



Pathway to the 2022 rate of return instrument

Consultation paper

November 2019

© Commonwealth of Australia 2019

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601 or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Mr Warwick Anderson
General Manager
Network Finance and Reporting
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165

Email: RateOfReturn@aer.gov.au

AER Reference: 65402

Amendment Record

Version	Date	Pages
1.0	4 November 2019	20

Contents

1	Overview.....	1
	1.1. How have we evaluated the 2018 review?	1
	1.2. What must be in the next review?	2
	1.3. What might we keep the same?.....	2
	1.4. What might we change?.....	4
	1.5. What is the process from here?	5
2	Background.....	6
	2.1. About the rate of return instrument	6
	2.2. Stakeholder interviews by Brattle	6
3	Timeline	8
	3.1. Consultation and position papers	9
	3.2. Annual updates and working papers	9
4	Key elements	10
	4.1. Consumer Reference Group	10
	4.2. Investor and Retailer Reference Groups	13
	4.3. Concurrent evidence sessions	13
	4.4. Independent Panel	17
5	Submissions to the paper	19
	5.1. Consolidated question list	19

1 Overview

In December 2022 we will publish the next rate of return instrument (2022 instrument). This binding instrument will determine the allowed rate of return on capital in electricity and gas network determinations for the following four year period. The rate of return is a significant driver of regulated revenue, and estimation of the rate of return is complex and contentious. It is therefore important that we carefully consider the process that we will follow to arrive at the 2022 instrument.

This consultation paper proposes a pathway to the 2022 instrument, and asks for stakeholder comments on that pathway. This paper:

- Has an explicit focus on the decision making process, not the content of the instrument.
- Provides a high-level outline of the decision making stages and our proposed timelines for them.
- Outlines high-level roles for various entities involved in the consultation and review process.
- Describes key elements of the process to the 2022 review and the high-level purpose for each.

We invite stakeholder submissions on all of these elements.

After we have considered all the submissions received in response to this consultation paper, we will publish a position paper with our decision on the overall framework to be followed for the development of the 2022 instrument.

1.1 How have we evaluated the 2018 review?

This consultation paper is primarily informed by reflections on the process used to develop the 2018 rate of return instrument (2018 Instrument). This includes internal reflections from the AER, but also external reflections from those involved in the 2018 process. We engaged The Brattle Group (Brattle) to undertake a series of independent stakeholder interviews. The Brattle report summarising this feedback is published alongside this consultation paper.

The Brattle stakeholder interviews were focused on obtaining feedback on the review process and not the content of the final instrument. Brattle sought out a cross-section of stakeholders, including consumers, networks, investors, retailers, and independent panel members.

We have carefully considered the stakeholder comments presented to us in the Brattle report. It is valuable for us to have received these honest and constructive comments on what stakeholders felt worked well, and what can be improved. As might be expected, in several areas different stakeholders have differing views on the same process element. Our internal perspective differs from external views in several areas as well. We describe throughout this paper how we have evaluated these different perspectives, and how this has impacted our proposed pathway to the 2022 instrument.

The 2018 rate of return instrument was released after an 18 month process involving extensive stakeholder consultation. It included new process steps that had not been taken by us in any previous review. Our view is that this innovation, while posing some challenges, resulted in a significantly improved process relative to that used for the 2013 rate of return guideline. The Brattle report found that the 2018 process was a positive step in ensuring a more collaborative and open approach to regulation.¹ However, Brattle also reported that there are steps that stakeholders believe need to be improved or altered to be more effective, and there were instances in which more upfront or clearer communication from us would have avoided areas of potential miscommunication which hindered the process.

1.2 What must be in the next review?

The NEL and NGL prescribe several elements of the decision making process we must use in developing the 2022 instrument. This includes several of the innovations introduced in the 2018 review.

One such element is the use of an Independent Panel to review the AER's draft decision. It provides us the benefit of an independent review, whilst aiming to promote confidence that our findings on rate of return issues were supported by sound reasoning based on the available information.

The concurrent evidence sessions were designed to increase the collaborative nature of our 2018 review and will remain a part of future reviews as they are now legislated. We discuss below some potential changes to the scope for the concurrent evidence sessions.

The consumer reference group (CRG) is also legislated to continue in order to provide a strong consumer perspective in the consultation process. We see this as an important element given the challenges (such as resourcing, coordination and information asymmetry) facing individual consumers seeking to be heard in our consultation processes. Though not legislated, we also see an important role for the investor reference group (IRG) and retailer reference group (RRG) in advocating for their perspectives.

The 2022 review will benefit from these legislative requirements being settled well in advance of the review. There were ongoing legislative changes parallel to the 2018 review, and the final legislation was only passed shortly before the publication of the 2018 instrument. The Brattle report contains feedback from stakeholders that 'more could have been achieved in the first half of the process and that the second half of the process was too rushed'.² We agree that timelines in the latter half of 2018 were very tight. In our view, one major cause was the contemporaneous legislative changes, which prevented us from communicating the timing and role of each review step early.

1.3 What might we keep the same?

We propose that the basic structure of the active phase of the review should remain the same as in the 2018 process. This includes:

¹ Brattle, *Stakeholder Feedback on the AER's Process for the 2018 Rate of Return Instrument*, June 2019, p. 5.

² Brattle, *Stakeholder Feedback on the AER's Process for the 2018 Rate of Return Instrument*, June 2019, p. 5.

- Initial consultation around process and roles (although some elements are to be brought forward, such as this consultation paper)
- Initial analysis stage (including production of AER information papers and engagement via various forums, such as the concurrent evidence sessions)
- Draft decision (incorporating consideration of submissions on information papers and concurrent evidence sessions)
- Final decision (incorporating consideration of submissions on the draft decision and independent review findings).

Whilst there were many comments and suggestions from stakeholders in the report compiled by Brattle, 'stakeholders recognised that the AER had put significant thought and effort into the 2018 Rate of Return Instrument process' and that there were 'sufficient opportunities for each stakeholder to participate'.³

This indicates that our process has provided, and will provide, a large number of opportunities for input from stakeholders in making the instrument.

After careful consideration, our proposed high-level role for the independent panel remains the same as that in the 2018 process

On balance we consider that the independent panel's high-level task should remain unchanged: it is to review the AER's draft decision, using the same information set as that before the AER, and report to the AER its assessment of the reasonableness of that decision. We consider this scope is appropriate given our role as the regulator. We do not consider the panel or the review process would be served by having direct contact with stakeholders. Providing the independent panel with new evidence we had not considered would change the remit of the panel from reviewing the decision to forming a new one. We consider that this would be to the detriment of the review process, shifting stakeholder focus from engagement with the regulator and other stakeholders to persuading an alternative 'higher' decision maker of their views. This consideration reflects our extensive experience under the (now removed) limited merits review framework.

We propose that the concurrent evidence sessions will retain a similar role: advising us of expert views and clarifying areas of agreement and disagreement. We do not consider it would be prudent to commit to adopting the majority opinion on issues dealt with at the sessions. The expert discussions at the concurrent evidence sessions will aid us and our decision by highlighting which topics are of most importance and what grounds or basis of support there is for a particular method or piece of evidence.

We believe the stakeholder forums and presentations to our Board aided the process in both improving communication between stakeholders and involving the stakeholders more thoroughly in the process. These stages will remain an important part of the process and will occur at regular intervals. We want to encourage stakeholders to present information they believe will be relevant to forming a new Instrument and continuing presentations and

³ Brattle, *Stakeholder Feedback on the AER's Process for the 2018 Rate of Return Instrument*, June 2019, p. 8.

forums alongside regular written submission opportunities will allow a wide range of inputs into the process.

1.4 What might we change?

Whilst we consider the structure of the 2018 review was a step in the right direction, feedback during the process and in the Brattle Report has indicated that we can make improvements. Adapting the process is key to ensuring stakeholder confidence in ongoing reviews as well as forming a robust rate of return Instrument.

Our proposed pathway to the 2022 instrument includes bringing forward foundational work that might be constructively undertaken before the commencement of the active phase of the review. We consider that this will provide a better developed information set for the active stage of the review when it commences and assist in smoothing resource requirements for all stakeholders. First, we propose to release annual papers containing updated time series data used in the rate of return process, with the first such paper envisaged in December 2019. Second, we propose to release targeted discussion papers on discrete and emerging rate of return issues, with the first of these released in 2020.

We also propose changes to the timing within the review itself. Broadly speaking, we aim to complete the first stages of the review earlier, so as to allow more time for the latter stages. We have chosen this approach rather than a substantial increase in the overall length of the active phase of the review, given the resource intensive nature of this phase of the review—for us, and for stakeholders. Our timing expectations rely on the foundational work noted above, as well as earlier establishment of the various reference groups that participated in the 2018 review.

Whilst we are committing to using the concurrent evidence sessions again we are also considering possible changes around the timing, and to better explain the role of, the expert joint report. We propose to increase the amount of time between the information papers and the sessions to ensure the experts involved have enough time to consider the topics for discussion. We also want to ensure that all experts are available to comment on the expert joint report and that there is equal involvement by all experts to ensure the report accurately represents the discussions which took place in the sessions.

We are also considering the possible introduction of an additional round of evidence sessions, earlier in the process. These would likely discuss topics at a broader or less technical level and help frame the topics which may receive the most attention during the review and which topics will be discussed in more detail later in the second round of sessions. However, we are currently uncertain about the value of the additional sessions particularly in light of the additional resources required from stakeholders.

We also propose some changes around the consumer reference group (CRG). Reflecting the feedback received from stakeholders, we will seek to improve the technical expertise on the CRG in order to help them engage on substantive matters throughout the review. We will also establish the CRG earlier and seek opinions on how to improve its effectiveness.

We also propose to formally review the 2022 process once completed. We had not included a formal post-review analysis in our 2018 process planning, and this led to delays in the collection of stakeholder feedback that may have made it less effective. By committing to the

process now we hope to ensure stakeholders will all be available and prepared to give feedback which will enable us to make the process better with each iteration.

1.5 What is the process from here?

We invite submissions from stakeholders on our proposed pathway to the 2022 instrument. We have highlighted particular questions on which feedback would be appreciated in boxes throughout the document, but submissions by 13 December 2019 on any part of the process are welcomed.

We will analyse and consider the submissions to distil a high-level position paper for the 2022 review.

Between now and the active phase, we intend to publish:

- Annual updates on data series used when making the 2018 rate of return instrument, in order to provide greater transparency and on-going communication to stakeholders.
- Working papers that discuss various issues and evidence on some rate of return topics (beyond changes in time series data). These papers will provide our perspective and consideration on some discrete topics ahead of the active phase of the review process.

2 Background

The AER is the independent economic regulator of monopoly gas and electricity networks in each Australian State and Territory (except Western Australia). We are guided in our role by the national electricity and gas 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 December 2018, we published our Rate of Return Instrument (2018 Instrument). This followed a process of extensive stakeholder consultation, including new steps that had not been taken by us in any previous review. As a result we were keen to receive feedback on the process, including the new steps, in order to ensure each review is as effective as possible. Having received feedback from internal and external stakeholders, we are now beginning to form a work pathway to the 2022 rate of return review (2022 review).

This consultation paper is the first step towards the determination of the 2022 Rate of Return Instrument (2022 Instrument). It is our preliminary consultation with stakeholders on the process we propose to undertake to produce the Instrument, rather than the substantive rate of return issues. It is focused on lessons learnt from the 2018 review process, including stakeholder feedback, which informs our decisions on the 2022 review process. Our proposed timelines are set out section 3 below.

2.1 About the rate of return instrument

We develop, maintain and apply the rate of return instrument in accordance with the requirements of the NER and NGR.⁴ It sets out the how we will calculate the allowed return on debt, return on equity and the value of imputation credits (γ) for the duration of the instrument. Estimation of the rate of return is complex and contentious, and the rate of return is a significant driver of regulated revenue. The instrument is now binding, and as such it is important that our review process provides a high degree of transparency and replicability.

For those reasons, we are seeking feedback on the 2018 review in order to ensure that the 2022 review process progresses our aims of being accessible, transparent and collaborative. We consider this will promote confidence in our decisions. Based on feedback from AER staff and external stakeholders we have identified a number of areas in the process we consider need alteration, and where roles of certain stages need to be clarified.

2.2 Stakeholder interviews by Brattle

In May 2019 we engaged the Brattle Group (Brattle) to conduct interviews with stakeholders who were involved in our 2018 review process. Their report has been published on our website alongside this consultation paper.

⁴ NGL, Part 1, division 1A; NEL, Part 3, division 1B.

We wanted the feedback to be anonymised so that stakeholders would be open and honest, and by not using AER staff to conduct these interviews we wanted to encourage discussion about the process and not the result of the 2018 review.

We note that Brattle's summary regarding overall stakeholder sentiment towards the review⁵ supported the view that the structure of the review was positive. However, the report highlights a number of areas where we can improve the structure and communication in order to increase the involvement of stakeholders and avoid any misunderstandings.

⁵ Brattle, *Stakeholder Feedback on the AER's Process for the 2018 Rate of Return Instrument*, June 2019, p. 5.

3 Timeline

Taking into account all of the feedback around the 2018 process, we are proposing a number of changes to the 2022 review timeline. We were most concerned with feedback stating that too much of the work was forced into the second half of the review. We are keen to ensure that more work is undertaken earlier in the timeline. To this end, this paper and the subsequent position paper will take some of the planning effort off of early months whilst the annual updates and working papers on rate of return issues will alleviate some of the early work on technical issues. We also want to ensure more time between key steps of the review to allow for review of stakeholder submissions.

3.1 Table showing dates of key steps in the 2018 Instrument Process and proposed draft timeline for the 2022 Process

Stage of Review	2018 Process - Actual	2022 Process - Proposed
Foundational phase		
Consultation Paper - High Level		November 2019
2019 Annual Updates		December 2019
Position Paper - High Level		Early 2020
Working Papers		Starting in 2020
2020 Annual Updates		November 2020
Active phase		
Consultation Paper - Detailed	31 July 2017	May 2021
Stakeholder Forum	18 September 2017	June 2021
Position Paper - Detailed	28 November 2017	October 2021
2021 Annual Updates		November 2021
Information Papers	February 2018	December 2021
Concurrent Evidence Sessions	15 March/5 April 2018	February 2022
Expert Joint Report	21 April 2018	4 weeks after concurrent evidence sessions
Draft Instrument	10 July 2018	June 2022
Independent Panel Report	September 2018	August 2022
Final Instrument	December 2018	December 2022

3.1 Consultation and position papers

This paper constitutes the first consultation paper and will be followed by a position paper. These papers will focus on high level elements of the review process including the structure of and various role setting within the process. They will inform stakeholders of the process we intend to undertake to make the 2022 Instrument, enabling them to be prepared ahead of time.

There will also be further consultation and position papers at the start of the active phase of the review process (in 2021) which will seek further feedback on details of the process. These papers will provide timings and discuss topics for consideration in more detail. These will be more focused than those in the foundational phase.

By splitting the papers into two rounds, we can consult and inform expectations early, before setting out the process in more detail. This should also enable stakeholders to better prepare their resources and contributions to the active stage of the review process.

3.2 Annual updates and working papers

The annual updates, the first of which we intend to publish in December 2019, would provide stakeholders with information on rate of return data in the years in between reviews. The focus of these annual updates will be on time series data used when making the 2018 rate of return instrument, so that stakeholders can observe the impact of changes in market conditions. They will include the data which contributes to our Risk Free Rate, Market Risk Premium and Return on Debt estimations.

In addition to the annual updates, we intend to publish working papers that discuss various issues and evidence on some rate of return topics (beyond changes in time series data). These papers will provide our perspective and consideration on some discrete topics ahead of the active phase of the review process. This will mean that there is more time during the active phase of the review to discuss issues rather than cover matters that could be better discussed between reviews. We propose to develop a timetable for these working papers in early 2020.

4 Key elements

4.1 Consumer Reference Group

The Consumer Reference Group (CRG) was a new addition to the 2018 review process and is now legislated to remain a part of future reviews. This was an important issue for many stakeholders, with a large number of comments received and stakeholders taking a range of positions, as summarised in the Brattle report. Some of these comments applied to the reference groups as a whole, but many were specific to the CRG and the role stakeholders felt it had and should hold within a review.

4.1.1 Formation

The CRG was formed through a nomination process managed by the AER and designed to represent the wide range of consumer interests in the development of the rate of return instrument.

The process commenced in August 2017 when an invitation for expressions of interest was released.⁶ We received 17 applications and, from these, appointed 15 members based on a number of factors such as their expertise with financial concepts, the segment of consumers they represent and the overall makeup of the group.

When asked about the CRG, stakeholders stated that in order to be useful to the process it was important 'to have people on the CRG that have a good understanding of the issues, the process, and the language used in the process'.⁷ There was widespread acknowledgement that the CRG was made up of a diverse group that 'gave the CRG greater perspective on issues, and [encouraged] other participants to reconsider the ways in which they explained issues throughout the process'.⁸ However other stakeholders were 'concerned about the lack of technical expertise from the CRG representatives'⁹ and called for nominations to take this into account, so as to improve its ability to contribute throughout the process.¹⁰

We consider that the CRG should be small enough to ensure that the group could reach a unified opinion and large enough that it will represent a range of consumers and capture sufficient expertise. While the CRG contained 15 members during the 2018 review, we do not think it would be necessarily prudent to fix the number of members because it is important to have suitably qualified members participate in the review.

We agree that a level of knowledge on financial concepts is necessary but we are mindful that selection to the CRG based purely on technical expertise could see the group overlap considerably with, and duplicate, the CCP's role.

⁶ <https://www.aer.gov.au/communication/aer-invites-expressions-of-interest-to-join-its-consumer-reference-group-for-the-review-of-the-rate-of-return-guideline>

⁷ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 13.

⁸ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

⁹ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p.14.

¹⁰ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

Some stakeholders suggested that the CRG could retain an ongoing core membership—'meeting between review periods, and allow continuity between ideas and approaches from period to period which would eliminate the need to begin from scratch'.¹¹ This would mean that a new core membership of the CRG would need to be formed, with the intention of supporting future rate of return reviews.

We agree that the members should be selected with the role of the group in mind. The potential changes to the role of the group are discussed in section 4.1.2. We also agree that the CRG should be formed earlier in order to improve the ability of the reference group to contribute throughout the process. This means we would be seeking nominations so that the CRG is formed prior to the start of the active process in June 2021.

We are open to the idea of maintaining an ongoing core membership CRG over multiple reviews. There may be benefits in avoiding repeating the on-boarding process each time and assisting the CRG in developing its expertise in rate of return matters. However, care would be needed in selecting the core members and a process by which they could be replaced if necessary would need to be put in place. We acknowledge this would be a large commitment for members to remain as an active part of the group in between reviews and may not be possible for some who would wish to contribute to the reference group.

1. How could the CRG be adapted to improve their contribution to the review?
2. Is there anything that needs to change about the CRG nomination process?
3. What characteristics should be sought for CRG members?

4.1.2 Role

We note that we had to develop the process for making the 2018 Instrument as we were making it. Therefore, the decision to set up the CRG may not have been undertaken sufficiently early in the 2018 instrument process which led to stakeholders holding contradicting views on the role of the CRG. The Brattle report highlighted that 'most stakeholders brought up concerns about the lack of clarity of the CRG's role'¹² and 'the AER was enthusiastic...but did not have a plan upfront on how best to incorporate the CRG'.¹³

When setting up the CRG, we considered that its role was to provide direct and ongoing feedback to the AER during the instrument process and to facilitate broader consumer participation and engagement. However, we did not explicitly detail how those roles would be implemented and supported given the diverse backgrounds of the CRG members. This was due to the speed at which the process was developed. Stakeholders acknowledged our desire and enthusiasm in supporting the CRG, but noted that it was only 'effective after the AER had settled on the CRG's role'.¹⁴

¹¹ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

¹² Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 13.

¹³ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 13.

¹⁴ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

In response to this we are looking to refine and better implement and support the role of the CRG early in this process. Stakeholders supported maintaining the diverse membership backgrounds of the CRG.¹⁵ Therefore, we want to ensure that any role does not unnecessarily prevent broad representation.

As noted above, the CRG was set up primarily to ensure that consumer perspectives were represented in the process and to balance what may otherwise be seen as a process in which only networks have input to our decision. We are intent on keeping that as a core part of its role. However, we are also aware that the CRG and CCP may be seen to overlap if the CRG are to provide in-depth technical submissions of their own to the process. The interaction was seen as confusing for some stakeholders.¹⁶

We are keen to ensure that consumers are well represented in our process. A degree of duplication may perhaps be unavoidable due to the technical nature of the rate of return review but the CRG and CCP can bring different perspectives to the review. The CRG is currently formed specifically for the review and brings together experiences and views from a broader range of consumer representatives. The CCP meanwhile is a panel of experts that has an ongoing role in advising us on whether network businesses' proposals are in the interest of consumers and the effectiveness of the businesses' engagement activities. We therefore welcome submissions on how to best use both groups in forming the Instrument.

4. What should the CRG's main role be when in the 2022 process? Should the CRG's main role be to provide technical submissions or more customer focused submissions to the review process?
5. What scope is there for the CRG and CCP to work collaboratively to jointly contribute to the 2022 process?

4.1.3 Support

A key part of how the CRG functions, as with other reference groups as well, is the support we give them during the process. This includes assisting in getting up to speed with rate of return topics, potentially sourcing and funding experts to aid with submissions and discussions, as well as facilitating meetings with other stakeholders. Stakeholders informed Brattle that 'they were appreciative of the support that the AER gave CRG members'.¹⁷

Stakeholders reported to Brattle that the resourcing provided to the CRG could have been more targeted towards the role the CRG was expected to have. They stated that as it entered the process, the CRG was lacking resources in comparison to other well-funded stakeholder groups. Stakeholders also noted that 'better resourcing would alleviate the power asymmetry that exists between the stakeholder groups'.¹⁸

¹⁵ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

¹⁶ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 15.

¹⁷ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

¹⁸ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

We want the CRG to be able to contribute to the review process, and do not want resourcing constraints to be a factor in them not participating effectively. We are aware that the identified role of the CRG will drive the support required, but we are committed to enabling the CRG to participate effectively in the process. To this end, we are keen to ensure a program of support is set out earlier and is tailored to the CRG's requirements.

6. Does the AER's support of the CRG need to change ahead of the 2022 review? If so, how should that support change?

4.2 Investor and Retailer Reference Groups

The Investor and Retailer reference groups were set up as part of the 2018 review to provide direct and ongoing feedback to the AER, and to facilitate broader stakeholder participation and engagement.

Stakeholders had mixed opinions about the Investor and Retailer reference groups but overall felt that they 'had the resources to be effective but ultimately were not'.¹⁹ It was also noted that whilst the retail group could offer some expertise they could not 'match the resources devoted by both the AER and networks'.²⁰ We note that there is some overlap of perspectives between these reference groups and other key stakeholders in the review—in particular, between investor and network representatives; and between consumer and retailer representatives. However, our experience in the 2018 process was that separate investor and retailer reference groups did bring unique contributions to the review. The latter pairing—between consumer representatives and retailer representatives—might be an area for further constructive collaboration in the 2022 process, given that there is likely to be some alignment of interests between these groups.

Whilst both groups represented stakeholders in the process, we acknowledge the difficulty that both may have had in contributing as a single voice (for each group) or on the level of other groups. However it is important to us and our process that we continue to receive submissions and inputs at the relevant points in the process from both groups so we can have regard to all stakeholder perspectives in our decision. We consider they should be formed before the release of the June 2021 Consultation Paper so that they are able to contribute to all parts of the 2022 Instrument process.

7. Do the IRG and RRG need to be altered to enable them to be able to more effectively contribute to the development of the Instrument? If so, what changes should be made to the groups?

4.3 Concurrent evidence sessions

The concurrent evidence sessions involved the AER Board receiving expert advice on specific rate of return issues to assist in our consideration of material that we had to respond

¹⁹ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 15.

²⁰ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 15.

to in each round of the process. By bringing experts (nominated by various stakeholders) together we were able to identify areas of agreement and then focus our attention on the topics which did not have agreement. Stakeholders were positive about the introduction of the sessions, but there were areas where stakeholders wanted to see improvement.²¹

4.3.1 Timing and Execution

As with other aspects of the process, there were issues surrounding the timing of the concurrent evidence sessions brought on by the speed at which the process developed in response to the legislative changes. However, stakeholders did note a number of specific issues with the speed and timing of the sessions.

One stakeholder pointed out an issue with the schedule which left their expert unable to participate fully. Another stakeholder stated that we had not finalised our own expert appointments sufficiently early which impeded the expert search process for other stakeholders.²² With the earlier commencement of the 2022 review we believe this will address these timing and planning issues. As with all areas of the 2022 review we are looking to set a timeline early in order to improve stakeholder participation.

There were parts of the feedback that suggested the formation of the CRG could have been better conceived. One such piece of feedback was that 'experts nominated by the CRG were not there from the beginning for all sessions, in contrast with the experts for the network groups.'²³ It may be therefore be advisable to appoint experts earlier to allow them to assist the CRG members for more of the process and be fully up to speed ahead of the sessions.

During the 2018 review, the evidence sessions were closed sessions between the AER Board and the participating experts. We are open to the idea of stakeholders attending the sessions to improve transparency

However, if the sessions retain a similar format as that for the 2018 review where the AER Board and the experts discussed matters, then it is uncertain if stakeholder attendance at the sessions would materially improve the outcome of the sessions. This is because a transcript of the sessions and an expert joint report are (and will be) published on our website.

The intent of the sessions is for the AER Board to hear experts' opinion on rate of return matters so it is not clear that stakeholder participation would add value to this process element.

4.3.2 Additional Sessions

There were a number of comments in the Brattle report on the timing and speed of the sessions.²⁴ Some stakeholders felt that the sessions were rushed and suggested extending the time, or that the sessions should have been held with more AER Board members in

²¹ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 16.

²² Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 16.

²³ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 14.

²⁴ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 15.

attendance. In addition, some stakeholders noted that it was hard to discern 'what was open for discussion and what was not' in the sessions.²⁵ Given this feedback, we are open to the suggestion of additional rounds of concurrent evidence sessions.

If stakeholders want more to be discussed at the sessions then these additional rounds may provide the best way of allowing more input into the process. They may discuss topics at a broader or less technical level and help frame the topics which may receive the most attention during the review and those that will be discussed in more detail later in subsequent rounds of the concurrent evidence sessions.

However, we are cautious of committing to further sessions for a number of reasons. Firstly, it would increase the cost to stakeholders as experts would need to be retained for more time. Second, we are unsure as to whether increasing the number of sessions will materially improve the outcome of the sessions. Third, rather than simply holding more sessions, it may be more effective to focus on improving the role and focus of the sessions.

8. How could the concurrent evidence sessions be adapted to improve discussion on topics?
9. At what points in the process would the concurrent evidence sessions aid the most?

4.3.3 Role of the Sessions

In the position paper leading up to the 2018 Rate of Return process we defined the role of the concurrent evidence sessions as being 'to highlight material issues of agreement and disagreement to aid us in consideration of submission material'.²⁶ However there were concerns from stakeholders about the role of the sessions, including ambiguity regarding the session's objectives.²⁷ We want to ensure that the role of the concurrent evidence sessions is clearly defined in order to aid the participating experts and other stakeholders.

We consider that the role of the sessions should remain consistent with the 2018 review. The concurrent evidence sessions are an important input into our process in forming the instrument. The purpose of the sessions is to aid the AER Board in making a decision which will contribute to achieving the NEO and NGO by allowing them to clearly define the issues of agreement and areas of disagreement between relevant experts. They are an input to our decision where we will assess the relative merits of the evidence available to us (including views from the sessions).

The presence of the AER Board members at the sessions was an important aspect for many stakeholders and is important to our decision making process as it allows the Board members to question experts directly when necessary or receive clarification on new presentation of evidence.²⁸

²⁵ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 17.

²⁶ AER, *Rate of Return positions paper*, 28 November 2017, p. 21.

²⁷ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 17.

²⁸ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, pp. 17–18.

The facilitator, independent to the AER, will also remain integral to the process. Their role will be to monitor and direct the discussion to assist the Board's decision making.²⁹ Feedback on the facilitator was positive.

10. What could be done to better assist the concurrent evidence sessions to fulfil their role? Do the evidence sessions need to be extended to allow more discussion on certain topics or should the number of rounds be increased?

4.3.4 Expert Joint Report

During the 2018 process the concurrent evidence session facilitator co-ordinated a report after the sessions which aimed to record the opinions of the participating experts in a single document—the expert joint report. Some stakeholders supported the expert joint report, saying it provided further value on top of the transcripts of the sessions.³⁰ However a number of stakeholders felt the report was not useful to the process.

Some stakeholders felt that we should have relied more heavily on the expert joint report, that we 'rejected points that were unanimously agreed upon by the experts'³¹ or 'the AER ignored points in the joint report that it found inconvenient'.³² However, the report was, and will remain, supplementary to the evidence sessions. The report aids us by providing context and a summary of matters discussed in the sessions including areas of agreement and disagreement. It should not be considered separate to or a replacement for the sessions. The report was, and will still be, considered alongside to submissions made by stakeholders.

We also acknowledge the stakeholder feedback that stated the expert joint report should have been 'discounted because not all experts had been able to participate'.³³ For the 2022 review, engagement with the report will be part of the terms of being involved in the evidence sessions. We want to ensure that all experts have an equal input to the process to provide a document that summarises expert positions faithfully.

We consider that the role of the report should align with that of the evidence sessions because the report should provide context and summary of the matters discussed in the sessions including areas of agreement and disagreement. As part of our review, we need to assess and consider other evidence in addition to the sessions to aid us in forming the instrument. By ensuring that all experts will be able to contribute to the report, and that stakeholders are aware of the role the report will play, this should address stakeholder concerns raised on this subject in the Brattle report.

11. Do stakeholders consider the Joint Expert Report was useful to the process? How could it be improved?

²⁹ AER, *Rate of Return positions paper*, 28 November 2017, p. 21.

³⁰ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 18.

³¹ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 18.

³² Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 18.

³³ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 18.

4.4 Independent Panel

The Independent Panel was set up as part of the 2018 review in order to review the draft instrument and report on whether it was supported by sound reasoning based on the available information such that it was capable of promoting achievement of the national gas and electricity objectives.

The main purposes of the Independent Panel process were to give us the benefit of an independent review, and to promote confidence amongst stakeholders that our findings on rate of return issues were robust and had been tested.

4.4.1 The Role of the Panel

Most stakeholders 'thought having the Independent Panel was a good idea' and some 'were happy with what was achieved'.³⁴ However, there were comments on how the Panel's role could have been improved or better communicated. Some stakeholders stated that the Panel's role was 'an inappropriate use of the panel's expertise', 'were not happy with how the independent panel was instructed' and that 'it would be beneficial if the Panel were able to check the AER's work'.³⁵ However, others thought the Panel's role 'was fair' and that its commentary 'was robust'.³⁶

As noted above, the role of the Panel was not to propose or set specific numeric values. Whilst we understand that some stakeholders wanted the Panel to arrive at its own values for the rate of return parameters, its role was to provide the benefit of an independent review and ensure we made a decision supported by the material available to us. Its role is not to make a separate decision which could blur the lines with the AER Board's authority. The findings from the Panel are to assist us as we determine the rate of return that meets our legislated objectives.

Further, we consider a degree of regulatory judgement is required in making the instrument because the available evidence can, and does, provide contrasting information. This judgement should be exercised by the AER Board.

The Panel also had full access to all information we had and was able to request clarification from us when necessary in order to fulfil its role. It can, and did, request us to further consider (aspects of) the draft 2018 decision.

One stakeholder suggested that the Panel should be involved at a later part of the process, on a 'draft final instrument' so it can consider submissions on the draft instrument as well.³⁷ However, the benefit of this is not clear to us. We note that we have provided, and will provide, a large number of opportunities for input from stakeholders in making the draft instrument. In reviewing the draft instrument, the Panel will consider all these submissions as well as our consideration of them. The draft instrument is set with the intent of being used

³⁴ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 19.

³⁵ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 19.

³⁶ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 19.

³⁷ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 20.

as the final instrument if no errors are present or issues are found by the Panel. We therefore consider it appropriate to have the Panel review the draft instrument only.

4.4.2 Panel's considerations and contact

The Panel did not focus on any particular issues but reviewed each part of the decision, consistent with its role. However, some stakeholders felt that the Panel 'spent too much time focusing on issues that no one found controversial.'³⁸ The Panel is created from a list of qualified nominees and, as appropriate, it should be trusted to step through its task as appointed. To focus the Panel on a particular set of issues may result in it not considering all the information appropriately, or missing areas it may otherwise have commented on.

Other stakeholders also suggested that there should be contact between the Panel and stakeholders 'with a presentation and Q&A session to allow for issues to be brought up' and to 'help the focus on issues that each group wanted.'³⁹ Through submissions and presentations stakeholders have had, and will have, the opportunity to identify and discuss issues and communicate issues important to them. These will all be available to the Panel as part of its review so it is not clear to us why additional contact is needed for this purpose.

Further, we did not allow contact previously as the Panel's role is to review the draft instrument in the context of the evidence available to us. Direct contact may mean the Panel being introduced to material that was not given to us. All submissions made to the process should be made to us as we seek to form a new instrument taking into account the evidence available. Directing submissions to another entity would not benefit us in our formation of the instrument and therefore this is not part of our current plan for the 2022 review.

12. Are there any adjustments that could be made to the Independent Panel that would assist it in undertaking its role?

³⁸ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 20.

³⁹ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019, p. 20.

5 Submissions to the paper

We invite stakeholder feedback on any aspect of this consultation paper, including on the questions listed below. Submissions are requested by close of business on Friday 13 December 2019 and should be emailed to RateOfReturn@aer.gov.au.

The AER prefers that all submissions be sent in an electronic format in Microsoft Word or other text-readable document form and publicly available, to facilitate an informed, transparent and robust consultation process.

Alternatively, submissions can be sent to:

Mr Warwick Anderson
General Manager
Networks Finance and Reporting
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Submissions will be treated as public documents and posted on the AER's website unless prior arrangements are made with the AER to treat the submission, or portions of it, as confidential. Those wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim; and
- provide a non-confidential version of the submission.

5.1 Consolidated question list

Throughout this paper we have posed a series of questions. We have listed them here for convenience.

1. How could the CRG be adapted to improve their contribution to the review?
2. Is there anything that needs to change about the CRG nomination process?
3. What characteristics should be sought for CRG members?
4. What should the CRG's main role be when in the 2022 process? Should the CRG's main role be to provide technical submissions or more customer focused submissions to the review process?
5. What scope is there for the CRG and CCP to work collaboratively to jointly contribute to the 2022 process?
6. Does the AER's support of the CRG need to change ahead of the 2022 review? If so, how should that support change?
7. Do the IRG and RRG need to be altered to enable them to be able to more effectively contribute to the development of the Instrument? If so, what changes should be made to the groups?
8. How could the concurrent evidence sessions be adapted to improve discussion on topics?

9. At what points in the process would the concurrent evidence sessions aid the most?
10. What could be done to better assist the concurrent evidence sessions to fulfil their role? Do the evidence sessions need to be extended to allow more discussion on certain topics or should the number of rounds be increased?
11. Do stakeholders consider the Joint Expert Report was useful to the process? How could it be improved?
12. Are there any adjustments that could be made to the Independent Panel that would assist it in undertaking its role?