



Mr Chris Pattas  
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Australian Energy Regulator  
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18 April 2016

Dear Chris

**CITIPOWER AND POWERCOR 2016-2020 DISTRIBUTION DETERMINATIONS - SUBMISSION ON IMPLICATIONS OF RECENT AUSTRALIAN COMPETITION TRIBUNAL DECISIONS**

On 26 February 2016, the Australian Competition Tribunal (**Tribunal**) set aside the final distribution determinations made by the Australian Energy Regulator (**AER**) in April 2015 in respect of the Networks NSW (**NNSW**) distributors, ActewAGL Distribution and the AER's June 2015 full access arrangement decision for Jemena Gas Networks. The Tribunal remitted the matters to the AER to re-make the decisions in accordance with the Tribunal's directions.

The Tribunal's decisions have implications for the AER's upcoming final decisions in respect of the distribution determinations for CitiPower Pty Ltd and Powercor Australia Limited (**the Businesses**) for the 2016-20 regulatory control period (**Final Determinations**).

The AER advised that it does not intend to run a formal consultation process on the implications of the Tribunal's decisions, however, we still consider it prudent to submit our views on the implications of the Tribunal's decision for the Final Determinations.

This submission sets out our views on the implications of the Tribunal's reasoning in the *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1 (**Ausgrid Decision**)—the 'lead' decision in respect of the issues common to the NNSW businesses, ActewAGL Distribution and Jemena Gas Networks (together, **Network Applicants**)—in relation to the following aspects of the Final Determinations:

- the value of imputation credits (or gamma); and
- the real price growth of labour costs component of our operating and capital expenditure forecasts.

The AER has lodged applications for judicial review of the Tribunal's decisions, which will not be heard and determined prior to the making of the Final Determinations. We consider that, until the applications are heard and determined, the Final Determinations should be made in accordance with the Tribunal's decisions and reasons underpinning those decisions.

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Below we submit our views on each of the issues mentioned.

## **Gamma**

The AER's preliminary distribution determinations for the Businesses adopted a value of imputation credits (gamma) of 0.4, rather than our proposed value of 0.25.

The AER also adopted a value for gamma of 0.4 in the distribution determinations for the Network Applicants. The Tribunal decided that the value set by the AER for gamma, however, was too high and the AER decision on gamma should be set aside.<sup>1</sup> The tribunal directed that the AER adopt a value for gamma of 0.25 on remittal.<sup>2</sup>

The Tribunal did not accept the AER's approach that imputation credits are valued at their claimable amount or face value; their value is investors' determination of their worth, as reflected in observable market behaviour. The Tribunal further concluded that:

- tax statistics can only provide an upper bound for the value of theta; they can only be used as a 'check';<sup>3</sup>
- the equity ownership approach overstates the redemption rate; even on the AER's own definition of theta, equity ownership rates are above the true maximum possible figure for theta. Like tax statistics, they can only be useful as a 'check' on other estimates;<sup>4</sup>
- the equity ownership approach and tax statistics are inconsistent with a proper interpretation of the Officer framework underlying the Rules (because they make no attempt to assess value to shareholders and ignore factors that reduce value below face value);<sup>5</sup>
- it follows that market studies must be used to estimate the value of imputation credits; market studies are consistent with the methods used to calculate the returns on equity and debt;<sup>6</sup>
- the best estimate of theta is that derived by the updated SFG study of 0.35; and<sup>7</sup>
- the AER erred in using a listed equity only measure of the distribution rate; it is appropriate to follow past practice (being all equity) at the present time (giving a rate of 0.7);<sup>8</sup>

The Tribunal's determinations and findings regarding the correct estimation of gamma affirm that the only correct and reasonably open decision for the AER in respect of gamma in the Final Determinations is to adopt a gamma value of 0.25.

Our revised regulatory proposals are consistent with the reasoning and conclusions of the Tribunal and so we submit that the value of 0.25 be applied in the Final Determinations.

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<sup>1</sup> Tribunal, Ausgrid Decision, at [1110]-[1111].

<sup>2</sup> See, for example, paragraph 1(c) of the Tribunal's directions in the Ausgrid Decision.

<sup>3</sup> Tribunal, Ausgrid Decision, at [1048].

<sup>4</sup> Tribunal, Ausgrid Decision, at [1093].

<sup>5</sup> Tribunal, Ausgrid Decision, at [1095].

<sup>6</sup> Tribunal, Ausgrid Decision, at [1074], [1096] and [1097].

<sup>7</sup> Tribunal, Ausgrid Decision, at [1103].

<sup>8</sup> Tribunal, Ausgrid Decision, at [1104] to [1106].

## Real price growth of labour costs

As set out in our revised regulatory proposals for 2016-20, we submit that the AER must have regard to our enterprise bargaining agreements (**EBAs**) in forecasting real price growth rates for labour.

Our proposed labour price growth rates are based on historical EBA outcomes, being our own EBAs until they expire and forecasts based on the EBAs of all Australian privately owned electricity networks thereafter. We maintain that the requirement under the *Fair Work Act 2009* (Cth) to comply with EBAs is a 'regulatory obligation or requirement' within the meaning of the Law and Rules, which means that our expenditure forecasts must allow for compliance with our existing EBAs and the EBAs we are likely to enter into after our existing EBAs expire.

In the AER's preliminary distribution determinations for the Businesses, the AER rejected our proposed labour price growth forecasts.

In the Ausgrid Decision (in the context of considering the AER's operating expenditure decisions in respect of the NSW distributors), the Tribunal found that the NSW distributors are bound by their EBAs as a matter of law and that the EBAs should not be viewed as an endogenous managerial choice, but rather a restriction attributable to an exogenous factor (namely, the *Fair Work Act 2009* (Cth)).<sup>9</sup> The Tribunal did not determine whether compliance with an EBA is a 'regulatory obligation or requirement' but found that, even if it was not, it may be reasonably regarded as:<sup>10</sup>

- otherwise required to achieve an operating expenditure objective, namely, the clause 6.5.6(a)(4) objective to: 'maintain the safety of the distribution system through the supply of standard control services'; and
- reasonably reflecting the operating expenditure criteria in clause 6.5.6(c)(3) of the Rules: 'a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives'.

Further, the Tribunal stated that:<sup>11</sup>

It may be said that, in the view of the Tribunal, it is the policy of the legislative arm of government that, to the extent that the EBA's are (if they are) an inefficient imposition on the DNSPs, nevertheless they are a cost to be borne by the consumers of electricity...the Tribunal does not accept that [the AER] may, by the use of the EI model, simply select the measurement of efficiency which it did in this respect without regard to the obligations under the EBAs as they presently exist.

The Tribunal's Ausgrid Decision strongly supports our submission that our forecasts of labour price growth rates, and resulting forecasts of operating and capital expenditure, are required to allow for compliance with our EBAs. In particular:

- the Ausgrid Decision is clear in characterising the requirement to comply with EBA obligations as a matter that is exogenous to distributors. We maintain our submission that the requirement under the *Fair Work Act 2009* (Cth) to comply with EBAs is a 'regulatory obligation or

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<sup>9</sup> Tribunal, Ausgrid Decision, at [427] and [434]-[435].

<sup>10</sup> Tribunal, Ausgrid Decision, at [418].

<sup>11</sup> Tribunal, Ausgrid Decision, at [436].

requirement' within the meaning of the Law and Rules. However, even if it is not, we adopt the findings of the Tribunal and contend that:

- the requirement under the *Fair Work Act 2009* (Cth) to comply with EBAs may reasonably be regarded as required to achieve the clause 6.5.6(a)(4) operating expenditure objective and reasonably reflecting the operating objective criteria in clause 6.5.6(c)(3) of the Rules (as set out in the Ausgrid Decision); and
  - similarly, as clauses 6.5.7(a)(4) and 6.5.7(c)(3) of the Rules (in respect of forecast capital expenditure) mirror clauses 6.5.6(a)(4) and 6.5.6(c)(3) in respect of operating expenditure, compliance with an EBA may reasonably be regarded as required to achieve the clause 6.5.7(a)(4) capital expenditure objective and reasonably reflecting the capital expenditure objective criteria in clause 6.5.7(c)(3) of the Rules.
- accordingly, the costs of complying with our existing EBAs must be reflected in expenditure forecasts.

For similar reasons, the Ausgrid Decision supports our position that our expenditure forecasts must allow for compliance with EBAs that we are likely to enter in the period after our existing EBAs expire. As previously submitted, our existing EBAs apply for part of the 2016-20 regulatory control period, meaning we will enter into new EBAs during the period. Compliance with those new EBAs will, as with existing EBAs, be a 'regulatory obligation or requirement' (or, as set out above, required to achieve the expenditure objectives and reasonably reflect the expenditure criteria). We therefore maintain our submission that, following expiration of our existing EBAs, these industry average EBA wage growth rates provide the best estimates of the wage growth rates in the new EBAs that we will enter into during the period.

Our EBA-based forecasts are the most representative measure of expected prudent and efficient labour price growth in the 2016-20 regulatory control period.

Please do not hesitate to contact me on (03) 9683 4465 should you have any questions on this submission.

Yours sincerely



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