**Summary of CRG and ENA current perspectives on elements of the RoR Guideline**

Cells coloured pink are promoted by that group for consideration at the concurrent evidence sessions.

Cells coloured green have been nominated by that group as potential low hanging fruit.

NOTE: Gearing is most significant gap. Prepared by David Havyatt 1 Feb 2018

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| **Component** | **CRG** | **ENA** | **Proposed priority of issue being discussed in concurrent evidence session** |
| The concept of risk and how to compensate for it | What is the concept of risk in corporate finance? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Risks actually faced by providers | What impacts investor confidence and how to measure/take account of it when faced with a range of possibilities?  What risk should the rate of return compensate?  How can the risk of businesses providing regulated services be estimated? | How should the changing risk profile faced by networks be taken into account in the regulatory framework? | High |
| Differences in risks between providers |  |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Data | How do you deal with inadequate data?  How best to deal with a range of outcomes and picking a point estimate?  Can the foundational model be converted to a ‘formula’ (e.g. to address the concept of ‘’being informed by’) or does it just reconcile to point estimates?  How should the AER pick the point estimate from a range of equity beta information consistent with the NEO? | Where does the balance between judgement and data lie, and how precisely can we seek to estimate rate of return parameters objectively, and in a way that can be replicated independently by any stakeholder, using market data? | Medium |
| Sources of data | What is involved in developing additional data sets? Can more data be drawn from the RINs? |  | Low |
| Vicious circles in data | Is there a circular feedback loop that starts with a high rate of return and perpetuates the same outcome due to the focus on market data to make decisions? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| MRP Data Issues |  | How should the set of relevant evidence be distilled into a single MRP point estimate? What position did we take about data questions in the end? | Medium |
| Role of out-turn | How should profitability of networks’ and their RAB (trading and acquisition) multiples influence the final rate of return (or component) point estimate |  | Low – but happy to discuss separately further into AER network profitability project |
| WACC=(1-G)\*Re + G\*Rd |  |  |  |
| G = gearing | Is there sufficient relevant market data to determine an estimate for gearing for an efficient network business? | Application of settled AER approach to updated data  ‘Low hanging fruit’ – approach to benchmark gearing assumptions and evidence | Low |
| Data for unlisted companies | How should data relating to privately owned/non-listed entities debt be accounted for in calculating gearing?  Should overseas ownership, and parent companies’ financing acquisitions of network equity entirely from parent-company debt, be accounted for in determining gearing and how? |  | Medium |
| Risk of vicious loop | Is the relationship between equity beta and gearing a ‘vicious/virtuous’ feedback loop if gearing is based on market value/enterprise value of the entity? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Appropriate categorisation | Should the business obtain a rate of return on equity or on debt for retained earnings, revaluation values? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Apportioning debt | If a business has regulated and unregulated assets, how much of the debt should be assigned to each? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Re=Rrf + Beta\*MRP = Return on equity |  | Broad agreement to apply incremental approach to past AER approach to reach **more stable** allowances/prices that are capable of acceptance | High |
| Rrf = Risk Free Rate |  |  |  |
| Term and Averaging period | Low hanging fruit | Shared concern on unstable/lottery type outcomes for customers Low hanging fruit avoiding unnecessary volatility’ | Low |
| Benchmark approach to setting risk free rate |  | ‘Low hanging fruit’ | Medium |
| Beta = Equity Beta |  |  |  |
| Sample size | Is there sufficient data and are there other improvements, such as where network businesses sit relative to other industries, that can be informative in setting the point estimate? | Can a reliable estimate of equity beta, or a reliable range, be obtained from the three remaining firms? If not, how can the reliability of equity beta estimates used by the AER be improved? | High |
| Levering |  | Should equity beta estimates be re-levered to the 60% gearing of the BEE?  (DH: I thought they were)  (GC: that is standard, however AER has elsewhere compared betas without undertaking this) | Medium |
| Overseas data |  | What is the appropriate role for the evidence on equity betas of overseas energy network businesses? | Medium |
| Other Infrastructure data |  | What is the appropriate role for the evidence from domestic infrastructure businesses? | Medium |
| Other approaches |  |  |  |
| (Supposed) low Beta bias |  | How should low-beta bias associated with the SL-CAPM, and evidence from the Black CAPM, be taken into account when implementing the foundation model approach? Assuming there is one | High |
| Time variation | Does the equity beta move over time and if so over what period? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| MRP = Market Risk Premium | Is there an inverse relationship between MRP and risk-free rate? *(note: personal view that this is only being included because the AER needs to be able to respond to the proposition*) |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Historic Excess returns | What data should be considered? | What role should the geometric mean of historical excess returns play in arriving at an estimate of the MRP? | Medium |
| Dividend Growth Model | Why is the DGM’s market risk premium higher than indicated from other evidence? | What role should DGM estimates play in arriving at an estimate of the MRP? | High |
| Sharpe ratios | Why are networks’ Sharpe ratios high? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| The Wright evidence |  | How should the Wright evidence be used to inform the estimate of the MRP? How is this evidence used by other regulators? | High |
| Independent Expert Evaluation Reports |  | How should independent expert valuation reports be used to inform the estimate of the MRP? | Medium |
| Regulatory consistency |  | What estimate of MRP is supported by recent decisions of other Australian regulators? | Propose discuss at a joint ENA-CRG Experts Session? |
| Survey data | In developing the MRP we use the ASX accumulation index as the prime source of data to develop the measure. This data reflects the operations of firms where assets are depreciated from actual cost and not indexed, where revaluations are taken to profit, firms are exposed to optimisation of assets, firms are subject to technological obsolescence, etc, whereas the firms we apply the outcomes of the data are not subject to any of these aspects, implying that the data is not necessarily sufficiently closely relevant. {Or does the equity Beta adequately represent this difference?} | What estimate of MRP is supported by recent surveys? | Propose discuss at a joint ENA-CRG Experts Session? |
| Rd = Return on debt |  |  |  |
| Transition approach |  | Transition to AER approved trailing average approach  ‘Low hanging fruit’ | Low |
| Type of debt to be measured | In applying the cost of debt we use corporate bond rates but this is only one form of debt that a firm uses for its operation. Is the use of a corporate bond rate appropriate to use as a surrogate for all debt or does it provide an excessive return? |  | Propose discuss at a joint ENA-CRG Experts Session? |
| Number of series used to calculate | Low hanging fruit – issue is visibility |  | Medium |
| Debt term | David Headbury still concerned about ten years rather than seven |  | Propose discuss at a joint ENA-CRG Experts Session?  May be appropriate to defer consideration of this issue until AER data request information is available |
| Credit rating | Do energy networks have a different gearing to the average BBB-rated firm (from all industries), and why?  Is BBB credit rating appropriate? |  | Medium |
| Gamma |  | Acceptance of appeal outcomes, focus on implementation and refinement of ATO data supporting AER approach | Medium |
| Utilisation Rate | Should an efficient benchmark entity utilise 100% of its franking credits?  What weight should be given to tax statistics data relative to equity ownership? (note: personal view that this is only being included because the AER needs to be able to respond to the proposition | What are the relative merits of the ATO tax statistics and equity ownership approaches to estimating gamma under a utilisation rate interpretation? | High |
| Distribution Rate | What weight should be given to tax statistics data relative to equity ownership? (note: personal view that this is only being included because the AER needs to be able to respond to the proposition | What are the relative merits of the ATO tax statistics and the “Lally” approach to estimating the distribution rate? | High |
| Currency |  | What role should data that is 12 or more years out of date have when estimating gamma using the equity ownership approach? | Low |
| Reopening guidelines | Can possibility of movements in underlying data be captured in such a way that a formula could be constructed (e.g. ENA proposition about changing the MRP in response to movement in Risk Free Rate).  If not what kind of movement in the empirical data should qualify as re-opening. | Under what circumstances should a binding Rate of Return Guideline be re-opened? | High – noting that any joint position might be more relevant to feed back to COAG EC policy consultation process, not the AER guideline review |

Note: There are members of CRG who nominated relevance of tax stats and reopening guidelines as low hanging fruit.