



Consultation paper Process for reviewing the rate of return guidelines

July 2017

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CCP	Consumer Challenge Panel
NEL	national electricity law
NEO	national electricity objective
NER	national electricity rules
NGL	national gas law
NGO	national gas objective
NGR	national gas rules

1 About this consultation

This consultation paper is the first step towards reviewing the current rate of return guidelines. It is our preliminary consultation with stakeholders on the process we propose to undertake to review the guidelines, rather than the substantive rate of return issues.

Our proposed timelines are set out Section 2.2 below.

1.1 How to make a submission

Interested parties are invited to make submissions on this consultation paper by **28 August 2017**.

In each section, we have set out some preliminary views on potential process steps for consideration. This may guide your submission, however we encourage you to address any other matters of relevance.

We prefer that all submissions are in Microsoft Word or another text readable document format. Submissions on our issues paper should be sent to: rateofreturn@aer.gov.au.

Alternatively, submissions can be sent to:

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

- (1) clearly identify the information that is the subject of the confidentiality claim
- (2) provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy (October 2008), which is available on our website.

2 Overview

The AER is the independent regulator for the Australia's national energy markets. We are guided in our role by the national electricity, gas, and energy retail objectives set out in the National Electricity Rules (NER) and the National Gas Rules (NGR). These objectives focus on promoting the long term interests of consumers.

In 2012, the Australian Energy Market Commission amended the NER and the NGR . These changes included, amongst other things, a requirement for us to develop guidelines which outline our approach to setting the rate of return for regulated electricity and gas network businesses. We completed the first guidelines in December 2013. Following more recent rule changes,¹ we are required to complete a review of the current guidelines within five years (December 2018) of publishing the current guidelines.

This consultation paper is the first step in that review.

2.1 About the rate of return guidelines review

We develop, maintain and apply the rate of return guidelines in accordance with the requirements of the NER and NGR. It sets out the approach by which we will estimate the return on debt, return on equity and the value of imputation credits (gamma) for the duration over which the guidelines apply. Estimation of the rate of return is complex and contentious, and the rate of return is a significant driver of regulated revenue. While the guidelines are currently not binding on how we make rate of return decisions, it should provide a high degree of certainty and transparency for stakeholders. As set out below the Commonwealth Government has signalled its intention to introduce new legislation such that the guidelines will be binding on both the AER and the regulated businesses.

For those reasons, we are exploring options for making our rate of return guidelines review process more accessible, transparent and collaborative. We consider this will promote confidence in our guidelines. As such, we have identified a number of mechanisms we propose to include in the process, including our preliminary views on how they might work.

The mechanisms set out in this paper reflect our initial thinking. We are interested in hearing stakeholders' views about these mechanisms and other potential approaches. We will publish our intended process for developing the rate of return guidelines, having regard to your feedback, in October 2017.

¹ NER clauses 6.5.2(p)(1) and 6A.6.2(p)(1); NGR clause 87(16)(a).

2.2 Review timeline

Our proposed timeline for the guidelines review is set out below in table 1. At this stage the timeline is indicative only and has been developed to accommodate our preliminary views on new process steps and the estimated time requirements of including those steps.

Table 1 Indicative timeline for the guidelines review process

Date	Milestone
July 2017	Review process consultation paper
October 2017	Issues paper
November 2017 – December 2017	Submissions on issues paper
February 2018 – March 2018	Hot-tubbing sessions
May 2018	Publication of draft guidelines
June–August 2018 (approximately 10 weeks)	Independent panel process
August 2018	Submissions on draft guidelines
17 December 2018	Publication of final guidelines

We will publish the final rate of return guidelines by no later than 17 December 2018.² Under the consultation procedures in the NER and NGR,³ this would mean draft guidelines would need to be published by 24 August 2018.⁴ However, the consultation procedures allow for flexibility where the consultation involves issues of unusual complexity or difficulty. In our view, development of the rate of return guidelines is sufficiently complex to justify an extension of time between the draft and final guidelines.⁵ We therefore propose to expand the time period between the draft and final guidelines by publishing draft guidelines in May 2018, while retaining the December 2018 timing for the publication of the final guidelines. We consider that a longer window between the draft and final guidelines will assist the AER and stakeholders in undertaking the processes discussed in section 3.

While we must publish our guidelines in line with our 17 December 2018 deadline, the application of the guidelines to particular revenue resets is less certain. The Commonwealth government has stated that it intends to remove limited merits review of our regulatory determinations, and the COAG Energy Council has committed to developing a framework for binding rate of return guidelines. These reforms may involve changes to relevant legislation and rules, and these changes may have

² This is five years from publication of the current guidelines (17 December 2013).

³ NER clauses 6.16 and 6A.20; NGR clause 9B.

⁴ This is 80 business days (using ACT public holiday calendar) prior to 17 December 2018.

⁵ NER clauses 6.16(g)(1) and 6A.20(g)(1); NGR clause 9B(4)(a).

implications for the timing and application of the rate of return guidelines to particular upcoming determinations.

Table 2 outlines the application of the final guidelines to our ongoing and upcoming regulatory determinations based on the current legislative framework. We submitted a rule change request to the AEMC in June 2016 requesting the review of the rate of return guidelines be deferred to December 2018. In October 2016 the AEMC approved this rule change request, and also made transitional provisions addressing the application of the current and new guidelines to particular determinations. Table 2 reflects the arrangements put in place by the AEMC and the transitional provisions included in its rule determination.

Table 2 Application of reviewed guidelines to ongoing and upcoming regulatory determinations (under current legislation)

Regulatory determinations	Applicable rate of return guidelines
2018-22 access arrangements for AusNet Services, AGN, MultiNet, and APAVTS	2013 Guidelines apply to entire process
2018-23 transmission determinations for ElectraNet, Murraylink, and TransGrid	2013 Guidelines apply to entire process
2019-24 distribution determinations for Ausgrid, Endeavour Energy, Essential Energy, ActewAGL, and NT Power and Water	2013 Guidelines apply to entire process
2019-24 transmission determination for TasNetworks	2013 Guidelines apply to entire process
2019-24 distribution determinations for TasNetworks	2013 Guidelines apply to initial regulatory proposal (January 2018), draft decision (September 2018) and revised regulatory proposal (December 2018). 2018 Guidelines apply to final decision (April 2019). However, in June 2017 TasNetworks submitted a rule change request to the AEMC requesting that the 2013 Guidelines apply to the entirety of its distribution process. This will align the treatment of its distribution and transmission determinations.
2019-24 access arrangement for Central Ranges Pipeline	2013 Guidelines apply to initial access arrangement proposal (July/September 2018). 2018 Guidelines apply to draft decision (indicative January 2019) revised access arrangement proposal (indicative February 2019) and final decision (May 2019).
2020-25 transmission determination for Directlink	2018 Guidelines apply to entire process
2020-25 distribution determinations for SA Power Networks, Energex, and Ergon Energy	2018 Guidelines apply to entire process
2020-25 access arrangement for Jemena Gas Networks	2018 Guidelines apply to entire process
2021-25 distribution determinations for AusNet Services, CitiPower, Jemena Electricity Networks, Powercor, and United Energy	2018 Guidelines apply to entire process

Source: National Electricity Rules, clauses 6.5.2(p)(1), 6A.6.2(p)(1), and Part ZZU.
National Gas Rules, subrule 87(16)(a).

See also *AEMC National Electricity Amendment (Rate of Return Guidelines Review) Rule 2016 No. 9*, and *AEMC National Gas Amendment (Rate of Return Guidelines Review) Rule 2016 No. 2* (Commenced 20 October 2016).

For TasNetworks' proposed rule change, see: TasNetworks, *Request for rule change submission*, 9 June 2017.

3 Proposed steps in the review process

In line with the relevant consultation procedures in the NER and NGR,⁶ we will publish draft and final rate of return guidelines. However, due to the significance of the guidelines for the sector, we propose to include more consultation than what is required under the rules. In the section below we set out a series of steps we propose to include in the process, including:

- A consumer reference group
- A dedicated consumer challenge sub-panel
- Targeted workshops and information sessions
- An October 2017 issues paper
- 'Hot-tubbing' of expert advisers
- An independent review of our draft guidelines.

Below we set out some preliminary views on how we think these steps should work and what they will add to the guidelines review process. This is not an exhaustive list and we are open to views from stakeholders on other potential options.

3.1 Consumer reference group

The rate of return has a substantial impact on consumers' electricity and gas bills. For that reason, it is important that we maximise the opportunities for consumer participation. A consumer reference group could serve as a central point of contact for individual consumers or small consumer groups to coordinate participation in various steps of the process and to provide ongoing feedback to their members. We anticipate this feedback would go beyond the technical feedback provided by the consumer challenge panel (section 3.2).

The benefit of establishing a consumer reference group is to facilitate the participation and engagement of consumers throughout the process. It would also allow us to provide more targeted consultation, such as through workshops and information sessions (section 3.3).

⁶ NER clauses 6.16 and 6A.20; NGR clause 9B.

Table 3 Preliminary thoughts on the consumer reference group

Issue	AER's preliminary thoughts
Purpose	The consumer reference group will facilitate consumer participation and engagement throughout the rate of return guidelines development process.
When	We propose to constitute the consumer reference group prior to publishing the issues paper in October 2017.
Opportunity for stakeholder input	Following release of the issues paper we would expect the commencement of substantive consultation on rate of return issues.

3.2 Consumer challenge subpanel

The consumer challenge panel (CCP) is a panel of experts—each appointed in their individual capacity—to a non-statutory advisory board to assist us in making better regulatory determinations by providing input on issues of importance to consumers. This ongoing consumer perspective helps us to achieve a balanced consideration of all views. We established the CCP in 2014, and have established a separate sub-panel with a specific focus on the rate of return guidelines review.

Table 4 Preliminary thoughts on the CCP sub-panel

Issue	AER's preliminary thoughts
Purpose	The CCP role is to challenge the AER's analysis from a consumer's perspective, to provide consumer focussed advice on technical matters, and suggest any approaches we may explore through our process.
When	We have formed a guidelines review sub-panel from the existing CCP.
Opportunity for stakeholder input	Following release of the issues paper we would expect substantive consultation on rate of return issues to commence.

3.3 Targeted workshops and information sessions

Rate of return decisions are detailed and complex. As a result, many consumers have found rate of return discussions inaccessible, even where there are opportunities for consultation. However, the ultimate objective of the national electricity and gas frameworks is to promote the long-term interests of consumers. In our view, it is critical to have informed consumer perspectives on their own long-term interests. To address this, we intend to facilitate a series of introductory workshops, targeted workshops and skills sessions. These could include topics such as:

- Introductory workshops on the role of the rate of return in the broader regulatory framework, the rate of return objective, and interrelationships between the rate of return and other aspects of our determinations
- Targeted workshops on specific rate of return issues
- Finance theory

- The impact of court precedents and tribunal decisions on how we interpret the rate of return framework
- Summaries of submissions and distillation of issues raised at various stages into key areas of contention.

Table 5 Preliminary thoughts on workshops and information sessions

Issue	AER's preliminary thoughts
Purpose	To provide ongoing general and targeted assistance to stakeholders
When	We are open to holding these sessions at any stage during the guidelines development process subject to feedback from stakeholders. However, it may be most useful to conduct workshops in the lead-up to the October issues paper so stakeholders are in a position to contribute to any early 'filtering' of less contentious issues.
How will we coordinate the sessions	We propose that the consumer reference group could serve as a point of contact between consumers more broadly and the AER in requesting and coordinating workshops.

3.4 Issues paper

The relevant consultation procedures for making rate of return guidelines require a draft and final decision. We propose to publish the draft decision in May 2018 and the final decision in December 2018. However, in order to promote earlier consultation on substantive issues, we propose to publish an issues paper in October 2017. While we may undertake specific targeted consultation with key stakeholders prior to this time, the issues paper would mark the commencement of broad consultation on substantive issues.

Table 6 Preliminary thoughts on the issues paper

Issue	AER's preliminary thoughts
Purpose	<p>The issues paper will serve several purposes, including:</p> <ul style="list-style-type: none"> • A summary of significant developments since the previous guidelines review, including discussion of any relevant changes to the framework under which the rate of return guidelines are made • An opportunity for stakeholders to express their preliminary views on whether there are any non-contentious aspects of the current guidelines that do not require substantive re-evaluation
When	October 2017. This allows around six months of consultation, including the hot-tubbing process, before publication of the draft guidelines.
Opportunity for stakeholder input	Following release of the issues paper we would expect substantive consultation on rate of return issues to commence.

3.5 'Hot-tubbing' of expert advisers

Expert advisers such as economic and finance consultants play a critical role in the development of the rate of return guidelines. Rate of return issues are complex and often rely on the exercise of expert judgement to resolve. 'Hot-tubbing' of expert advisers is a mechanism through which we can have concurrent discussions with

various experts that are participating in the guidelines review process. The mechanism has precedent in both court and administrative settings.

The purpose of ‘hot-tubbing’ is to identify, scope, and narrow the relevant issues, identify the points on which the views of the experts differ and the reasons for any disagreement. The process may also require experts to appear together as a concurrent expert panel for the purposes of answering questions from the AER board and other parties, and providing comments on the views of the other experts on the same panel. This enables all parties to focus subsequent analysis on the areas of legitimate and material disagreement.

Table 7 Preliminary thoughts on an expert adviser hot-tub

Issue	AER's preliminary thoughts
Purpose?	The main purpose of the hot-tubbing session is to highlight material issues of agreement and disagreement between experts to aid us in consideration of submission material.
When?	<p>Beginning in February 2018. This allows time for stakeholders to make submissions on the issues paper and for these to shape the areas of expertise and issues to be discussed in the hot-tubbing sessions. We expect that we would be in a position to make invitations to experts to participate during March 2018.</p> <p>Following the hot-tubbing sessions we will have approximately two months to take account of the 'hot-tubbing' discussions in making our draft decision.</p> <p>We will be responsible for establishing the meetings.</p>
Who would participate?	<p>In our view it is important to retain some flexibility about how many and which experts would be involved in a hot-tubbing session. In making invitations to participate, we would aim to balance:</p> <ul style="list-style-type: none"> • making sure that the spectrum of views is well-represented • keeping the number of participants at a manageable level to allow for effective discussion of the issues <p>We expect that we would go through this selection process for each scheduled hot-tubbing session, meaning the participating experts might vary across issues.</p>
How would the issues be divided?	<p>We propose to maintain some flexibility in the specific composition and timing of issues, but we expect it may be practical to divide hot-tubbing sessions based on specific content areas. For example, we might hold individual sessions on:</p> <ul style="list-style-type: none"> • Return on equity • Return on debt • Value of imputation credits • Interrelationships and the overall rate of return. <p>We may wish to settle areas of agreement before exploring areas of potential disagreement between the experts.</p>

Prior to the meeting, we would circulate a draft set of agreed positions and request participants to discuss, make any necessary changes, and sign off on the statement.

We also expect we would document outcomes of the meeting through either or both of:

What would be the outcome of the hot-tubbing process?

- publishing a minute of the hot-tubbing session
- a final statement of key issues in which we summarise the important issues or assumptions on which the experts' views differ

In either case we consider there may be value in having the relevant experts 'sign-off' on the minute and final statement of key issues.

We will take the outcomes of the hot-tubbing sessions into account in making our draft and final decisions.

3.6 Independent panel review of the draft guideline

Given the importance of the guidelines to the sector and the need transparency and confidence in its development we consider that a review of our draft guidelines by an independent panel may be a useful step in promoting stakeholder confidence in both the process and the ultimate decision.

To get the most out of any independent panel review, it is important to consider what we expect the independent review panel to deliver.

Ultimately, our objective when making the rate of return guidelines is to achieve the National Gas and Electricity Objectives. One option is to ask an independent panel to provide their views on whether the draft guidelines achieve these objectives. However, this may result in the independent panel duplicating the work of the regulator. Where our decision is the result of the application of our regulatory judgment, duplicating this aspect of the process may create uncertainty rather than resolve substantive issues.

We note that while the Commonwealth government has stated that it intends to remove limited merits review, the ability for parties to seek judicial review of our regulatory determinations remains.

Further, an independent panel may engage with expert material, either from the expert hot-tub or from submissions or other sources. Due to the complex nature of many of the issues discussed in expert material, the identification of errors or deficiencies in the material may require interaction with the relevant experts, to clarify understanding of key concepts and test counter-arguments. However, that would be duplicative and time consuming.

For these reasons our preliminary view is that the role of the independent panel should not include duplication of our regulatory judgment or provision of additional expert opinions on matters already addressed in the expert hot tubbing process. Our view is that the independent review panel is best suited to a role of reviewing that we have undertaken an effective review process; engaged with the material before us with an open mind; and have reached a decision that is supported by our stated reasons and the information available to us.

We are open to exploring other approaches to obtaining meaningful contributions from the independent panel review process and therefore seek stakeholders' views on the appropriate role for the independent panel.

Table 8 Preliminary thoughts on an independent panel review of the draft guidelines

Issue	AER's preliminary thoughts
Purpose?	The main purposes of the independent panel process is to give us the benefit of an independent review, and to promote confidence amongst stakeholders that our findings on rate of return issues are robust and have been tested by a group of independent experts.
When?	<p>June-August 2018.</p> <p>In our view, the most productive opportunity for an independent panel to participate in the process is immediately following publication of the draft guidelines. That would allow the panel to review our complete draft decision and reasoning , and would give sufficient opportunity for us to take the panel's views into account in making a final decision.</p>
Who would participate?	<p>Selection of members for the panel will be a key aspect of the process. It is critical that panel members are both independent of the regulatory processes and have the relevant expertise.</p> <p>Our preliminary proposal is that we would specify a series of selection criteria that might include factors such as:</p> <ul style="list-style-type: none"> • Panel members should have relevant finance, economic and/or regulatory expertise. • Panel members must not have been engaged to provide advice to a network business or the AER on any AER regulatory determination processes within the preceding 2 years. • Panel members must be available for the two months following publication of the draft rate of return guidelines. <p>The AER will engage and fund the independent panel.</p>
What would the panel be required to do?	To promote stakeholder confidence in the independent panel process, we propose to publish the terms of reference for panel members. Our preliminary view is that the terms of reference would ask the panel to assess whether we have undertaken an effective review process; engaged with the material before us with an open mind; and have reached a decision that is supported by our stated reasons and the information available to us.
What would be the outcome of the independent panel process?	We expect that the independent panel would provide us with a report on the outcomes of its review. We would then have regard to this report in finalising the guidelines.