7 June 2018

Mr Warwick Anderson

General Manager, Networks

Australian Energy Regulator

GPO Box 3131

Canberra, ACT, 2601

Lodged electronically: rateofreturn@aer.gov.au

Dear Mr Anderson

**AER – Review of the rate of return guideline – Return on Debt – 30 May 2018**

EnergyAustralia welcomes the opportunity to inform the AER’s review of the Rate of Return Guideline. We are one of Australia’s largest energy companies with over 2.6 million electricity and gas accounts in New South Wales, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market and an annual gas portfolio of over 100PJ.

The AER has invited comments in response to new evidence and findings on its approach to estimating prevailing return on debt. In summary, we broadly support the AER’s overall return on debt approach but consider there may be merit in:

* Changing the credit rating from BBB+ to a tiered credit rating approach of A- and then BBB.
* Reduce the tenor from 10 years to 7.5 years as this is more reflective of actual tenor.
* Regular back-testing curve outcomes over time to inform adjustments to the benchmark.

Benchmark credit rating

The AER currently take the view that an appropriate proxy for an efficient entity's return on debt would be third party data series' published yields for BBB+ corporate bonds with a 10-year term to maturity. However, in practice we understand that data series for corporate BBB-rated bonds are used. At present we estimate that this could add between 10 and 15 basis points to the cost of debt. A tiered approach using a credit rating of A- and then BBB might provide a more accurate credit rating profile across the industry.

Debt term to maturity

In developing the current Rate of Return Guideline, the AER determined the weighted average term at issuance of debt issued by a representative sample of networks was 8.7 years. However, the AER instead adopted a 10-year benchmark term to maturity.

The choice of assumption to use a 10-year term maturity is a longer term than what we would expect in practice. Given that the AER’s analysis of data from January 2013 to December 2017 found a size weighted average term to maturity of 7.4 years (unweighted average of 7.5 years),[[1]](#footnote-1) we would recommend updating the 10-year benchmark term to 7.5 years.

While network assets have a long life, the debt books do not. This is due to many factors as described in the discussion paper (shorter debt is cheaper, internal funding policies, flexibility of debt mix – bank to bond to private placements etc). Using a longer-term of debt in the current market results in a level of conservatism in the rate of return calculation and is not providing the appropriate result for customers.

We do not consider that additional regulatory uncertainty arises if a consistent principle is applied. If this were to result in material differences in the cost of debt, compared to the current estimate, which is in transition from on-the-day rates to a 10-year trailing average, then a further transition period may be required.

Yield data

We support the AER’s current approach of using the RBA and BVAL curves, and consider that the other sourced curves should be incorporated as back-up. Using the RBA curve is particularly useful as the RBA also publish an A- curve. Further, we consider the curve availability over time quite important and are supportive of the impacts to adjustments as described.

EnergyAustralia looks forward to continuing to work with the AER as part of the retailer reference group. We welcome a forum or concurrent expert evidence session to consult further on the issues raised in the discussion paper. If you would like to discuss this submission please contact Carmel Forbes on (03) 8628 1596 or at carmel.forbes@energyaustralia.com.au.

Regards

**Kerryn Graham**

Head of Risk and Analytics

1. AER, Discussion paper – Estimating the allowed return on debt, May 2018, p.31 [↑](#footnote-ref-1)