER concludes:

> *We do not consider that the implications of alternative methods have been sufficiently discussed in APAVTS's regulatory proposal. We consider the research, analysis and reasoning submitted to us should be subject to review through a comprehensive process. This will allow for effective engagement with all stakeholders.*

Moreover, it would seem that APA's approach which in effect adjusts nominal review and nominal returns, would result in the real value of the return to investors varying with actual inflation outcomes.[115] This is an important debate – do investors value certainty around real returns or certainty around nominal returns? The existing arrangements in the PTRM vary nominal returns but retain the integrity of the promised real returns. APA's approach will maintain the nominal returns but at the cost of varying the real returns to its investors.

The AER's position on these issues seems reasonable and is currently being pursued through the auspices of the AER's project on inflation. In CCP11's view, it would be premature to make substantive changes to the revenue models prior to the consultation process. Our understanding of this program and outcomes to date is summarised below.

AER review of forecasting expected inflation

As noted, CCP11 considers that the current review of inflation by the AER, which will engage multiple stakeholders over some 9 months, is the appropriate forum for discussing the issues identified by the networks associated with forecasting expected inflation.

The public review commenced with the AER publishing a discussion paper for stakeholder consultation in April 2017, a public forum in June and a stakeholder workshop in August 2017. A CCP working group was appointed to be part of this review and has been an active participant throughout the process.[116] To date, the review process has confirmed that the inflation issue can be conceptualised in two parts:

1. *`What is the best measure of expected inflation (using the standard All Caps CPI as the reference point) in the regulatory context?* Since 2009, the AER has adopted a forecast of expected inflation over 10 years that is based on the geometric average of the RBA's forecast of inflation expectations for the next 2 years and the mid-point of the RBA inflation target range (2%-3%) for the remaining 8 years. In its current Draft Decision, the AER has forecast expected inflation across the regulatory period as 2.45% using this approach.
2. *What is the impact of the AER's forecast when actual inflation differs significantly from the AER's forecast of inflation expectations?* In particular, some of the networks are concerned that the AER's expected inflation for the regulatory period (derived as above) is too high compared to

[114] AER Draft Decision APA VTS, Attachment 3, p. 3-154.
[115] Ibid, p. 3-155.
[116] See for instance, CCP's papers on expected inflation can be found on the AER's website at https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-expected-inflation-2017/initiation

actual inflation (which is currently below the target range). They claim that this has the effect of reducing the returns allowed to the network businesses below efficient returns. More specifically, the networks point to the design of the AER's revenue forecast models (the post-tax revenue model (PTRM) and the roll forward model (RFM)), and the annual pricing model.[117]

As noted above, APA has no argument at this stage with the AER's current approach to forecasting expected inflation. Its concern is with addressing the second issue, namely, how to modify the claimed impact of inflation forecast errors on actual financial outcomes.

The arguments around the 'true' nature of the impact of forecast errors are complex but are being carefully considered by the AER and stakeholders. The CCP representatives on the inflation working have concluded on the basis of a preliminary analysis that, taking the three models together, the networks **do** receive adequate compensation for efficient real financing costs over time, even when actual inflation is less than the expected inflation set by the AER for the regulatory period.[118] The discussions have also highlighted the importance of distinguishing between:

- Forecast error in estimating long-term inflation expectations; and
- Differences between inflation expectations and actual inflation outturn.

The regulatory model is an ex ante model, and deals with expectations. Testing actual outcomes against forecast expectations (as some networks have done) does not tell us much about the accuracy of the initial forecast of expectations forecast. The subsequent 'correction' to use actual inflation in the Roll Forward Model (RFM) and the pricing model provides an ex-post 'protection mechanism' for the value of the asset base and the real revenues received. But these 'corrections' to the building blocks are not intrinsically necessary in an ex ante, incentive framework. For example, the Rules foreshadow that the AER can use either forecast or actual capital expenditure in calculating depreciation in the RFM.[119]

It is also noted above that there is an assumption in the current framework that the focus of an investor in regulated assets is on the certainty that they will receive a real rate of return - irrespective of inflation outturn. Some networks, perhaps including APA, suggest that investors seek certainty in nominal returns rather than real returns. More recently, it would appear that APA may be suggesting that the rate of return should deliver certainty on the nominal return for debt and the real return for equity.

At this stage, CCP11 considers there are many important issues to work through and it is not appropriate for the AER to change its approach in the current Draft Decision or to give some form of 'compensation' via the roll-forward model for the 2013-17 period 'under-recovery'. Such a change is likely to introduce new risks and/or a shift in risk allocation between networks and consumers that, in turn, has wider implications for the rate of return framework

As a result, any change in approach should only be made following a very thorough review of all the options for estimating expected inflation – to reiterate, it is unacceptable to the CCP in general that new methodologies with significant impacts on outcomes for consumers are proposed during a regulatory determination cycle without accompanying evidence of extensive consultation with

[117] Under the CPI-X framework, the annual pricing model is applied each year to adjust the allowed revenues for actual CPI each year, while holding the X factor constant.
[118] See for instance, "CCP –Core scenario models – 2 August 2017", at https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-expected-inflation-2017/initiation
[119] NGR, r. 90 (2).

independent experts and consumers and without a coherent industry-wide position. CCP11 supports the AER's view as stated in the Draft Decision:[120]

> *We consider that alternative methods for modelling the impact of inflation on regulated revenues and asset values raise a number of matters that require robust testing…We do not consider that the implications of alternative methods have been sufficiently discussed in the APAVTS's regulatory proposal. We consider the research, analysis and reasoning submitted to us should be subject to review through a comprehensive process.*

As noted above, CCP11 supports the industry-wide review process proposed by the AER and are concerned that APA continues to proposal significant changes outside this process.

4.4 AER's Draft Decision and value of imputation credits (gamma)

The AER had adopted a value of gamma of 0.4 across all its decisions since 2013 notwithstanding various appeals by the networks to the Tribunals. The NSW and SA Tribunals have made conflicting decisions on the approach to valuing gamma; the NSW Tribunal found in favour of the networks and their 'market' based approach, while the SA Tribunal upheld the AER's approach and decision to value gamma at 0.4.

The AER successfully appealed to the Full Federal Court regarding the NSW Tribunal's decision. SA Power Networks (SAPN) has, in turn, appealed to the Federal Court against the decision of the SA Tribunal in favour of the AER. The SAPN appeal was heard in May 2017, however, the Full Federal Court has reserved its decision.

The different conclusions on what are basically the same facts indicates how complex the decision on gamma is and the uncertainty created by the way the Rules are framed. That is, at the heart of the debate is the different perspectives on what the Rules mean when they refer to "the value of imputation credits".[121]

In their initial regulatory proposals for 2018-22, three of the four Victorian gas networks (AusNet, Multinet and APA VTS) proposed a gamma of 0.25 rather than 0.4, the effect of which was to increase the building block allowance for taxation costs.

The AER's Draft Decisions rejected the initial proposal by the three gas networks and confirmed its view that the value of gamma most consistent with the ARORO and NGO is 0.4 based on a dividend pay out ratio of 0.7 and a utilisation rate (theta) of 0.6. The most controversial element of the gamma calculation is the value of theta, the utilisation rate. While there is some empirical data to support the pay out ratio, and both the networks and the AER agree on a value of 0.7, there is no such evidence available to calculate the utilisation rate; the rate must be inferred from other data.

The AER considered a variety of methods for estimating theta, including the dividend drop off studies, but also noting there is no one method agreed by practitioners. Its conclusion is important as it emphasises the point that the regulatory framework requires the AER to make decisions on a

[120] AER Draft Decision APA VTS, Attachment 3, p. 3-155.

[121] See NGR, r. 87A which sets out the calculation of the corporate income tax, including the proposed "value of imputation credits". Corporate income tax is one of the important building block components in its own right but imputation credits are also relevant to the assessment of the return on equity. For example, NGR r. 87(4)(b): the allowed rate of return must be determined on a nominal vanilla basis that is consistent with the estimate of the value of imputation credits. The AER's approach must be set out in the rate of return guidelines including is approach to determining the value of imputation credits (NGR, r. 87(14)(b)).

transparent and repeatable basis. While conceptually useful, the difficulty of the dividend drop off studies is what McKenzie and Partington (2013) described as the "allocation problem", i.e. the allocation of the change in share prices cum and ex-dividend between the value to the investor of the dividend stream, the value of the franking credits attached to this stream, and general market noise. As McKenzie and Partington stated: "the problem with allocations is that by their nature they are arbitrary".[122] Other commentators talk of the problem of the "noise" associated with trading activity around ex-dividend dates.

All three networks, including APA VTS have now submitted Revised Proposals that include a gamma of 0.4. This follows the decision by the Full Federal Court that the AER did not make an error in its approach to calculating the value of gamma and its components, thus putting aside the NSW Tribunal's decision.

While we did not make a submission on the networks' approach to gamma, CCP11 generally supports the AER's Draft Decisions. The various papers provided over the years by the networks do not adequately address this allocation problem, leaving open the opportunity for cherry picking and further disputes over the 'right' allocation.

While CCP11 appreciates the AER's evolving explanation of the value of gamma, it is also noted that in the 'real world' of infrastructure businesses (including the gas network businesses), actual taxation payments and policies and practices around the distribution of franking credits appear to be removed from average market based activity calculated in the dividend drop-off studies.

[122] See for instance, Ibid, Attachment 4, p 4-211. The AER cites a report by McKenzie and Partington to the Queensland Resources Council: McKenzie and Partington, *Report to the Queensland Resources Council: Review of Aurizon Network's draft access undertaking*, 5 October 2013, p.p. 33-34.

5. Tariffs

5.1 CCP advice on APA's initial regulatory proposal

CCP11 had concerns with the following two aspects of APA VTS' tariff proposals:

- APA VTS' 'cap and collar' proposal; and
- Cost recovery of the significant expansion of the RAB and additional opex and depreciation arising from the VNI project.

CCP11 recommended:

- If APA does propose to reinstate a 'cap and collar' mechanism, the AER should consider what risks might arise for Victorian gas consumers if the mechanism were to be approved, and whether it is appropriate for the consumers to bear those risks.
- The AER should ensure that the arrangements put in place in this regulatory determination fully quarantine all the costs associated with expenditure to benefit interstate shippers of gas from Victoria into New South Wales with separate accounting and reporting. This should be coupled with ensuring that it is in accordance with the National Gas Rules to disallow recovery of these quarantined costs from Victorian consumers.

5.2 The AER's Draft Decision

In regard to the cap and collar, the AER wrote:[123]

> *We note that APA considers that a cap and collar mechanism may be desirable for the 2018–22 access arrangement. The proposal is silent on the application of the cap and collar mechanism, other than to suggest that it will take the same form as in a previous access arrangement. Furthermore, it has not actually proposed a cap and collar mechanism for the access arrangement. Therefore, we have not considered the merits of one for this draft decision.*

In regard to the VNI, the AER confirmed with APA that only NSW customers would pay for the VNI in the 2018–22 access arrangement. This is because VNI expansion costs are attributed to the Culcairn tariff. These customers will not have to pay a tariff for injection points that are in Victoria and as such, Victorian customers do not bear any VNI expansion costs.[124]

> *We consider where demand or gas volumes on the VNI does not eventuate beyond the 2018–22 access arrangement, and gas is not flowing into Victoria then APA should bear the costs and risk associated with this. That is, other non-NSW customers would not pay for the VNI unrecovered costs (that is, not yet recouped through depreciation).*
>
> *We understand from APA that it has contracts in place that underpin the VNI. We note CCP11's concern that beyond the period of the initial contracts, Victorian customers might have to pay for the unrecovered portion of the VNI.*
>
> *Our view is that this draft decision can only set revenues and tariffs that pertain to the 2018–22 access arrangement period. During future access arrangements reviews we will again check APA's proposal for costs recovery and associated tariff implications. Forecasts of*

[123] AER Draft Decision APA VTS Attachment 11 – Reference tariff variation mechanism, p.11-8

[124] AER Draft Decision APA VTS Attachment 10 – Reference tariff setting, p.10-21

demand and throughput for the transmission pipeline will also affect our determinations of revenues and tariffs for future access arrangements.

CCP11 believes that the AER's Draft Decision satisfactorily addressed the CCP11 tariff concerns raised on APA's initial regulatory proposal.

5.3 APA's supplementary proposal regarding the Western Outer Ring Main (WORM)

After submitting its initial regulatory proposal, APA submitted a supplementary proposal to bring forward the completion of the WORM, on which CCP11 gave separate advice.

This advice included concerns regarding the long-term costs and risks to Victorian end-use gas consumers, these costs being recovered through user tariffs. CCP11 emphasised that the AER should give consideration to how the costs of the investment (return on assets and return of assets) will be recovered over its long regulatory life. CCP11 advised that it is important to ensure that all the beneficiaries of the investment pay their fair share of the costs, and not leave Victorian end-use gas consumers to pick up residual costs that are not recovered from other beneficiaries.

In its Draft Decision, with regard to tariffs, the AER stated:[125]

> *We approve APA's proposed incremental increase to the Iona storage refill tariff. We consider the proposed approach allocates costs of the westbound expansion to those users benefiting from the expansion. However, we consider APA's cross-system tariff should be charged in addition to the refill tariff, to users who ship gas from Longford or Culcairn into Iona storage and then on to the Sea Gas pipeline.*

This was intended to address CCP11 concerns regarding paying for the WORM.

5.4 APA VTS Revised Proposal

In its Revised Proposal, APA did not propose to reinstate a 'cap and collar' mechanism.

However, APA raised issues with the AER's Draft Decision to apply the cross-system tariff in addition to the refill tariff to users who ship gas from Longford or Culcairn into Iona storage and later take it out of storage for export to South Australia:[126]

> *APA VTS does not own or have access to meter data to ascertain gas volumes that are sent to South Australia via the Iona UGS facility, and has no meaningful way of identifying or measuring gas going to South Australia.*
>
> *Further, there is a temporal aspect to the AER's draft decision. Gas may flow across the VTS and into the Iona UGS, only to be diverted to South Australia some time later. Aligning billing for Iona refill with South Australian flows may not be possible. It would also be very difficult to identify whether gas that is sent to South Australia via the Iona UGS facility was originally sourced from Longford or Port Campbell.*
>
> *These elements mean that the AER's draft decision cannot be effectively implemented in practice.*

[125] AER Draft Decision APA VTS Attachment 10 – Reference tariff setting, pp.10-18 to 10-20
[126] APA VTS *Access arrangement revision proposal submission*, section 9.2

APA instead made an alternative proposal that would meet the AER's principle of 'user pays':

> *APA VTS considers that a user pays principle would support broader application of the cross system tariff to all Iona refill volumes that are sourced from Longford, as it is these flows that have increased the peak needs for westbound flows on the South West Pipeline that have driven the WORM project. Put simply, all flows from Longford to Iona drive the need for the WORM, not just those that ultimately travel to South Australia.*
>
> *The cross system tariff is calculated as the metro zone tariff, discounted for indirect cost allocations. In this respect, it is a direct marker for the cost of using the specific assets involved to move across the VTS between Iona and Longford (in either direction). There is therefore a good argument for any gas flows across the system to pay this charge.*
>
> *APA VTS notes that use of the cross system charge contributes to the recovery of WORM costs, as the WORM is part of the metro zone. As increased Iona refill flows from Longford have largely driven the need for the WORM investment, it would appear consistent with the AER's rationale set out in its draft decision to apply the cross system tariff to all Iona UGS flows, and not just those that subsequently go to South Australia.*
>
> *Importantly, gas that is ultimately reinjected back into the VTS will contribute to the WORM in line with direct usage of the asset, but only pay one for system common costs. Further, as all revenue from the cross system tariff is returned to customers through the operation of the price control model, APA VTS earns no additional revenue from the application of the cross system tariff to Longford sourced Iona injections. The only impact is that those that contribute to flow gas across the system, thereby driving part of the need to invest in the WORM, contribute more directly to those costs.*

5.5 CCP views on AER's Draft Decision and APA's Revised Proposal

CCP11 sees merit in APA's proposed solution, to ensure that the appropriate parties pay for the costs of the WORM.

In the process since APA submitted its supplementary proposal to bring forward the completion of the WORM, various stakeholders including AEMO, the owners of Iona storage, and large direct users of the VTS have been actively involved in consultation and providing their views on the proposal.

However, other stakeholders, including residential, small business and industrial gas customers who are not directly connected to the VTS, have to date not had the same opportunity to review and provide comment on the business case for the WORM and APA's supplementary submission. The current consultation on the AER's Draft Decision and APA's Revised Proposal will be their first opportunity to provide their views, which the AER will need to take into account in reaching its Final Decision.

The principle of 'user pays' has been agreed by the AER and APA as being the appropriate basis for setting tariffs. This view should be maintained, and carried into the AER's Final Decision. It is the view of CCP11 that the current tariff proposal from APA in its Revised Proposal seems the best option to meet this principle. It appears to be fair, simple to apply, and with low risk of gaming. If other options are proposed in the current consultation, they will need to be considered on their merits, and measured taking into account how well they meet the 'user pays' principle.

6 Access Arrangement

6.1 The AER's Draft Decision

In its Advice to the AER regarding APA's proposed Access Arrangement,[127] CCP11 expressed concern with two proposed changes to cost pass through events, being:

- A new "*gas market structure development event*" - This pass though was sought recognising that the AEMC had recommended substantial changes to the structure of the Victorian gas market. If this recommendation is adopted by governments, there will be a major project in developing the detail of the market structure, drafting legislation and rules, and preparing systems and processes for compliance with the new requirements. APA sought to provide for the pass through of its costs in this process. The definition for the new gas market structure development event was wide, being triggered from when a "decision is made to develop" a new market structure. Once across this threshold, all costs associated with "developing" systems, processes and procedures were to be captured. This appears to include involvement in working groups and panels and APA lobbying for its interests in the process, which might be considered "business as usual" activities. If through this development process it was determined not to proceed with the new market, the cost would appear still to be passed through under the proposed mechanism.
- Amendments to the existing definition of "*carbon cost event*" - This provided for removal of the specific reference to the Clean Energy Act 2011 (Cth). The proposed change to this definition, which is currently clearly focused on cost arising from the now defunct Clean Energy Act, would be to provide a much wider definition of what might be a pass though. It is also proposed that this event not be subject to the materiality trigger (being an impact of one per cent of the smoothed forecast revenue).

CCP11 made the following recommendations to the AER:

- The AER should assess whether the proposed definition of new gas market structure development event could include costs that it might typically consider operating expenses and whether the legitimate concerns of APA are addressed under the existing regulatory change pass through event.
- The AER should not accept amendment to, or continuation of, the definition of carbon cost event in APA's Access Arrangement if it is satisfied that APA's legitimate concerns are covered by other existing pass through events.

The AER's Draft Decision was to delete the Carbon Cost Event and the New Gas Market Structure Development Event,[128] noting that:

- The existing Regulatory Change Event and the Tax Change Event potentially allow for pass through of costs of a carbon abatement scheme, subject to the AER's assessment and meeting the materiality threshold; and
- The existing Regulatory Change Event would cover cost of involvement in developing a new gas market structure.[129]

[127] Advice to the AER – CCP11 – Response to proposal from APA VTS for a revenue reset/access arrangement for the period 2018 to 2022 – 3 March 2017 pp.37-40

[128] AER Draft Decision APA VTS Australia gas access arrangement Attachment 11 – reference tariff variation mechanism p.11-13

[129] Ibid. pp.11.19 to 11.21

CCP11 considers that the Draft Decision on these matters addresses its concerns.

6.2 APA VTS Revised Proposal

APA VTS does not accept the AER's deletion of the Carbon Cost Event and the New Market Structure Development Event. It contends that the existing Regulatory Change Event and the Tax Change Events may not address the issues.[130]

In the case of a Carbon Cost Event APA is concerned that if such costs cannot be passed through to customers it might defeat the public policy purpose by preventing consumers from being exposed to the additional cost.[131] However, this seems unlikely as it would require the government to design and enact a carbon scheme, intended to send a price signal to gas users through gas transmission pricing, without ensuring that the carbon scheme overrides an instrument like an access arrangement (which is created under law by a governmental authority).

In its revised Access Arrangement (dated 14 August 2017), APA has made minor variations to the definitions of Carbon Cost Event and the New Gas Market Structure Development Event. CCP11 does not consider that these revised definitions address its original concerns.

[130] Victorian transmission system access arrangement proposal – submission in response to draft decision 14 August 2017, pp.106-110
[131] Ibid. p.107

CONCLUSION

There are a few remaining areas where CCP11 is concerned that the proposal from the APA may not be in the long term interests of consumers.

CCP11 commends to the AER the issues raised in this Advice, and particularly the comments made on remaining issues of concern.

Deemed Signed

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Chris Fitz-Nead	Bev Hughson	David Prins	Robyn Robinson
Sub-panel Chairperson			