2 September 2022

Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra, ACT, 2601

Email: RateOfReturn@aer.gov.au

Dear Warwick

Draft 2022 Rate of Return Instrument

Energy Queensland Limited (Energy Queensland) welcomes the opportunity to comment on the Australian Energy Regulator's (AER's) Draft 2022 Rate of Return Instrument (2022 RoRI) published in June 2022. The Final 2022 RoRI, due by 16 December 2022, will be used in the AER's revenue determinations for regulated networks for the subsequent four years (from 2023 to 2026). These include Energy Queensland's electricity distribution businesses', Energex Limited and Ergon Energy Corporation Limited, 2025-30 revenue determinations.

Energy Queensland is a member of Energy Networks Australia (ENA) and endorses the comprehensive submissions from the ENA. We also wish the make the following brief comments on the Draft 2022 RoRI.

The rate of return, which is the forecast of the cost of funds network businesses require to attract investment in their networks, is a significant driver of regulated networks' revenues. It typically accounts for more than 50 per cent of regulated revenues due to the capital-intensive nature of network businesses. Therefore, the rate of return is arguably the most critical decision made by the AER in the economic regulation of energy network businesses. If the AER sets a rate of return that is too low, network businesses may not be able to attract the required funding to invest in their networks. Conversely, if the AER sets a rate of return that is too high, customers will pay inefficiently higher network prices.

The AER must set an efficient rate of return and we acknowledge that this is a challenging exercise. The AER's task is to determine an allowed rate of return that is at least equal to the opportunity cost of capital, i.e., the return that real-world investors would expect from other investments with similar risk. Otherwise, investors would deploy their capital elsewhere. However, the rate of return is not directly observable and has to be estimated using a range of evidence (financial models, market data, estimation methods etc) that require significant discretion and exercise of judgement.

The AER is developing the 2022 RoRI at an inflection stage in the energy transition. Substantial network investment over the next decade is imperative to facilitate the decarbonisation of the electricity system and a move towards a distributed energy resources future. The 2022 RoRI will replace the 2018 RoRI, which, in our view, had significant shortcomings and did not deliver robust outcomes in the economic conditions that have prevailed over the life of the instrument. As noted in the AER commissioned Brattle Report, the 2018 RoRI delivered the lowest returns on equity to Australian networks relative to comparable international peers.[1]

In this context, Energy Queensland is disappointed to note that the AER's Draft 2022 RoRI proposes to continue the trend from previous AER rate of return reviews (2009, 2013 and 2018), where the AER made decisions that had the effect of lowering the rate of return. We do not support the AER's Draft 2022 RoRI proposal to change the term for the return on equity from the long-standing regulatory precedent of using ten years and match it to the length of the regulatory period, i.e., five years.

The proposed change to the term for the return on equity in the Draft 2022 RoRI is disappointing because it is not based on any new evidence. Energy Queensland notes that AER has previously considered the issue of term-matching, as advocated by Dr Martin Lally, in previous three successive rate of return reviews and on each occasion the AER rightly considered that ten years was the appropriate term for the return on equity.

The AER's proposed change to the term for the return on equity is also inconsistent with the decisions of regulators such as the Queensland Completion Authority and Economic Regulation Authority Western Australia, who both recently revisited their positions on the term for the return on equity and adopted a ten-year term after previously adopting Dr Martin Lally's preferred five-year term.

Finally, we note that the AER's publication of Draft RoRI follows a lengthy consultation period which commenced in 2019. Over this consultation period, the AER's term-matching proposal has not been widely supported by stakeholders. Therefore, we submit that the AER should retain the current ten-year term for the return on equity. The ten-year term for the return on equity is consistent with the long-lived nature of network assets, reflects the standard commercial practise and is widely adopted by Australian and international regulators.

Should you wish to discuss any aspect of this matter further, please contact Guy Mutasa on [redacted]

Yours sincerely

[redacted]

Nicola Roscoe
General Manager Strategy and Regulation

Telephone: [redacted]
Email: [redacted]

[1] Brattle Group, June 2020, A review of international approaches to regulated rates of return.

Energy Queensland Limited ABN 96 612 535 583
Head Office Level 6, 420 Flinders Street, Townsville QLD 4810 PO Box 1090, Townsville QLD 4810 www.energyq.com.au