18 September 2018

Mr Warwick Anderson
General Manager Networks Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Email: [redacted]

Dear Mr Anderson

AER RATE OF RETURN GUIDELINE

Origin Energy (Origin) appreciates the opportunity to comment on the AER's draft Rate of Return Guideline.

The allowed rate of return objective requires the rate of return for a service provider is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of the provision of regulated services.

We recognise that the AER has applied extensive analysis and consultation to both the development of its Guideline and in the calculation of its cost of capital parameter values. Nevertheless, when comparing the cost of capital of the regulated businesses with the cost of capital of firms operating in a similar market segment but under competitive conditions we believe there is a case for the risk profile of the regulated business to be revised downwards.

As the AER notes when estimating the benchmark rate of return, it is well accepted that there is a risk-return trade-off and it would not be efficient to determine an allowed return that is not commensurate with the risks involved. Origin considers that the concept of risk a fundamental issue in the derivation of the cost of capital as it penetrates the majority of WACC parameters.

As we have highlighted in our previous submission to this process, the commercial risk of a regulated network is very low. We reiterate our views that regulated networks are largely insulated from the business cycle as they are not exposed to volume risk and have a guaranteed revenue stream under the revenue cap arrangements. For this reason, increases in financial risk as leverage increases is also relatively low as the businesses effectively pass on borrowing costs to consumers.

Networks argue that fair returns are necessary to attract capital for future investment. However, we believe regulation was never designed to deliver a riskless environment. If returns were guaranteed, the regulatory rate of return should trade marginally above government bonds.

Given the protections around its revenue and low default risk, we would expect any assessment of risk the businesses face to be at the lowest end of the spectrum. We believe this is a view that has also been expressed by a large number of expert opinions provided to the AER in its deliberations to date.

The AER has updated its empirical analysis to 2018. This analysis supports a range for the equity beta of 0.4–0.8 with clustering in the 0.5–0.6 range. The AER has chosen a point estimate of 0.6.

We support the AER position to give most weight to empirical estimates of relevant Australian energy network businesses and less weight to other relevant evidence. We also believe that the empirical evidence demonstrates that the point estimate of 0.6 is conservative. Notwithstanding, it continues to provide a certain and predictable outcome for investors and meets the AER's obligations under the rules.

Origin continues to support the approach adopted by the AER in its review of the rate of return Guideline. If you have any questions regarding this submission, please contact Sean Greenup in the first instance on [redacted].

Yours sincerely

[redacted]

Keith Robertson
Manager, Wholesale and Retail Regulatory Policy
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