Covering Email to AER Board from Frontier Economics

From: Andrew Dillon
To: AER Board Members
CC: John Devereaux, Warwick Anderson, Esmond Smith, Garth Crawford, Irina Umback, Craig de Laine
Date: 10 August 2018
Subject: re Nystar - follow up from AER RoR Public Forum 2 August

Good Afternoon AER Board

Thank you for the opportunity to present at the AER Public Forum on the AER Rate of Return Guideline Review on 2 August.

I wanted to follow up a specific question posed during the 'Question and Discussion' section of the public forum, around the network charging arrangements between Nyrstar smelters located in South Australia and the Netherlands, and any implications for the AER Rate of Return guideline review decision process.

We have commissioned Frontier to provide the attached memorandum, which they have developed in drawing upon data from member networks serving Nystar. This highlights a number of reasons why network charges might be expected to differ substantially between South Australia and Holland.

A key finding of the analysis is that on a like-with-like basis, the equity risk premium allowed by the Dutch regulator for electricity transmission and distribution firms (geared to 60%) is 4.63%, more than 1% above the corresponding allowance proposed by the AER in the draft guideline. That is, the higher network charges in Australia certainly do not result, in any measure, from an over-estimation in the return on equity.

We have provided this analysis for the purpose of clarification. It reflects our concern that a range of unsubstantiated claims have been made relating to the implications of network prices. While the AER noted at the public forum that "consumers themselves are facing large risks associated with increasing energy prices", it is essential to keep in mind:

1) As we presented to the public forum, AEMC data clearly shows that while retail bills have increased, network prices have been falling across the country over the last 3-5 years; and
2) as the AER noted at the forum, it is important for all stakeholders to focus on the specific task facing the AER in relation to estimating an appropriate rate of return.

Should further claims of a similar nature be put forward, it is critical that the AER seek to carefully query and establish the true evidentiary basis for such claims before it can place any weight or reliance on any claimed implications for the guideline review task.

We note a further query made at the public forum on the current CKI bid for the APA Group. We have been advised that the most appropriate party to respond in detail to that issue, should the AER seek further information, is the CKI Group. At a high level, it is worth noting that over 80% of APA's revenues are from unregulated pipelines and even if those pipelines were to become regulated in the future, existing contracts would remain in place for many years.

We would welcome the AER placing the attached memorandum on the AER's guideline review website, and it contains no confidential information

We would also welcome the opportunity to discuss this with you at any stage.

Regards

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